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PROPOSED ISA 200 (REVISED AND REDRAFTEDE)

OVERALL OBJECTIVES OF THE INDEPENDENT AUDITOR, AND THE CONDUCT OF AN AUDIT IN ACCORDANCE WITH INTERNATIONAL STANDARDS ON AUDITING

(Effective for audits of financial statements for periods beginning on or after December 15, 2009 [date])

CONTENTS

Introduction
Scope of this ISA ................................................................. 1-2
An Audit of Financial Statements ............................................. 3-9
Effective Date ........................................................................ 10
Overall Objectives of the Independent Auditor ....................... 11-12
Preparation of the Financial Statements ................................ 7-8
An Audit of Financial Statements, and Related Concepts ........ 9-13
Auditor Independence .......................................................... 14-15
Definitions ............................................................................. 13

Requirements
Ethical Requirements Relating to an Audit of Financial Statements ........................................... 14
Professional Skepticism .......................................................... 15
Professional Judgment ............................................................ 16
Sufficient Appropriate Audit Evidence and Audit Risk ........... 17
Conduct of an Audit in Accordance with ISAs ......................... 18-24

Application and Other Explanatory Material
The Objective of an Audit and its Relationship to the Overall Objective of the Auditor — A1
Preparation of the Financial Statements — A2-A8
Ethical Requirements Relating to an Audit of Financial Statements — A13-A16
Professional Skepticism — A17-A21

*See footnote 1.
<table>
<thead>
<tr>
<th>Topic</th>
<th>Pages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Professional Judgment</td>
<td>A22-A26</td>
</tr>
<tr>
<td>Sufficient Appropriate Audit Evidence and Audit Risk</td>
<td>A27-A51</td>
</tr>
<tr>
<td>Conduct of an Audit in Accordance with ISAs</td>
<td>A52-A75</td>
</tr>
</tbody>
</table>
Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) establishes the independent auditor’s overall responsibilities when conducting an audit of financial statements in accordance with ISAs. Specifically, it sets out the overall objectives of the independent auditor, and explains the nature and scope of an audit designed to enable the independent auditor to meet those objectives. It also explains the scope, authority and structure of the ISAs, and includes requirements establishing the general responsibilities of the independent auditor applicable in all audits, including the obligation to comply with the ISAs. The independent auditor is referred to as “the auditor” hereafter.

2. ISAs are written in the context of an audit of financial statements by an independent auditor. They are to be adapted as necessary in the circumstances when applied to audits of other historical financial information.

An Audit of Financial Statements

4. The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

39. An audit of financial statements is an assurance engagement. The auditor is engaged for purposes of expressing an opinion designed to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, that opinion is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework. An audit conducted in accordance with ISAs and relevant ethical requirements enables the auditor to form that opinion. (Ref: Para. A1)

47. An audit by an independent auditor is premised on the fact that the financial statements subject to audit are those of the entity, prepared and presented by management of the entity with, where applicable, oversight from those charged with governance, with the auditor engaged for purposes of forming and expressing an opinion on them. ISAs do not impose responsibilities on management or those charged with governance and do not override laws and regulations that govern their responsibilities. However, an audit in accordance with ISAs is conducted on the premise that management and, where appropriate, those charged with governance have responsibilities that are fundamental to the conduct of the audit. The audit of the financial statements does not relieve management and those charged with governance of those responsibilities. The auditor is also entitled to expect that

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4 Referred to hereafter and in the ISAs as “the auditor” unless the context requires emphasis of independence.

2 The terms “management” and “those charged with governance” are described in [proposed] ISA 260 (Revised and Redrafted), “Communication with Those Charged with Governance.”
management and those charged with governance will make available to the auditor all the
information the auditor requires for the purposes of the audit. (Ref: Para. A2-A11)

5. As the basis for the auditor’s opinion, the auditor obtains ISAs require the auditor to obtain
reasonable assurance about whether the financial statements as a whole are free from
material misstatement, whether due to fraud or error. Reasonable assurance, which is
required by the ISAs, is a high, but not absolute, level of assurance. It is obtained when the
auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk
that the auditor expresses an inappropriate opinion when the financial statements are
materially misstated) there is an unidentified material misstatement of the financial statements
(i.e., audit risk) to an acceptably low level. However, reasonable assurance is not an absolute
level of assurance, because there are inherent limitations of an audit which result in most of
the audit evidence on which the auditor draws conclusions and bases the auditor’s opinion
being persuasive rather than conclusive. (Ref: Para. A27-A51)

6A9. Misstatements in the financial statements can arise from fraud or error. The auditor is
responsible for obtaining reasonable assurance about whether the financial statements as a
whole are free from material misstatement, whether due to fraud or error, but is not
responsible for the detection of misstatements that are not material to the financial statements
taken as a whole. The concept of materiality is applied by the auditor both in planning and
performing the audit, and in evaluating the effect of identified misstatements on the audit and
of uncorrected misstatements, if any, on the financial statements. In general, misstatements,
including omissions, are considered to be material if they, individually or in the aggregate,
could reasonably be expected to influence the economic decisions of users taken on the
basis of the financial statements. Judgments about materiality are made in the light of
surrounding circumstances, and are affected by the auditor’s perception of the financial
information needs of users of the financial statements, and by the size or nature of a
misstatement, or a combination of both. The concept of materiality is used both in planning
and performing the audit, and in evaluating the effect of identified misstatements on the
financial statements and the related auditor’s report, as discussed further in [proposed] ISA
320 (Revised and Redrafted), “Materiality in Planning and Performing an Audit” and
[proposed] ISA 450 (Redrafted), “Evaluation of Misstatements Identified during the Audit,”
respectively. The auditor’s opinion deals with the financial statements taken as a whole and
therefore the auditor is not responsible for the detection of misstatements that are not
material to the financial statements taken as a whole.

7A4. The ISAs are designed to support the auditor in obtaining reasonable assurance contain
objectives, requirements and application and other explanatory material that are designed to
support the auditor in obtaining reasonable assurance. They ISAs require that the auditor
exercise professional judgment and maintain professional skepticism throughout the
planning and performance of the audit; and, among other things:

3 [Proposed] ISA 320 (Revised and Redrafted), “Materiality in Planning and Performing an Audit” and [Proposed]
ISA 450 (Redrafted), “Evaluation of Misstatements Identified during the Audit.”
• Identify and assess risks of material misstatement, whether due to fraud or error, based on an understanding of the entity and its environment, including the entity’s internal control.

• Obtain sufficient appropriate audit evidence about whether the assessed risks have given rise to material misstatements, through designing and implementing appropriate responses to those risks.

• Obtain audit evidence about whether the risks have given rise to material misstatements in order to reduce audit risk to an acceptably low level.

• Form an opinion on the financial statements based on conclusions drawn from the audit evidence obtained.

8. The form of opinion expressed by the auditor will depend upon the applicable financial reporting framework and any applicable laws or regulations. Unless specifically stated otherwise, references in the ISAs to the auditor’s opinion covers both opinions on whether the financial statements are presented fairly, in all material respects, or give a true and fair view, and opinions on compliance with the specific requirements of the applicable financial reporting framework. (Ref: Para. A12)

9. The auditor may also have certain other communication and reporting responsibilities to users, management, those charged with governance, or parties outside the entity, in relation to matters arising from the audit. These may be established by the ISAs or by applicable laws or regulations.4

Effective Date

103. This ISA is effective for audits of financial statements for periods beginning on or after December 15, 2009[10].

Overall Objectives of the Independent Auditor

115. In conducting an audit of financial statements so as to achieve its objective, the overall objectives of the independent auditor are:

(a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and

(b) To report on the financial statements, or otherwise as required by the ISAs, in accordance with the auditor’s findings. (Ref: Para. A1)
126. The objective of an audit cannot be fulfilled unless the auditor achieves the overall objective of the auditor. In all cases when reasonable assurance the overall objective of the auditor cannot be obtained, and a qualified opinion in the auditor’s report is insufficient in the circumstances for purposes of reporting to the intended users of the financial statements, the ISAs require that the auditor disclaim an opinion and withdraws from the engagement, where withdrawal is legally permitted.

Preparation of the Financial Statements
7. [MOVED TO PARAGRAPH 4]
8. [MOVED TO PARAGRAPHS 4 AND A2]

An Audit of Financial Statements, and Related Concepts
9. [MOVED TO PARAGRAPH 3]
10. [MOVED TO PARAGRAPH 5]
11. [MOVED TO PARAGRAPH 7]
12. An audit is not intended to, and cannot, provide a guarantee or absolute assurance, i.e., certainty, that the financial statements are free from material misstatement due to fraud or error. This is primarily because there are inherent limitations of an audit that affect the auditor's ability to detect material misstatements, whether due to fraud or error.

13. The following concepts provide the basis for a proper understanding of the overall objective of the auditor and the objectives and requirements of the ISAs:
   (a) Materiality (Ref: Para. A9)
   (b) Audit risk (Ref: Para. A10-A19)
   (c) Sufficiency and appropriateness of audit evidence (Ref: Para. A20-A23)
   (d) Professional judgment (Ref: Para. A24-A25)
   (e) Professional skepticism (Ref: Para. A26-A27)
   (f) Inherent limitations of an audit (Ref: Para. A28-A40)

Auditor Independence
14. [MOVED TO PARAGRAPH A13]
15. [MOVED TO PARAGRAPH A15]

Definitions
136. For purposes of the ISAs, the following terms have the meanings attributed below:
   (a) Applicable financial reporting framework – The financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation and presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.
For purposes of the ISAs, the term “fair presentation framework” is used to refer to a financial reporting framework that requires compliance with the specific requirements of the framework and:

(i) Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the specific requirements of the framework; or

(ii) Acknowledges explicitly that, in extremely rare circumstances, it may be necessary for management to depart from a specific requirement of the framework to achieve fair presentation of the financial statements.

The term “compliance framework” is used to refer to a financial reporting framework that requires compliance with the specific requirements of the framework, but does not contain the acknowledgements in (i) or (ii) above.

(b) Audit evidence – All of the information used by the auditor in arriving at the conclusions on which the auditor’s opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. For purposes of the ISAs:

(i) Sufficiency of audit evidence is the measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor’s assessment of the risks of material misstatement and also by the quality of such audit evidence.

(ii) Appropriateness of audit evidence is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor’s opinion is based.

(c) Audit risk – The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk.

(d) 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.

(e) Detection risk – The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

(f) Financial statements – A structured representation of historical financial information, including which ordinarily includes related explanatory notes, intended to communicate an entity’s economic resources or obligations at a point in time or the

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2 This definition does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not.
changes therein for a period of time in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The term “financial statements” ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework, but can also refer to a single financial statement.

(gf) Historical financial information – Information expressed in financial terms in relation to a particular entity, derived primarily from that entity’s accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

(h) Management – The person(s) with executive responsibility for the conduct of the entity’s operations. For some entities in some jurisdictions, management includes some or all of those charged with governance, for example, executive members of a governance board, or an owner-manager.

(ig) Misstatement – A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud, and may result from:

(i) An inaccuracy in gathering or processing data from which the financial statements are prepared;

(ii) An omission of an amount or disclosure;

(iii) An incorrect accounting estimate arising from overlooking or clear misinterpretation of facts; or

(iv) Management’s judgments concerning accounting estimates that the auditor considers unreasonable or the selection and application of accounting policies that the auditor considers inappropriate.

When the auditor expresses an opinion on whether the financial statements give a true and fair view or are presented fairly, in all material respects, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the auditor’s judgment, are necessary for the financial statements to give a true and fair view or be presented fairly, in all material respects.

(j) Premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit is conducted – That management and, where appropriate, those charged with governance have the following responsibilities that are fundamental to the conduct of an audit in accordance with ISAs. That is, responsibility:

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8 Examples of a single financial statement, each of which would include related explanatory notes, are: statement of income or statement of operations; statement of cash receipts and disbursements; statement of assets and liabilities that does not include owner’s equity; and statement of operations by product lines.
(i) For the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework; this includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error; and

(ii) To provide the auditor with:

a. All information, such as records and documentation, and other matters that are relevant to the preparation and presentation of the financial statements;

b. Any additional information that the auditor may request from management and, where appropriate, those charged with governance; and

c. Unrestricted access to those within the entity from whom the auditor determines it necessary to obtain audit evidence.

In the case of a fair presentation framework, management is responsible for the preparation and fair presentation of the financial statements in accordance with the financial reporting framework; or the preparation of financial statements that give a true and fair view in accordance with the financial reporting framework. This applies to all references to “preparation and presentation of the financial statements” in the ISAs.

The “premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit is conducted” may also be referred to as the “premise.”

(k) Professional judgment – The application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making decisions about the courses of action that are appropriate in the circumstances of the audit engagement.

(l) Professional skepticism – An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.

(m) Reasonable assurance – In the context of an audit of financial statements, a high, but not absolute, level of assurance.

(n) Risk of material misstatement – The risk that the financial statements are materially misstated prior to audit. This consists of two components, described as follows at the assertion level:

(i) Inherent risk – The susceptibility of an account balance, class of transaction, or disclosure assertion to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any assuming that there are no related controls.

(ii) Control risk – The risk that a misstatement that could occur in an account balance, class of transaction, or disclosure assertion and that could be material,
either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity’s internal control.

(o) Those charged with governance – The person(s) or organization(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.

Requirements

Ethical Requirements Relating to an Audit of Financial Statements

147. The auditor shall comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. (Ref: Para. A1341-A16)

Professional Skepticism

158. The auditor shall plan and perform an audit with an attitude of professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated. (Ref: Para. A1742-A21)

Professional Judgment

16. The auditor shall exercise professional judgment in planning and performing an audit of financial statements. (Ref: Para. A22-A26)

Sufficient Appropriate Audit Evidence and Audit Risk

179. In order to obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to be able to draw reasonable conclusions on which to base the auditor’s opinion. Reasonable assurance is obtained when the auditor has thereby reduced audit risk to an acceptably low level. (Ref: Para. A27-A51)

Conduct of an Audit in Accordance with ISAs

Complying with ISAs Relevant to the Audit

1820. The ISAs, taken together, are designed to support the achievement of the overall objective of the auditor. Accordingly, the auditor shall comply with all ISAs relevant to the audit. An ISA is relevant to the audit when the ISA is in effect and the circumstances addressed by the ISA exist. (Ref: Para. A5243-A5647)

1924. The auditor shall read and understand consider the entire text of an ISA to understand its objective and to apply its requirements properly. The nature of the ISAs requires the auditor to exercise professional judgment in applying them. (Ref: Para. A5748-A6552)
2022. The auditor shall not represent compliance with ISAs in the auditor’s report unless the auditor has complied with the requirements of this ISA and all other of the ISAs relevant to the audit.

Objectives Stated in Individual ISAs

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.

24. To achieve the overall objectives of the auditor, the auditor shall use the objectives stated in relevant ISAs to judge whether in planning and performing the audit, having regard to the interrelationships amongst the ISAs and having complied with the requirements of the ISAs, to:

- (Ref: Para. A66-A68)
  - (ab) Determine whether any other audit procedures in addition to those required by the ISAs are necessary to be performed in pursuance of the objectives stated in the ISAs; and
  - (ba) Evaluate whether sufficient appropriate audit evidence has been obtained in the context of the overall objective of the auditor; and

The assessment of whether sufficient appropriate audit evidence has been obtained and the other audit procedures, if any, that may be necessary in the circumstances are matters of professional judgment. 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.

Applying, and Complying with, Relevant Requirements

26. ISAs contain requirements expressed using the word “shall.” The requirements are designed to enable the auditor to meet the objectives specified in the ISAs, and thereby the overall objective of the auditor.

27. Subject to paragraph 238, the auditor shall comply with each the requirements of an ISA in all cases where such requirements are relevant. A requirement is relevant unless, in the circumstances of the audit:

- (a) The entire ISA is not relevant; or
- (b) The circumstances envisioned in the requirement do not apply because the requirement is not relevant because it is conditional and the condition does not exist. (Ref: Para. A71-A72)

28. In exceptional circumstances, the auditor may judge it necessary to depart from a relevant requirement in an ISA to achieve the aim of that requirement. In such circumstances, the auditor shall perform alternative audit procedures to achieve the aim of that requirement. The need for the auditor to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective in achieving the aim of the requirement. The auditor need not apply a requirement that is not relevant in the circumstances of the audit; this does not constitute a departure from the requirement. (Ref: Para. A73)
29. The auditor shall apply the requirements in the context of the other material included in the ISA.

**Failure to Achieve an Objective**

245. If an objective in a relevant ISA cannot be achieved, the auditor shall evaluate whether this prevents the auditor from achieving the overall objectives of the auditor, thereby requiring the auditor, in accordance with the ISAs, to modify the auditor’s opinion accordingly or withdraw from the engagement. In most cases, the failure to achieve an objective will prevent the achievement of the overall objective of the auditor. Failure to achieve an objective represents a significant matter requiring documentation in accordance with [proposed] ISA 230 (Redrafted)⁹, “Audit Documentation.” (Ref: Para. A7457-A7560)

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**Application and Other Explanatory Material**

**The Objective of an Audit and its Relationship to the Overall Objective of the Auditor** (Ref: Para. 5)

A1. The overall objective of the auditor restates the objective of an audit in a way that can more readily be related to the objectives and requirements of the ISAs. For the financial statements to be prepared, in all material respects, in accordance with an applicable financial reporting framework, they must be free from material misstatement. The overall objective of the auditor reflects the fact that the basis for the auditor’s opinion is reasonable assurance. The auditor obtains reasonable assurance by reducing audit risk to an acceptably low level, through accumulating and evaluating sufficient appropriate audit evidence. The auditor’s opinion on the financial statements is expressed in a written report.

**An Audit of Financial Statements**

**Scope of the Audit** (Ref: Para. 3)

A129. An audit is also necessarily limited by its scope and objective, which deal with the expression by the auditor of an opinion on the financial statements. The auditor’s opinion on the financial statements deals with whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Such an opinion is common to all audits of financial statements. The auditor’s opinion therefore does not assure, for example, the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity. In some jurisdictions, however, applicable laws and regulations may require auditors to provide opinions on other specific matters, such as the effectiveness of internal control, or the consistency of a separate management report with the financial statements. For example, the auditor does not express an opinion on matters such as the future viability of the entity or the efficiency or effectiveness with which management has conducted the affairs of the entity (including the effectiveness of internal control). The extent of compliance with all laws and regulations that

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⁹ ISA 230 (Redrafted), “Audit Documentation,” paragraph 8(c).
may be applicable to the entity. While the ISAs include requirements and guidance in relation
to such matters to the extent that they are relevant to forming an opinion on the financial
statements, the auditor would be required to undertake further work if the auditor had
additional responsibilities to provide such opinions.

Preparation of the Financial Statements (Ref: Para. A2- A28)

A28. Accordingly, although ISAs do not impose responsibilities on management and those
charged with governance and do not override laws and regulations that govern their
responsibilities, ISAs are written, and An audits in accordance with ISAs is are conducted, on
the premises that management and, where appropriate, those charged with governance have
responsibility:

(a) Acknowledge and understand their responsibility for the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework, this includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error; and (Ref: Para. A2-
A8);

(b) Acknowledge and understand their responsibility for designing, implementing and maintaining internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error; and

(b) To Will provide complete information to the auditor with:

(i) All information, such as records and documentation, and other matters that are
relevant to the preparation and presentation of the financial statements;
(ii) Any additional information that the auditor may request from management and,
where appropriate, those charged with governance; and
(iii) Unrestricted access to those within the entity from whom the auditor determines
it necessary to obtain audit evidence.

A32. As part of their responsibility for the preparation and presentation of the financial
statements, management and, where appropriate, those charged with governance are responsible for:

• The identification of the applicable financial reporting framework, in the context
of any relevant laws or regulations.
• Management is also responsible for The preparation and presentation of the financial statements in accordance with that framework, and
• An adequately description of that framework in the financial statements.

The preparation of the financial statements requires management to exercise judgment in
making accounting estimates that are reasonable in the circumstances, as well as to select and
apply appropriate accounting policies. These judgments are made in the context of the

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10 With oversight from those charged with governance.
applicable financial reporting framework. Management’s responsibility for preparing and presenting the financial statements in accordance with the applicable financial reporting framework includes:

- Designing, implementing and maintaining internal control relevant to preparing and presenting financial statements that are free from material misstatement, whether due to fraud or error;
- Selecting and applying appropriate accounting policies; and
- Making accounting estimates that are reasonable in the circumstances.

A43. The financial statements may be prepared in accordance with a financial reporting framework designed to meet:

- The common financial information needs of a wide range of users (i.e., “general purpose financial statements” prepared in accordance with a “general purpose framework”); or
- The financial information needs of specific users (i.e., “special purpose financial statements” prepared in accordance with a “special purpose framework”).

A54. The applicable financial reporting framework often encompasses financial reporting standards established by an authorized or recognized standards setting organization, or legislative or regulatory requirements. In some cases, the financial reporting framework may encompass both financial reporting standards established by an authorized or recognized standards setting organization and legislative or regulatory requirements. Other sources may provide direction on the application of the applicable financial reporting framework. In some cases, the applicable financial reporting framework may encompass such other sources, or may even consist only of such sources. Such other sources may include:

- The effect of the legal and ethical environment, including statutes, regulations, court decisions, and professional ethical obligations in relation to accounting matters;
- Published accounting interpretations of varying authority issued by standards setting, professional or regulatory organizations;
- Published views of varying authority on emerging accounting issues issued by standards setting, professional or regulatory organizations;
- General and industry practices widely recognized and prevalent; and
- Accounting literature.

Where conflicts exist between the financial reporting framework and the sources from which direction on its application may be obtained, or amongst the sources that encompass the financial reporting framework, the source with the highest authority prevails.

A65. The requirements of the applicable financial reporting framework determine the form and content of the financial statements. Although the framework may not specify how to account for or disclose all transactions or events, it ordinarily embodies sufficient broad principles that can serve as a basis for developing and applying accounting policies that are consistent with the concepts underlying the requirements of the framework.
A76. Some financial reporting frameworks are fair presentation frameworks, while others are compliance frameworks. Financial reporting frameworks that encompass primarily the financial reporting standards established by an organization that is authorized or recognized to promulgate standards to be used by entities for preparing and presenting general purpose financial statements are often designed to achieve fair presentation, for example, International Financial Reporting Standards (IFRSs).

A87. The requirements of the applicable financial reporting framework also determine what constitutes a complete set of financial statements. In the case of many frameworks, financial statements are intended to provide information about the financial position, financial performance and cash flows of an entity. For such frameworks, a complete set of financial statements would include a balance sheet; an income statement; a statement of changes in equity; a cash flow statement; and related explanatory notes, comprising a summary of significant accounting policies and other explanatory notes. For some other financial reporting frameworks, a single financial statement and the related explanatory notes might constitute a complete set of financial statements:

- For example, the International Public Sector Accounting Standard (IPSAS), “Financial Reporting Under the Cash Basis of Accounting” states that the primary financial statement is a statement of cash receipts and payments when a public sector entity prepares and presents its financial statements in accordance with that IPSAS.

- Other examples of a single financial statement, each of which would include related notes, are:
  - Balance sheet.
  - Statement of income or statement of operations.
  - Statement of retained earnings.
  - Statement of cash flows.
  - Statement of assets and liabilities that does not include owner’s equity.
  - Statement of changes in owners’ equity.
  - Statement of revenue and expenses.
  - Statement of operations by product lines.


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A10. Because of the significance of the premise to the conduct of an audit, the auditor is required to obtain agreement from management and, where appropriate, those charged with governance that they acknowledge and understand their responsibilities set out in paragraph A2 as a precondition for accepting the audit engagement.\textsuperscript{13} The auditor is also required to obtain written representations about whether management and, where appropriate, those charged with governance have fulfilled those responsibilities.\textsuperscript{14}

Considerations Specific to Public Sector Entities

A11. The mandates for audits of the financial statements of public sector entities may be broader than those of other entities. As a result, the premise, relating to management’s responsibilities, on which an audit of the financial statements of a public sector entity is conducted may include additional responsibilities, such as the responsibility for the execution of transactions and events in accordance with legislation or proper authority.

Form of the Auditor’s Opinion (Ref: Para. 8)

A12. Where the applicable financial reporting framework is a fair presentation framework, as is generally the case for general purpose financial statements, the opinion required by the ISAs is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view, or are presented fairly, in all material respects — see [proposed] ISA 700 (Redrafted)\textsuperscript{15} (Amended as a Result of ISA 800 (Revised)), “The Independent Auditor’s Report on General Purpose Financial Statements.” Unless specifically stated otherwise, reference in the ISAs to the auditor’s opinion covers both opinions on whether the financial statements give a true and fair view, or are presented fairly, in all material respects, and opinions on compliance with the specific requirements of the applicable financial reporting framework.

An Audit of Financial Statements, and Related Concepts

Materiality (Ref: Para. 13(a))

A9. [MOVED TO PARAGRAPH 6]

Audit Risk (Ref: Para. 13(b))

A10-A19 [MOVED TO PARAGRAPHS A31-A42]

Sufficiency and Appropriateness of Audit Evidence (Ref: Para. 13(c))

A20-A23 [MOVED TO PARAGRAPHS A27-A30]

Professional Judgment (Ref: Para. 13(d))

A24-A25. [MOVED TO PARAGRAPHS A22-A24]

Professional Skepticism (Ref: Para. 13(e))

\textsuperscript{13} [Proposed] ISA 210 (Redrafted), paragraph [4(b)].

\textsuperscript{14} ISA 580 (Revised and Redrafted), “Written Representations,” paragraphs 10-11.

Ethical Requirements Relating to an Audit of Financial Statements (Ref: Para. 147)

A13. The auditor is subject to relevant independence and other ethical requirements, relating to financial statement audit engagements. Relevant ethical requirements which ordinarily comprise Parts A and B of the International Federation of Accountants’ Code of Ethics for Professional Accountants (the IFAC Code) related to an audit of financial statements together with national requirements that are more restrictive.

A14. Part A of the IFAC Code establishes the fundamental principles of professional ethics relevant to the auditor when conducting an audit of financial statements and provides a conceptual framework for applying those principles. The fundamental principles with which the auditor is required to comply by the IFAC Code are:

(a) Integrity;
(b) Objectivity;
(c) Professional competence and due care;
(d) Confidentiality; and
(e) Professional behavior.

Part B of the IFAC Code illustrates how the conceptual framework is to be applied in specific situations.

A15. In the case of an audit engagement it is in the public interest and, therefore, required by the IFAC Code, that the auditor be independent of the entity subject to the audit. The IFAC Code describes the concept of independence as comprising both the state of mind of the auditor and independence in appearance. The auditor’s independence of the auditor from the entity whose financial statements are subject to audit safeguards the auditor’s ability to form an audit opinion without being affected by influences that might compromise that opinion. Independence enhances the auditor’s ability to act with integrity, to be objective and to maintain an attitude of professional skepticism.

A16. [Proposed] International Standard on Quality Control (ISQC) 1 (Redrafted) sets out the responsibilities of the firm for establishing policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements, including those pertaining to independence. [Proposed] ISA 220 (Redrafted), “Quality Control for Audits of Historical Financial Information,” sets out the engagement partner’s responsibilities with respect to relevant ethical requirements. These include evaluating whether members of the engagement team have complied with relevant ethical requirements, determining the appropriate action if matters come to the engagement partner’s attention that indicate that members of the engagement team have not complied with relevant ethical requirements, and forming a conclusion on compliance with independence.
requirements that apply to the audit engagement.\textsuperscript{17} ISA 220 (Redrafted) recognizes that the engagement team is entitled to rely on a firm’s systems in meeting its responsibilities with respect to quality control procedures applicable to the individual audit engagement, unless information provided by the firm or other parties suggests otherwise. Accordingly, International Standard on Quality Control (ISQC) 1, “Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements,” requires the firm to establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements.

**Professional Skepticism** (Ref: Para. 158)

A17. Professional skepticism is an attitude that involves the critical assessment, with a questioning mind, of the validity of audit evidence obtained. It includes being alert to, for example:

- Recognizing that circumstances may exist that cause the financial statements to be materially misstated;
- Audit evidence that contradicts other audit evidence obtained;
- Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence and other information obtained from management and those charged with governance;
- Conditions that may indicate possible fraud;
- Circumstances that suggest the need for audit procedures in addition to those required by the ISAs.

A18. Maintaining an attitude of professional skepticism throughout the audit is necessary if the auditor is, for example, to reduce the risks of:

- Overlooking unusual circumstances;
- Overgeneralizing when drawing conclusions from audit observations; and
- Using inappropriate faulty assumptions in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof.

A19. Maintaining an attitude of professional skepticism is necessary to the critical assessment of audit evidence. This includes questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. It also includes consideration of the adequacy of audit evidence obtained in the light of the circumstances, for example in the case where fraud risk factors exist and a single document, of a nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount.

A20. Although the auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary, however, an audit rarely involves the authentication of documents, nor is the auditor trained as or expected to be an expert in such authentication.

\textsuperscript{17} ISA 220 (Redrafted), “Quality Control for an Audit of Financial Statements,” paragraphs [8-10].
auditor is nevertheless required to consider the reliability of information to be used as audit evidence. In cases of doubt about the reliability of information or indications of possible fraud (for example if conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document may have been falsified), the ISAs require that the auditor investigate further and determine what modifications or additions to audit procedures are necessary to resolve the matter. Accordingly, unless the auditor has reason to believe the contrary (for example if conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document have been falsified) the auditor may accept records and documents as genuine.

A belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain an attitude of professional skepticism nor does it allow the auditor to be satisfied with less than persuasive audit evidence when obtaining reasonable assurance about whether the financial statements, as a whole, are free from material misstatement, whether due to fraud or error. Further, although the auditor cannot be expected to disregard past experience of the honesty and integrity of the entity’s management and those charged with governance, nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism or allow the auditor to be satisfied with less-than-persuasive audit evidence when obtaining reasonable assurance the auditor’s attitude of professional skepticism is important because there may have been changes in circumstances.

**Professional Judgment** (Ref: Para. 1643(d))

Professional judgment in auditing may be described as the application of relevant knowledge and experience, within the context provided by auditing, accounting and ethical standards, in reaching decisions about the courses of action that are appropriate in the circumstances of the audit engagement. Professional judgment is essential to the proper conduct of an audit. This is because interpretation of relevant ethical requirements and the ISAs and the informed decisions required throughout the audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances. Professional judgment is necessary in particular regarding decisions about:

- Materiality and audit risk,
- The nature, timing, and extent of audit procedures used to meet the requirements of the ISAs and gather audit evidence,
- Evaluating whether sufficient appropriate audit evidence has been obtained, and whether more needs to be done to achieve the objectives of the ISAs and thereby, the overall objectives of the auditor,
- The evaluation of management’s judgments in applying the entity’s applicable financial reporting framework, and

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18 [Proposed] ISA 500 (Redrafted), “Audit Evidence,” paragraph [7].
• The drawing of conclusions based on the audit evidence obtained, for example, assessing the reasonableness of the estimates made by management in preparing the financial statements.

Professional judgment is therefore essential to the proper conduct of an audit.

A23. Professional judgment is a personal quality, and judgments may therefore differ between experienced auditors. However, the distinguishing feature of the professional judgment expected of an auditor is that it is exercised by an auditor whose training, knowledge and experience have assisted in developing the necessary competencies to achieve a reasonable consistency of judgment such that the exercise of professional judgment in any particular case may be regarded as reasonable if other experienced auditors can agree that this is the case.

A24. Any such agreement on whether the exercise of professional judgment in any particular case is reasonable is based on the facts and circumstances that are known by the auditor at the time the judgment was made. Consultation on difficult or contentious matters during the course of the audit, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm, such as that required by [proposed] ISA 220 (Redrafted), assist the auditor in making informed and reasonable judgments.

A25. 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.

A26. Professional judgment needs to be exercised throughout the audit. It also needs to be appropriately documented. In this regard, the auditor is required to prepare audit documentation sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the significant professional judgments made in reaching conclusions on significant matters arising during the audit. Professional judgment is not to be used as the justification for decisions that are not otherwise supported by the facts and circumstances of the engagement or sufficient appropriate audit evidence.

Sufficient Appropriate Audit Evidence and Audit Risk (Ref: Para. 17)

Sufficiency and Appropriateness of Audit Evidence (Ref: Para. 13(c))

A270. Audit evidence is necessary to support the auditor’s opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits (provided the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit) and a firm’s quality control procedures for client acceptance and continuance. In addition to other sources inside
and outside the entity, the entity’s accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared by an expert employed or engaged by the entity. Audit evidence comprises both information that supports and corroborates management’s assertions, and any information that contradicts such assertions. In addition, in some cases, the absence of information (for example, management’s refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence. Most of the auditor’s work in forming the auditor’s opinion consists of obtaining and evaluating audit evidence.

A282. Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor’s assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality.

A292. Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor’s opinion is based, or detecting misstatements in the financial statements. The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.

A302. The sufficiency and appropriateness of audit evidence are interrelated. Whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby enable the auditor to draw reasonable conclusions on which to base the auditor’s opinion, is a matter of for the auditor to determine using professional judgment. 

Audit Risk (Ref. Para. 13(b))

A3110. Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. This risk is a function of the risks of material misstatement and detection risk. The assessment of risks is a judgment based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of professional judgment rather than a matter capable of precise measurement. Reasonable assurance is obtained by reducing audit risk to an acceptably low level.

A32. For purposes of the ISAs, audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not. This risk is ordinarily insignificant. Further, audit risk is a technical term related to the process of auditing; it does not refer to the auditor’s business risks such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements.

Risks of Material Misstatement

A334. The risks of material misstatement may exist at two levels:

- The overall financial statement level;
- And
• The assertion level for, in relation to classes of transactions, account balances, and disclosures, at the assertion level.

A3442. Risks of material misstatement at the overall financial statement level refer to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions.

A3543. Risks of material misstatement at the assertion level class of transactions, account balances, and disclosure level are need to be assessed in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements taken as a whole at an acceptably low level of audit risk. Auditors use various approaches to accomplish the objective of assessing the risks of material misstatement. For example, the auditor may make use of a model that expresses the general relationship of the components of audit risk in mathematical terms to arrive at an acceptable level of detection risk. Some auditors find such a model to be useful when planning audit procedures.

A3644. The risks of material misstatement at the assertion level consist of two components: inherent risk; and control risk. Inherent risk and control risk are the entity’s risks; they exist independently of the audit of the financial statements.

A3745. Inherent risk is higher for some assertions and related classes of transactions, account balances, and disclosures than for others. For example, it may be higher for complex calculations or for accounts consisting of amounts derived from accounting estimates that are subject to significant estimation uncertainty. External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement. In addition to those circumstances that are peculiar to a specific assertion, factors in the entity and its environment that relate to several or all of the classes of transactions, account balances, or disclosures may also influence the inherent risk related to a specific assertion. Such factors may include, for example, a lack of sufficient working capital to continue operations or a declining industry characterized by a large number of business failures.

A3846. Control risk is a function of the effectiveness of the design, implementation, and maintenance operation of internal control by management to address identified risks that threaten the achievement of the entity’s objectives relevant to preparation of the entity’s financial statements. In addition, management designs, implements, and maintains internal control to address identified business risks that threaten the achievement of the entity’s objectives. The evidence available to the auditor includes information about the entity’s internal control. ISAs provide the conditions under which the auditor is required to, or may choose to, test the operating effectiveness of controls in determining the extent of substantive procedures to be performed. However, internal control, no matter how well

23 The auditor may make use of a model that expresses the general relationship of the components of audit risk in mathematical terms to arrive at an appropriate level of detection risk. Some auditors find such a model to be useful when planning audit procedures to achieve a desired audit risk though the use of such a model does not eliminate the judgment inherent in the audit process.
designed and operated, can only reduce, but not eliminate, risks of material misstatement in the financial statements, because of the inherent limitations of internal control. These include, for example, the possibility of human errors or mistakes, or of controls being circumvented by collusion or inappropriate management override. Accordingly, control risk will always exist because of the inherent limitations of internal control. The ISAs provide the conditions under which the auditor is required to, or may choose to, test the operating effectiveness of controls in determining the extent of substantive procedures to be performed.24

A3912. The ISAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the “risks of material misstatement.” However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.

A40. ISA 315 (Redrafted) establishes requirements and provides guidance on identifying and assessing the risks of material misstatement at the financial statement and assertion levels.

Detection Risk

A4118. Detection risk relates to the nature, timing, and extent of the auditor’s procedures that are determined by the auditor to reduce audit risk to an acceptably low level. It is therefore a function of the effectiveness of an audit procedure and of its application by the auditor. For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessment of the risks of material misstatement at the assertion level. For example, the greater the risks of material misstatement the auditor believes exists, the less the detection risk that can be accepted and, accordingly, the more persuasive the audit evidence required by the auditor. Conversely, the less risks of material misstatement the auditor believes exist, the greater the detection risk that can be accepted.

A4219. Detection risk relates to the nature, timing, and extent of the auditor’s procedures that are determined by the auditor to reduce audit risk to an acceptably low level. It is therefore a function of the effectiveness of an audit procedure and of its application by the auditor. Detection risk cannot be reduced to zero because of the inherent limitations of an audit, as described in paragraphs A28 to A40, and other factors. Such other factors include the possibility that an auditor might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results. These other factors ordinarily can be addressed through matters such as:

- Adequate planning,
- Proper assignment of personnel to the engagement team,
- The application of professional skepticism, and
- Supervision and review of the audit work performed.

assist to enhance the effectiveness of an audit procedure and of its application and reduce the possibility that an auditor might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results.

A43. ISAs 300 (Redrafted)\(^\text{25}\) and 330 (Redrafted) establish requirements and provide guidance on planning an audit of financial statements and the auditor’s responses to assessed risks. Detection risk, however, can only be reduced, not eliminated, because of the inherent limitations of an audit. Accordingly, some detection risk will always exist.

**Inherent Limitations of an Audit** (Ref: Para. 13(f))

A44. An audit is undertaken to enhance the degree of confidence of intended users in the financial statements. Based on the conclusions drawn from the audit evidence obtained, the auditor expresses an opinion on the financial statements. However, the auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain a guarantee or absolute assurance (i.e., certainty) that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit arising from which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor’s opinion being persuasive rather than conclusive. The inherent limitations of an audit arise from:

- The fundamental nature and characteristics of financial reporting and business processes;
- The nature of audit evidence and procedures; and
- The need for the audit to be conducted within a reasonable period of time and at a reasonable cost.

A29. [MOVED TO PARAGRAPH A1]

A30. [MOVED TO PARAGRAPH A50]

A31. The ISAs provide requirements and guidance to assist the auditor in applying professional judgment to mitigate the effect of the inherent limitations of an audit. However, inherent limitations, by their nature, cannot be overcome.

**The Nature of Financial Reporting and Business Processes**

A45. There are certain limitations inherent in financial reporting and business processes that neither the entity nor the auditor can overcome. The preparation of financial statements in accordance with the entity’s applicable financial reporting framework involves judgment by management in applying the requirements of the entity’s applicable financial reporting framework to the facts and circumstances of the entity. Further, although some financial statement items may be determined on the basis of objective and verifiable facts, others are of a nature such that the related audit evidence available can only be persuasive rather than conclusive, or In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty relating to the reliability of their measurement, and

\(^\text{25}\) ISA 300 (Redrafted), “Planning an Audit of Financial Statements.”
there may be a range of acceptable interpretations or judgments that may be made, for example, the estimation of the outcome of uncertain events that may only be confirmed in the future and the estimation of amounts reported on the basis of fair value. Consequently, some financial statement items are subject to an inherent level of variability which cannot be eliminated by the application of additional auditing procedures. For example, this is often the case with respect to certain accounting estimates. Nevertheless, the ISAs require the auditor to give specific consideration to whether accounting estimates are reasonable in the context of the applicable financial reporting framework and to related disclosures, and to the qualitative aspects of the entity’s accounting practices, including indicators of possible bias in management’s judgments.26 There may be valid differences in judgment about such matters, and in the case of judgments about future outcomes those outcomes are highly likely to differ from any judgments that are made, however skilled.

A33. [MOVED TO PARAGRAPH A38]

The Nature of Audit Evidence and Procedures

A4634. The nature of audit evidence is such that it is often persuasive rather than conclusive. There are legal and practical limitations on the auditor’s ability to obtain audit evidence. For example:

- There is the possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation and presentation of the financial statements or that has been requested by the auditor. Accordingly, the auditor cannot be certain of the completeness of information, even though the auditor has performed audit procedures to obtain assurance that all relevant information has been obtained in the absence of legal powers of search—which in themselves have limitations—it is inevitable that an auditor is dependent on management and others for aspects of the completeness of information.

- A35. Further, the risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the auditor to believe that audit evidence is valid when it is not. Because of this, ISA 240 (Redrafted) contains specific requirements designed to assist the auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement. Also, as explained in paragraph A27, an audit rarely involves the authentication of documents. The auditor is neither trained as nor expected to be an expert in the authentication of documents.

- An audit is not an investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.

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A36. Although it is often not possible to obtain audit evidence that is conclusive, the auditor is required to obtain audit evidence that is sufficient and appropriate to reduce audit risk to an acceptably low level.

Timeliness of Financial Reporting and the Balance between Benefit and Cost

A47. The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive. Appropriate planning assists in making sufficient time and resources available for the conduct of the audit. Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost. This is recognized in certain financial reporting frameworks (see, for example, the International Accounting Standards Board’s “Framework for the Preparation and Presentation of Financial Statements”). Therefore, there is therefore an expectation by users of financial statements that the auditor will form an opinion on the financial statements within a reasonable period of time and at a reasonable cost. Recognizing that it is impracticable, accordingly, the auditor is not expected to address all information that may exist or to pursue every matter exhaustively on the assumption that information is in error or fraudulent until proved otherwise. To do otherwise would not allow the audited financial statements to be available in time to be relevant or at a reasonable cost. A further consideration is that the evidence-gathering process may reach a point of diminishing returns, at which the incremental cost of additional audit evidence increases disproportionately to the incremental benefit obtained. However, the matter of time or cost involved is not in itself a valid basis for the auditor to be satisfied with audit evidence that is less than persuasive.

A48. Consequently, it is necessary for the auditor to:

• Plan the audit so that it will be performed in an effective manner;
• Direct audit effort to areas most expected to contain risks of material misstatement, whether due to fraud or error, with correspondingly less effort directed at other areas; and
• Use testing, including sampling, and other means of examining populations for misstatements.

Although samples with high levels of confidence can be designed, there is always a risk that the sample is not representative of the population and a material misstatement will fail to be detected. Similarly, analytical procedures cannot be designed or performed to a level of precision sufficient to ensure that all material misstatements would be detected.

A49. In light of the approaches described in paragraph A48, the ISAs contain requirements for the planning and performance of the audit and require the auditor, among other things, to:

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22 The International Accounting Standards Board’s “Framework for the Preparation and Presentation of Financial Statements” discusses further the constraints of timeliness and the balance between benefit and cost on the provision of relevant and reliable information in the preparation and presentation of financial statements.
• Have a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels by performing risk assessment procedures and related activities; 28 and
• Use testing, including sampling, and other means of examining populations in a manner that provides an appropriate basis for the auditor to draw conclusions about the population. 29

A40. Further, for an audit to be efficient and effective within reasonable time and cost constraints, the auditor needs to design an audit approach that focuses audit effort on identifying and assessing risks of material misstatement, and in performing audit procedures in response to the assessed risks. The assessment of risks of material misstatement, however, is a judgment rather than a precise measurement.

Other Matters that Affect the Inherent Limitations of an Audit

A50. Paragraphs A32-A40 describe the principal inherent limitations of an audit. Other ISAs may provide further explanation of limitations that are of particular relevance to their subject matter, e.g. ISA 240 (Redrafted), “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements” and [proposed] ISA 550 (Revised and Redrafted), “Related Parties.” In the case of certain assertions or subject matters, the potential effects of the inherent limitations on the auditor’s ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

• Fraud, particularly fraud involving senior management or collusion. See ISA 240 (Redrafted) for further discussion.
• The existence and completeness of related party relationships and transactions. See ISA 550 (Revised and Redrafted) 30 for further discussion.
• The occurrence of non-compliance with laws and regulations. See ISA 250 (Redrafted) 31 for further discussion.
• Future events or conditions that may cause an entity to cease to continue as a going concern. See ISA 570 (Redrafted) 32 for further discussion.

Relevant ISAs identify specific audit procedures to assist in mitigating the effect of the inherent limitations.

A51. Because of the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with ISAs. Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself, indicate a failure to conduct an audit in

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28 ISA 315 (Redrafted), paragraphs 5-10.
30 ISA 550 (Redrafted), “Related Parties.”
31 ISA 250 (Redrafted), “Consideration of Laws and Regulations in an Audit of Financial Statements.”
32 ISA 570 (Redrafted), “Going Concern.”
accordance with ISAs. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less-than-persuasive audit evidence. Whether the auditor has performed an audit in accordance with ISAs is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor’s report based on an evaluation of that evidence in light of the overall objectives of the auditor.

**Conduct of an Audit in Accordance with ISAs**

**Nature of ISAs** (Ref: Para. 1820)

A5243. ISAs, taken together, provide the standards for the auditor’s work in fulfilling the overall objectives of the auditor. The ISAs deal with the general responsibilities of the auditor, as well as the auditor’s further considerations relevant to the application of those responsibilities to specific topics.

A5344. The scope, effective date and any specific limitation of the applicability of a specific ISA is made clear in the ISA. Unless otherwise stated in the ISA, the auditor is permitted to apply an ISA before the effective date specified therein.

A5445. In performing an audit, the auditor may be required to comply with other professional, legal or regulatory requirements in addition to the ISAs. The ISAs do not override laws and regulations that govern an audit of financial statements. In the event that those laws and regulations differ from the ISAs, an audit conducted only in accordance with laws and regulations will not automatically comply with ISAs.

A5546. The auditor may also conduct the audit in accordance with both ISAs and auditing standards of a specific jurisdiction or country. In such cases, the auditor may be required to comply with additional requirements in order to comply with the relevant standards of that jurisdiction or country.

**Considerations Specific to Audits in the Public Sector**

A5647. ISAs are relevant to engagements in the public sector. The public sector auditor’s responsibilities, however, may be affected by the audit mandate, or by obligations on public sector entities arising from legislation, regulation, ministerial directives, government policy requirements, or resolutions of the legislature, which may encompass a broader scope than an audit of financial statements in accordance with the ISAs. These additional responsibilities are not dealt with in the ISAs. They may be dealt with in the pronouncements of the International Organization of Supreme Audit Institutions or national standards-setters, or in guidance developed by government audit agencies.

**Contents of ISAs** (Ref: Para. 1921)

A5748. In addition to objectives and requirements (requirements are expressed in the ISAs using “shall”), an ISA contains related guidance in the form of application and other explanatory material. It may also contain introductory material that provides context relevant essential to a proper understanding of the ISA, and definitions. The entire text of an ISA, therefore, is
relevant to an understanding of the objectives stated in an ISA and the proper application of the requirements of an ISA.

The application and other explanatory material is an integral part of the ISA, as it provides further explanation of, and guidance for carrying out, the requirements of an ISA and guidance for carrying them out, along with background information on the matters addressed in the ISA. In particular, it may:

- Explain more precisely what a requirement means or is intended to cover.
- Include examples of procedures, some of which the auditor may judge to be appropriate in the circumstances.

While such guidance does not in itself intend to impose a requirement, it is relevant to the proper application of the requirements of an ISA. The application and other explanatory material may also provide background information on matters addressed in an ISA. When appropriate, additional considerations specific to audits of smaller entities and public sector entities are included within the application and other explanatory material of an ISA.

Appendices, which form part of the application and other explanatory material, are an integral part of an ISA. The purpose and intended use of an appendix are explained in the body of the related ISA or within the title and introduction of the appendix itself.

Introductory material may include, as needed, such matters as explanation of:

- The purpose and scope of the ISA, including how the ISA relates to other ISAs;
- The subject matter of the ISA;
- The respective responsibilities of specific expectations on the auditor and others in relation to the subject matter of the ISA; and
- The context in which the ISA is set.

An ISA may include, in a separate section under the heading ‘Definitions’, a description of the meanings attributed to certain terms for purposes of the ISAs. These are provided to assist in the consistent application and interpretation of the ISAs, and are not intended to override definitions that may be established for other purposes, whether in law, regulation or otherwise. Unless otherwise indicated, those terms will carry the same meanings throughout the ISAs. The Glossary of Terms relating to International Standards issued by the International Auditing and Assurance Standards Board in the Handbook of International Auditing, Assurance, and Ethics Pronouncements published by IFAC contains a complete listing of terms defined in the ISAs. It also includes descriptions of other terms found in ISAs to assist in common and consistent interpretation and translation.

When appropriate, additional considerations specific to audits of smaller entities and public sector entities are included within the application and other explanatory material of an ISA. These additional considerations assist in the application of the requirements of the ISA in the audit of such entities. They do not, however, limit or reduce the responsibility of the auditor to apply and comply with the requirements of the ISAs.

Considerations Specific to Smaller Entities
A63. For purposes of specifying additional considerations to audits of smaller entities, a “smaller entity” refers to an entity which possesses qualitative characteristics such as:

(a) Concentration of ownership and management in a small number of individuals (often a single individual – either a natural person or another enterprise that owns the entity provided the owner exhibits the relevant qualitative characteristics); and

(b) One or more of the following:

(i) Straightforward or uncomplicated transactions;
(ii) Unsophisticated record-keeping;
(iii) Few lines of business and few products within business lines;
(iv) Limited internal controls;
(v) Few levels of management with responsibility for a broad range of controls; or
(vi) Few personnel, many having a wide range of duties.

These qualitative characteristics are not exhaustive, they are not exclusive to smaller entities, and smaller entities do not necessarily display all of those characteristics.

A64. While some of the considerations specific to smaller entities included in the ISAs may be helpful in audits of smaller listed entities, the considerations have been developed primarily with unlisted entities in mind.

A65. In some cases, a smaller entity may be an owner-managed entity. The ISAs refer to the proprietor of an entity who is involved in running the entity on a day-to-day basis as the ‘owner-manager.’

Objectives Stated in Individual ISAs (Ref: Para. 2124)

A66. Each ISA contains one or more objectives which provide a link between the requirements and the overall objectives of the auditor. The objectives in individual ISAs are designed to focus the auditor on the desired outcome of the ISA, while being specific enough to assist the auditor in:

• Understanding what needs to be accomplished and, where necessary, the appropriate means of doing so; and
• Deciding whether what, if anything, needs to be done to achieve them in the particular circumstances of the audit.

A67. Objectives are to be understood in the context of the overall objectives of the auditor stated in paragraph 11 of this ISA inherent limitations of an audit as well as the other concepts relevant to an audit of financial statements set out in paragraph 13 of this ISA. The ability to achieve an individual objective is equally subject to the inherent limitations of an audit, may be limited by circumstances; for example, by a limitation in the available audit evidence. Whether an objective has been, or can be, achieved is a matter for the auditor’s professional judgment, including whether other procedures will assist the auditor in doing so.

A68. In using achieving the objectives of the ISAs for the purposes described in paragraph 21, the auditor is required to have regard to the interrelationships among the ISAs. This is
because of the different nature of the ISAs, which as indicated in paragraph A5243, the ISAs deal in some cases with general responsibilities and in others with the application of those responsibilities to specific topics. For example, this ISA requires the auditor to adopt an attitude of professional skepticism; this is necessary in all aspects of planning and performing an audit but is not repeated as a requirement of each ISA. At a more detailed level, ISA 315 (Redrafted), “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment” and ISA 330 (Redrafted), “The Auditor’s Responses to Assessed Risks” contain, amongst other things, objectives and requirements that deal with the auditor’s responsibilities to identify and assess the risks of material misstatement and to design and perform further audit procedures to respond to those assessed risks, respectively; these objectives and requirements apply throughout the audit. An ISA dealing with specific aspects of the audit (for example, [proposed] ISA 540 (Revised and Redrafted), “Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures”) may expand on how the objectives and requirements of such ISAs as ISA 315 (Redrafted) and ISA 330 (Redrafted) are to be applied in relation to the subject of the ISA but does not repeat them. Thus, in achieving the objective stated in [proposed] ISA 540 (Revised and Redrafted), for example, the auditor has regard to the objectives and requirements of other relevant ISAs.

Use of Objectives to Determine Need for Additional Audit Procedures (Ref: Para. 21(a))

A69. The requirements of the ISAs are designed to enable the auditor to achieve the objectives specified in the ISAs, and thereby the overall objectives of the auditor. The proper application of the requirements of the ISAs by the auditor is therefore expected to provide a sufficient basis for the auditor’s achievement of the objectives. However, because the circumstances of audit engagements vary widely and all such circumstances cannot be anticipated in the ISAs, the auditor is responsible for determining the audit procedures necessary to fulfill the requirements of the ISAs and to achieve the objectives. In the circumstances of an engagement, there may be particular matters that require the auditor to consider further the audit procedures necessary to meet the objectives specified in the ISAs.

Use of Objectives to Evaluate Whether Sufficient Appropriate Audit Evidence Has Been Obtained (Ref: Para. 21(b))

A7056. The auditor is required to use the objectives to evaluate whether sufficient appropriate audit evidence has been obtained in the context of the overall objectives of the auditor. If as a result the auditor concludes that the audit evidence is not sufficient and appropriate, then the auditor may follow one or more of the following approaches to meeting the requirement of paragraph 2124(ba):

- Evaluate whether further relevant audit evidence has been, or will be, obtained as a result of complying with other ISAs;
- Extend the work performed in applying one or more requirements; or
- Perform other procedures judged by the auditor to be necessary in the circumstances.

Where none of the above is expected to be practical or possible in the circumstances, the auditor will not be able to obtain sufficient appropriate audit evidence and is required by the
ISAs to determine the effect on the auditor’s report or on the auditor’s ability to complete the engagement.

**Complying with Relevant Requirements**

**Relevant Requirements (Ref: Para. 227)**

A716. A requirement is relevant when the ISA is relevant in the circumstances of the engagement. In some cases, an ISA (and therefore all of its requirements) may not be relevant in the circumstances. For example, if an entity does not have an internal audit function in a continuing engagement, nothing in [proposed] ISA 610 (Redrafted) 33, “Initial Engagements—Opening Balances,” is relevant. [Similarly, [proposed] ISA 800 (Revised and Redrafted), which deals with special considerations relevant to an audit of special purpose financial statements and an audit of a specific element, account or item of a financial statement, would not be relevant to an audit of general purpose financial statements.]

A726. Within a relevant ISA, there may be conditional requirements. Such a requirement is relevant when the circumstances envisioned in the requirement apply and the condition exists. In general, the any-conditionality of a requirement will either be explicit or implicit, for example:

- (e.g., The requirement to modify the auditor’s opinion if where there is a limitation of scope 34 represents an explicit conditional requirement).

- In some cases, it may be implicit (e.g., The requirement to communicate significant deficiencies and material weaknesses in internal control identified during the audit to management and with those charged with governance, which depends on the existence of such identified significant deficiencies and material weaknesses, and the requirement to obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework, which depends on that framework requiring or permitting such disclosure), represent implicit conditional requirements.

**Departure from a Requirement (Ref: Para. 228)**

A736. [Proposed] ISA 230 (Redrafted) establishes documentation requirements in those exceptional circumstances where the auditor departs from a relevant requirement. 37 The omission of a requirement that is not relevant in the circumstances of the audit does not constitute a departure from the requirement.

**Failure to Achieve an of Objectives and the Overall Objective of the Auditor (Ref: Para. 245)**

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33 [Proposed] ISA 610 (Redrafted), “[Using the Work of Internal Auditors.]”
37 ISA 230 (Redrafted), paragraph 12.
A57. In most cases, the objectives stated in the ISAs are clearly related to the overall objective of the auditor. The majority of the ISAs deal with one or more of the following:

- Identifying, assessing and responding to risks of material misstatement;
- Obtaining sufficient appropriate audit evidence, either in relation to specific aspects of the evidence accumulation process (e.g., audit sampling, in relation to obtaining sufficient audit evidence) or in relation to specific subjects (e.g., accounting estimates);
- Evaluating the effect of identified misstatements on the financial statements; and
- Forming an opinion on the financial statements, and reporting.

Accordingly, the failure to achieve those objectives would prevent the auditor from achieving the overall objective of the auditor.

A58. In a few cases, however, the relationship between the objectives stated in the ISAs and the overall objective of the auditor is indirect. This is the case, for example, with the ISAs that deal with quality control and documentation. Such ISAs are intended to enhance the quality of the audit and to ensure that, in the public interest, the auditor maintains an appropriate record of the basis for the auditor’s report. In principle, an auditor could fail to achieve the objectives of such ISAs while nevertheless obtaining reasonable assurance and forming an appropriate opinion about the financial statements. There would, however, be a risk that this would not be the case.

A59. The auditor may fail to achieve the overall objective of the auditor through being unable to obtain reasonable assurance or through being unable to report. The ISAs deal with these circumstances and include appropriate requirements and guidance for the auditor.

A74. Whether an objective has been achieved is a matter for the auditor’s professional judgment. That judgment takes account of the results of audit procedures performed in complying with the requirements of the ISAs, and the auditor’s evaluation of whether sufficient appropriate audit evidence has been obtained and whether more needs to be done in the particular circumstances of the audit to achieve the objectives stated in the ISAs. Accordingly, circumstances that may give rise to a failure to achieve an objective include those that:

- Prevent the auditor from complying with the relevant requirements of an ISA.
- Result in its not being practicable or possible for the auditor to carry out the additional audit procedures or obtain further audit evidence as determined necessary from the use of the objectives in accordance with paragraph 21, for example due to a limitation in the available audit evidence.

A60. In those circumstances where the auditor concludes that a failure to achieve an objective in a relevant ISA does not prevent the achievement of the overall objective of the auditor, in accordance with [proposed] ISA 230 (Redrafted) the required documentation would include the basis for the auditor’s conclusion and the significant professional judgments made in arriving at that conclusion.

A75. Audit documentation that meets the requirements of ISA 230 (Redrafted) and the specific documentation requirements of other relevant ISAs provides evidence of the auditor’s basis for a conclusion about the achievement of the overall objectives of the auditor. While it is
unnecessary for the auditor to document separately (as in a checklist, for example) that individual objectives have been achieved, the documentation of a failure to achieve an objective assists the auditor’s evaluation of whether such a failure has prevented the auditor from achieving the overall objectives of the auditor.
This Exhibit presents a comparison of relevant text in ED-ISA 200 and Proposed ISA 200 (Revised and Redrafted) pertaining to the identified matters. For information purposes only.

<table>
<thead>
<tr>
<th>ED-ISA 200</th>
<th>Proposed ISA 200 (Revised and Redrafted)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Overall Objective</strong></td>
<td>In conducting an audit of financial statements, the overall objectives of the auditor are:</td>
</tr>
</tbody>
</table>
| In conducting the audit so as to achieve its objective, the overall objective of the independent auditor is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to report on the financial statements in accordance with the auditor’s findings. | (a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and  
(b) To report on the financial statements, or otherwise as required by the ISAs, in accordance with the auditor’s findings. |
| The objective of an audit cannot be fulfilled unless the auditor achieves the overall objective of the auditor. In all cases when the overall objective of the auditor cannot be achieved, the ISAs require that the auditor modifies the auditor’s opinion accordingly or withdraws from the engagement. | In all cases when reasonable assurance cannot be obtained and a qualified opinion in the auditor’s report is insufficient in the circumstances for purposes of reporting to the intended users of the financial statements, the ISAs require that the auditor disclaim an opinion or withdraw from the engagement, where withdrawal is legally permitted. |

**Reasonable Assurance, Sufficient Appropriate Audit Evidence and Audit Risk**

| Reasonable assurance – In the context of an audit of financial statements, a high, but not absolute, level of assurance.  
As a basis for the opinion, the auditor obtains reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. | Reasonable assurance – In the context of an audit of financial statements, a high, but not absolute, level of assurance.  
As the basis for the auditor’s opinion, ISAs require the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. |
Reasonable assurance, which is required by the ISAs, is a high, but not absolute, level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce the risk that there is an unidentified material misstatement of the financial statements (i.e., audit risk) to an acceptably low level. An audit is not intended to, and cannot, provide a guarantee or absolute assurance, i.e., certainty, that the financial statements are free from material misstatement due to fraud or error. This is primarily because there are inherent limitations of an audit that affect the auditor’s ability to detect material misstatements, whether due to fraud or error.

In order to obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion. Reasonable assurance is obtained when the auditor has thereby reduced audit risk to an acceptably low level.

<table>
<thead>
<tr>
<th>Reasonable assurance is a high level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. However, reasonable assurance is not an absolute level of assurance, because there are inherent limitations of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor’s opinion being persuasive rather than conclusive.</th>
</tr>
</thead>
<tbody>
<tr>
<td>To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor’s opinion.</td>
</tr>
</tbody>
</table>

### Objectives Stated in Individual ISAs

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.

To achieve the overall objective of the auditor, the auditor shall use the objectives stated in relevant ISAs to judge whether, having regard to the interrelationships amongst the ISAs and having complied with the requirements of the ISAs:

(a) Sufficient appropriate audit evidence has been obtained in the context of the overall objective of the auditor; and

(b) Other audit procedures need to be performed in pursuance of the objectives.

The assessment of whether sufficient appropriate audit evidence has been obtained and the other audit procedures, if any, that may be necessary in the circumstances are matters of professional judgment. The proper application of the requirements of the ISAs will ordinarily provide a sufficient basis for the auditor’s achievement of

<table>
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<th>[Text revised and repositioned – see [A] below]</th>
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| To achieve the overall objectives of the auditor, the auditor shall use the objectives stated in relevant ISAs in planning and performing the audit, having regard to the interrelationships among the ISAs, to:

(a) Determine whether any audit procedures in addition to those required by the ISAs are necessary in pursuance of the objectives stated in the ISAs; and

(b) Evaluate whether sufficient appropriate audit evidence has been obtained. |

| [Text revised and repositioned – see [B] below] |
the objectives. However, the ISAs cannot anticipate all circumstances that may arise.

If an objective in a relevant ISA cannot be achieved, the auditor shall consider whether this prevents the auditor from achieving the overall objective of the auditor thereby requiring the auditor, in accordance with the ISAs, to modify the auditor’s opinion accordingly or withdraw from the engagement. In most cases, the failure to achieve an objective will prevent the achievement of the overall objective of the auditor. Failure to achieve an objective represents a significant matter requiring documentation in accordance with [proposed] ISA 230 (Redrafted), “Audit Documentation.”

The objectives in individual ISAs provide a link between the requirements and the overall objective of the auditor. The objectives are designed to focus the auditor on the desired outcome of the ISA, while being specific enough to assist the auditor in:

- Understanding what needs to be accomplished and, where necessary, the appropriate means of doing so; and
- Deciding what more, if anything, needs to be done to achieve the objectives.

Objectives are to be understood in the context of the inherent limitations of an audit as well as the other concepts relevant to an audit of financial statements set out in paragraph 13 of this ISA. The ability to achieve an individual objective may be limited by circumstances; for example, by a limitation in the available audit evidence. Whether an objective has been, or can be, achieved is a matter for the auditor’s professional judgment, including whether other procedures will assist the auditor in doing so.

In achieving the objectives of the ISAs, the auditor is required to have regard to the interrelationships among the ISAs. This is because of the different nature of the ISAs, which as indicated in paragraph A43 deal in some cases with general responsibilities and in others with the application of those responsibilities to specific topics. For example, this ISA requires the auditor to adopt an attitude of

If an objective in a relevant ISA cannot be achieved, the auditor shall evaluate whether this prevents the auditor from achieving the overall objectives of the auditor, thereby requiring the auditor, in accordance with the ISAs, to modify the auditor’s opinion or withdraw from the engagement. Failure to achieve an objective represents a significant matter requiring documentation in accordance with ISA 230 (Redrafted).

Each ISA contains one or more objectives which provide a link between the requirements and the overall objectives of the auditor. The objectives in individual ISAs serve to focus the auditor on the desired outcome of the ISA, while being specific enough to assist the auditor in:

- Understanding what needs to be accomplished and, where necessary, the appropriate means of doing so; and
- Deciding whether more needs to be done to achieve them in the particular circumstances of the audit.

Objectives are to be understood in the context of the overall objectives of the auditor stated in paragraph 11 of this ISA. The ability to achieve an individual objective is equally subject to the inherent limitations of an audit.

In using the objectives of the ISAs for the purposes described in paragraph 21, the auditor is required to have regard to the interrelationships among the ISAs. This is because, as indicated in paragraph A52, the ISAs deal in some cases with general responsibilities and in others with the application of those responsibilities to specific topics. For example, this ISA requires the auditor to
professional skepticism; this is necessary in all aspects of planning and performing an audit but is not repeated as a requirement of each ISA. At a more detailed level, ISA 315 (Redrafted), “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment” and ISA 330 (Redrafted), “The Auditor’s Responses to Assessed Risks” contain, amongst other things, objectives and requirements that deal with the auditor’s responsibilities to identify and assess the risks of material misstatement and to design and perform further audit procedures to respond to those assessed risks, respectively; these objectives and requirements apply throughout the audit. An ISA dealing with specific aspects of the audit (for example, [proposed] ISA 540 (Revised and Redrafted), “Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures”) may expand on how the objectives and requirements of such ISAs as ISA 315 (Redrafted) and ISA 330 (Redrafted) are to be applied in relation to the subject of the ISA but does not repeat them. Thus, in achieving the objective stated in [proposed] ISA 540 (Revised and Redrafted), for example, the auditor has regard to the objectives and requirements of other relevant ISAs.

The auditor is required to use the objectives to judge whether sufficient appropriate audit evidence has been obtained. If as a result the auditor concludes that the audit evidence is not sufficient and appropriate, then the auditor may follow one or more of the following approaches to meeting the requirement of paragraph 24(a):

| A and B | The requirements of the ISAs are designed to enable the auditor to achieve the objectives specified in the ISAs, and thereby the overall objectives of the auditor. The proper application of the requirements of the ISAs by the auditor is therefore expected to provide a sufficient basis for the auditor’s achievement of the objectives. However, because the circumstances of audit engagements vary widely and all such circumstances cannot be anticipated in the ISAs, the auditor is responsible for determining the audit procedures necessary to fulfill the requirements of the ISAs and to achieve the objectives. In the circumstances of an engagement, there may be particular matters that require the auditor to consider further the audit procedures necessary to meet the objectives specified in the ISAs.

The auditor is required to use the objectives to evaluate whether sufficient appropriate audit evidence has been obtained in the context of the overall objectives of the auditor. If as a result the auditor concludes that the audit evidence is not sufficient and appropriate, then the auditor may follow one or more of the following approaches to meeting the requirement of paragraph |
Evaluate whether further relevant audit evidence has been, or will be, obtained as a result of complying with other ISAs;
Extend the work performed in applying one or more requirements; or
Perform other procedures judged by the auditor to be necessary in the circumstances.

Where none of the above is expected to be practical or possible in the circumstances, the auditor will not be able to obtain sufficient appropriate audit evidence and is required to determine the effect on the audit report or on the auditor’s ability to complete the engagement.

In most cases, the objectives stated in the ISAs are clearly related to the overall objective of the auditor. The majority of the ISAs deal with one or more of the following:

- Identifying, assessing and responding to risks of material misstatement;
- Obtaining sufficient appropriate audit evidence, either in relation to specific aspects of the evidence accumulation process (e.g., audit sampling, in relation to obtaining sufficient audit evidence) or in relation to specific subjects (e.g., accounting estimates);
- Evaluating the effect of identified misstatements on the financial statements; and
- Forming an opinion on the financial statements, and reporting.

Accordingly, the failure to achieve those objectives would prevent the auditor from achieving the overall objective of the auditor.

In a few cases, however, the relationship between the objectives stated in the ISAs and the overall objective of the auditor is indirect. This is the case, for example, with the ISAs that deal with quality control and documentation. Such ISAs are intended to enhance the quality of the audit and to ensure that, in the public

21(b):
Evaluate whether further relevant audit evidence has been, or will be, obtained as a result of complying with other ISAs;
Extend the work performed in applying one or more requirements; or
Perform other procedures judged by the auditor to be necessary in the circumstances.

Where none of the above is expected to be practical or possible in the circumstances, the auditor will not be able to obtain sufficient appropriate audit evidence and is required by the ISAs to determine the effect on the auditor’s report or on the auditor’s ability to complete the engagement.
interest, the auditor maintains an appropriate record of the basis for the auditor’s report. In principle, an auditor could fail to achieve the objectives of such ISAs while nevertheless obtaining reasonable assurance and forming an appropriate opinion about the financial statements. There would, however, be a risk that this would not be the case.

The auditor may fail to achieve the overall objective of the auditor through being unable to obtain reasonable assurance or through being unable to report. The ISAs deal with these circumstances and include appropriate requirements and guidance for the auditor.

In those circumstances where the auditor concludes that a failure to achieve an objective in a relevant ISA does not prevent the achievement of the overall objective of the auditor, in accordance with [proposed] ISA 230 (Redrafted) the required documentation would include the basis for the auditor’s conclusion and the significant professional judgments made in arriving at that conclusion.

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**Professional Judgment**

Whether an objective has been achieved is a matter for the auditor’s professional judgment. That judgment takes account of the results of audit procedures performed in complying with the requirements of the ISAs, and the auditor’s evaluation of whether sufficient appropriate audit evidence has been obtained and whether more needs to be done in the particular circumstances of the audit to achieve the objectives stated in the ISAs. Accordingly, circumstances that may give rise to a failure to achieve an objective include those that:

- Prevent the auditor from complying with the relevant requirements of an ISA.
- Result in its not being practicable or possible for the auditor to carry out the additional audit procedures or obtain further audit evidence as determined necessary from the use of the objectives in accordance with paragraph 21, for example due to a limitation in the available audit evidence.

Audit documentation that meets the requirements of ISA 230 (Redrafted) and the specific documentation requirements of other relevant ISAs provides evidence of the auditor’s basis for a conclusion about the achievement of the overall objectives of the auditor. While it is unnecessary for the auditor to document separately (as in a checklist, for example) that individual objectives have been achieved, the documentation of a failure to achieve an objective assists the auditor’s evaluation of whether such a failure has prevented the auditor from achieving the overall objectives of the auditor.
The nature of the ISAs requires the auditor to exercise professional judgment in applying them.

Professional judgment in auditing may be described as the application of relevant knowledge and experience, within the context provided by auditing, accounting and ethical standards, in reaching decisions about the courses of action that are appropriate in the circumstances of the audit engagement.

Informed decisions throughout the audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances, in particular regarding decisions about:

- Materiality and audit risk;
- The nature, timing and extent of audit procedures used to gather audit evidence;
- The evaluation of management’s judgments in applying the entity’s applicable financial reporting framework; and
- The drawing of conclusions based on the audit evidence obtained, for example, assessing the reasonableness of the estimates made by management in preparing the financial statements.

Professional judgment is therefore essential to the proper conduct of an audit.

Professional judgment is a personal quality, and judgments may therefore differ between experienced auditors. However, training and experience are intended to promote consistency of judgment such that the exercise of professional judgment in any particular case may be regarded as reasonable if other experienced auditors can agree that this is the case. Any such agreement on whether a judgment is reasonable is based on the facts and circumstances at the time the judgment was made.

The auditor shall exercise professional judgment in planning and performing an audit of financial statements.

Professional judgment – The application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making decisions about the courses of action that are appropriate in the circumstances of the audit engagement.

Professional judgment is essential to the proper conduct of an audit. This is because interpretation of relevant ethical requirements and the ISAs and the decisions required throughout the audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances.

Professional judgment is necessary in particular regarding decisions about:

- Materiality and audit risk.
- The nature, timing, and extent of audit procedures used to meet the requirements of the ISAs and gather audit evidence.
- Evaluating whether sufficient appropriate audit evidence has been obtained, and whether more needs to be done to achieve the objectives of the ISAs and thereby, the overall objectives of the auditor.
- The evaluation of management’s judgments in applying the entity’s applicable financial reporting framework.
- The drawing of conclusions based on the audit evidence obtained, for example, assessing the reasonableness of the estimates made by management in preparing the financial statements.

The distinguishing feature of the professional judgment expected of an auditor is that it is exercised by an auditor whose training, knowledge and experience have assisted in developing the necessary competencies to achieve reasonable consistency of judgment.

The exercise of professional judgment in any particular case is based on the facts and circumstances that are known by the auditor. Consultation on difficult or
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.

Professional judgment needs to be exercised throughout the audit. It also needs to be appropriately documented. In this regard, the auditor is required to prepare audit documentation sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the significant professional judgments made in reaching conclusions on significant matters arising during the audit. Professional judgment is not to be used as the justification for decisions that are not otherwise supported by the facts and circumstances of the engagement or sufficient appropriate audit evidence.

### Inherent Limitations of an Audit

An audit is undertaken to enhance the degree of confidence of intended users in the financial statements. Based on the conclusions drawn from the audit evidence obtained, the auditor expresses an opinion on the financial statements. However, an audit is not intended to, and cannot, provide a guarantee or absolute assurance (i.e., certainty) that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit arising from:

- The fundamental nature and characteristics of financial reporting and business processes;
- The nature of audit evidence and procedures; and
- The need for the audit to be conducted within a reasonable period of time and

The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor’s opinion being persuasive rather than conclusive. The inherent limitations of an audit arise from:

- The nature of financial reporting;
- The nature of audit procedures; and
- The need for the audit to be conducted within a reasonable period of time and at a reasonable cost.
at a reasonable cost.

An audit is also necessarily limited by its scope and objective, which deal with the expression by the auditor of an opinion on the financial statements. For example, the auditor does not express an opinion on such matters as:

- The future viability of the entity.
- The efficiency or effectiveness with which management has conducted the affairs of the entity (including the effectiveness of internal control).
- The extent of compliance with all laws and regulations that may be applicable to the entity.

Paragraphs A32-A40 describe the principal inherent limitations of an audit. Other ISAs may provide further explanation of limitations that are of particular relevance to their subject matter, e.g. ISA 240 (Redrafted), “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements” and [proposed] ISA 550 (Revised and Redrafted), “Related Parties.”

The ISAs provide requirements and guidance to assist the auditor in applying professional judgment to mitigate the effect of the inherent limitations of an audit. However, inherent limitations, by their nature, cannot be overcome.

Financial Reporting and Business Processes

There are certain limitations inherent in financial reporting and business processes that neither the entity nor the auditor can overcome. The preparation of financial statements in accordance with the entity’s applicable financial reporting framework involves judgment by management in applying the requirements of that framework to the facts and circumstances of the entity. Further, although some financial statement items may be determined on the basis of objective and verifiable facts, others are of a nature such that the related audit evidence available can only be persuasive rather than conclusive, or involve subjective decisions or assessments or a degree of uncertainty relating to the reliability of their measurement; for example, the estimation of the outcome of uncertain events that may only be confirmed in the future and the estimation of amounts reported on the basis of fair
value. There may be valid differences in judgment about such matters, and in the case of judgments about future outcomes those outcomes are highly likely to differ from any judgments that are made, however skilled.

In addition, management designs, implements and maintains internal control to address identified business risks that threaten the achievement of the entity’s objectives. The evidence available to the auditor includes information about the entity’s internal control. ISAs provide the conditions under which the auditor is required to, or may choose to, test the operating effectiveness of controls in determining the extent of substantive procedures to be performed. However, internal control, no matter how well designed and operated, can only reduce, but not eliminate, risks of material misstatement in the financial statements, because of the limitations inherent in internal control. These include, for example, the possibility of human errors or mistakes, or of controls being circumvented by collusion or inappropriate management override.

The Nature of Audit Evidence and Procedures

The nature of audit evidence is such that it is often persuasive rather than conclusive. There are legal and practical limitations on the auditor’s ability to obtain audit evidence; for example, in the absence of legal powers of search – which in themselves have limitations – it is inevitable that an auditor is dependent on management and others for aspects of the completeness of information. Also, as explained in paragraph A27, an audit rarely involves the authentication of documents.

Further, the risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, falsified documentation which may cause the auditor to believe that audit evidence is valid when it is not. Because of this, ISA 240 (Redrafted) contains specific requirements designed to assist the auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement.

practices, including indicators of possible bias in management’s judgments.

[Text revised and repositioned as part of explanation of control risk – see paragraph A38 of Exhibit 1]

The Nature of Audit Procedures

There are legal and practical limitations on the auditor’s ability to obtain audit evidence. For example:

- There is the possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation and presentation of the financial statements or that has been requested by the auditor. Accordingly, the auditor cannot be certain of the completeness of information, even though the auditor has performed audit procedures to obtain assurance that all relevant information has been obtained.

- Fraud may involve sophisticated and carefully organized schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the auditor to believe that audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.

- An audit is not an investigation into alleged wrongdoing. Accordingly, the
Although it is often not possible to obtain audit evidence that is conclusive, the auditor is required to obtain audit evidence that is sufficient and appropriate to reduce audit risk to an acceptably low level.

Timeliness of Financial Reporting and the Balance between Benefit and Cost

The relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost. There is therefore an expectation by users of financial statements that the auditor will form an opinion on the financial statements within a reasonable period of time and at a reasonable cost. Accordingly, the auditor is not expected to address all information that may exist or to pursue every matter exhaustively on the assumption that information is in error or fraudulent until proved otherwise. To do otherwise would not allow the audited financial statements to be available in time to be relevant or at a reasonable cost. A further consideration is that the evidence gathering process may reach a point of diminishing returns, at which the incremental cost of additional audit evidence increases disproportionately to the incremental benefit obtained. However, the matter of time or cost involved is not in itself a valid basis for the auditor to be satisfied with audit evidence that is less than persuasive.

Consequently, it is necessary for the auditor to use testing, including sampling, and other means of examining populations for misstatements. Although samples with high levels of confidence can be designed, there is always a risk that the sample is not representative of the population and a material misstatement will fail to be detected. Similarly analytical procedures cannot be designed or performed to a level of precision sufficient to ensure that all material misstatements would be detected. The auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.

Timeliness of Financial Reporting and the Balance between Benefit and Cost

The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive. Appropriate planning assists in making sufficient time and resources available for the conduct of the audit. Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost. This is recognized in certain financial reporting frameworks (see, for example, the International Accounting Standards Board’s “Framework for the Preparation and Presentation of Financial Statements”). Therefore, there is an expectation by users of financial statements that the auditor will form an opinion on the financial statements within a reasonable period of time and at a reasonable cost, recognizing that it is impracticable to address all information that may exist or to pursue every matter exhaustively on the assumption that information is in error or fraudulent until proved otherwise.

Consequently, it is necessary for the auditor to:

- Plan the audit so that it will be performed in an effective manner;
- Direct audit effort to areas most expected to contain risks of material misstatement, whether due to fraud or error, with correspondingly less effort directed at other areas; and
- Use testing, including sampling, and other means of examining populations beyond the normal risk assessment procedures.

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1 The International Accounting Standards Board’s “Framework for the Preparation and Presentation of Financial Statements” discusses further the constraints of timeliness and the balance between benefit and cost on the provision of relevant and reliable information in the preparation and presentation of financial statements.
detected. 
Further, for an audit to be efficient and effective within reasonable time and cost constraints, the auditor needs to design an audit approach that focuses audit effort on identifying and assessing risks of material misstatement, and in performing audit procedures in response to the assessed risks. The assessment of risks of material misstatement, however, is a judgment rather than a precise measurement.

Because of the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements will not be detected, even

for misstatements.
In light of the approaches described in paragraph A48, the ISAs contain requirements for the planning and performance of the audit and require the auditor, among other things, to:

• Have a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels by performing risk assessment procedures and related activities; and
• Use testing, including sampling, and other means of examining populations in a manner that provides an appropriate basis for the auditor to draw conclusions about the population.

Other Matters that Affect the Inherent Limitations of an Audit
In the case of certain assertions or subject matters, the potential effects of the inherent limitations on the auditor’s ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

• Fraud, particularly fraud involving senior management or collusion. See ISA 240 (Redrafted) for further discussion.
• The existence and completeness of related party relationships and transactions. See ISA 550 (Revised and Redrafted) for further discussion.
• The occurrence of non-compliance with laws and regulations. See ISA 250 (Redrafted) for further discussion.
• Future events or conditions that may cause an entity to cease to continue as a going concern. See ISA 570 (Redrafted) for further discussion.

Relevant ISAs identify specific audit procedures to assist in mitigating the effect of the inherent limitations.

Because of the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with
though the audit is properly planned and performed in accordance with ISAs. Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not, in and of itself, indicate a failure to conduct an audit in accordance with ISAs. Whether the auditor has performed an audit in accordance with ISAs is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor’s report based on an evaluation of that evidence.

ISAs. Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with ISAs. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less-than-persuasive audit evidence. Whether the auditor has performed an audit in accordance with ISAs is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor's report based on an evaluation of that evidence in light of the overall objectives of the auditor.