Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services (Preface)

[There are no changes proposed to paragraphs 1-3. According, they are not reproduced.]

The Authority Attaching to International Standards Issued by the International Auditing and Assurance Standards Board

[There are no changes proposed to paragraphs 4-5 and 7-9. Accordingly, they are not reproduced.]

6. International Standards on Assurance Engagements (ISAEs) are to be applied in assurance engagements dealing with subject matters other than audits or reviews of historical financial information.

International Standards on Auditing

10. 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. The authority of ISAs is set out in ISA 200 (Revised and Redrafted).

11. 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. It is undertaken to enhance the degree of confidence of intended users in the financial statements. ISAs, taken together, provide the standards for the auditor’s work in fulfilling this objective.

12. In conducting an audit, the overall objective of the 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. In all cases when this overall objective has not been or cannot be achieved, the ISAs require that the auditor modifies the auditor’s opinion accordingly or withdraws from the engagement.

13. The auditor applies each ISA relevant to the audit. An ISA is relevant when the ISA is in effect and the circumstances addressed by the ISA exist.

14. 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. An ISA contains objectives and requirements together with related guidance in the form of application and other explanatory material. It may also contain introductory material that provides context essential to a proper understanding of the ISAs, and definitions. It is, therefore, necessary to consider the entire text of an ISA to understand and apply its requirements.
ISA Objectives

15. Each ISA contains an objective or objectives, which provide the context in which the requirements of the ISA are set. The auditor aims to achieve these objectives, having regard to the interrelationships amongst the ISAs. For this purpose, the auditor uses the objectives to judge whether, having complied with the requirements of the ISAs, sufficient appropriate audit evidence has been obtained in the context of the overall objective of the auditor. Where an individual objective has not been or cannot be achieved, the auditor considers whether this prevents the auditor from achieving the auditor’s overall objective.

Requirements

16. The requirements of each ISA are contained in a separate section and expressed using the word “shall.” The auditor applies the requirements in the context of the other material included in the ISA.

17. The auditor complies with the requirements of an ISA in all cases where they are relevant in the circumstances of the audit. In exceptional circumstances, however, the auditor may judge it necessary to depart from a relevant requirement by performing 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.

18. A requirement is not relevant only in the cases where: the ISA is not relevant; or the circumstances envisioned do not apply because the requirement is conditional and the condition does not exist. The auditor is not required to comply with a requirement that is not relevant in the circumstances of the audit; this does not constitute a departure from the requirement.

Application and Other Explanatory Material

19. The application and other explanatory material contained in an ISA is an integral part of the ISA as it provides further explanation of, and guidance for carrying out, the requirements of an ISA, along with background information on the matters addressed in the ISA. It may include examples of procedures, some of which the auditor may judge to be appropriate in the circumstances. Such guidance is, however, not intended to impose a requirement.

20. 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 and Definitions

21. 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; specific expectations on the auditor and others; and the context in which the ISA is set.
22. 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 in the Handbook 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.

International Standards on Quality Control

23. ISQCs are written to apply to firms in respect of all their services falling under the IAASB’s Engagement Standards. The authority of ISQCs is set out in the introduction to the ISQCs.

[There are no changes proposed to paragraphs 24-33, except renumbering. According, they are not reproduced.]

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1 The terms and concepts in this Preface are explained further in the ISAs, in particular in ISA 200, “Objective and General Principles Governing an Audit of Financial Statements.” (ISA 200 will be revised, inter alia, to incorporate relevant provisions of this Preface that deal with the obligations of the auditor, and the status and authority of objectives, requirements and other material. When ISA 200 is revised and exposed for public comment in 2007, respondents will be invited to comment on the material derived from this Preface in that new context.)

2 Unless otherwise stated, “financial statements” mean financial statements comprising historical financial information.

3 ISA 200 (Revised and Redrafted), “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing.”

4 Referred to hereafter as “the auditor.”

ISA 230 (Redrafted), “Audit Documentation”

Nature and Purposes of Audit Documentation

2. Audit documentation that meets the requirements of this ISA and the specific documentation requirements of other relevant ISAs provides:
   
   (a) Evidence of the auditor’s basis for a conclusion about the achievement of the overall objectives of the auditor; and

   (b) Evidence that the audit was planned and performed in accordance with ISAs and applicable legal and regulatory requirements…

Documentation of Significant Matters and Related Significant Professional Judgments (Ref: Para. 8(c))

A11. The auditor may consider it helpful to prepare and retain as part of the audit documentation a summary (sometimes known as a completion memorandum) that describes the significant matters identified during the audit and how they were addressed, or that includes cross-references to other relevant supporting audit documentation that provides such information. Such a summary may facilitate effective and efficient reviews and inspections of the audit documentation, particularly for large and complex audits.
Further, the preparation of such a summary may assist the auditor’s consideration of the significant matters. It may also help the auditor to consider whether, in light of the audit procedures performed and conclusions reached, there is any individual relevant ISA objective that the auditor has not met or is unable to meet that would prevent the auditor from achieving the overall objectives of the auditor’s overall objective…

Departure from a Relevant Requirement (Ref: Para. 12)

A18. The objectives and requirements of the in-ISAs are designed to enable the auditor to achieve the objectives specified in the ISAs, and thereby support the achievement of the overall objectives of the auditor. Accordingly, other than in exceptional circumstances, the ISAs call for compliance with each requirement that is relevant in the circumstances of the audit.

A19. The documentation requirement applies only to requirements that are relevant in the circumstances. A requirement is not relevant only in the cases where:

(a) The entire ISA is not relevant (for example, if an entity does not have an internal audit function in a continuing engagement, nothing in [proposed] ISA 610510 (Redrafted) is relevant); or

(b) The circumstances envisioned do not apply because the requirement is conditional and the condition does not exist (for example, the requirement to modify the auditor’s opinion where there is an inability to obtain sufficient appropriate audit evidence, and there is no such inability)…


7 [Proposed] ISA 200 (Revised and Redrafted), paragraph 22[27].


ISA 240 (Revised and Redrafted), “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements”

Responsibilities of the Auditor

5. An auditor conducting an audit in accordance with ISAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Owing to 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 the ISAs.3

6. As described in ISA 200 (Revised and Redrafted),4 the potential effects of inherent limitations are particularly significant in the case of misstatement resulting from fraud. 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, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by collusion. Collusion may cause the auditor to believe that audit evidence is persuasive when it is, in fact, false. The auditor’s ability to detect a fraud depends on factors such as the skillfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved. While the auditor may be able to identify potential opportunities for fraud to be perpetrated, it is difficult for the auditor to determine whether misstatements in judgment areas such as accounting estimates are caused by fraud or error.

7. Furthermore, the risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information or override control procedures designed to prevent similar frauds by other employees.

8. When obtaining reasonable assurance, the auditor is responsible for maintaining an attitude of professional skepticism throughout the audit, considering the potential for management override of controls and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud. The requirements in this ISA are 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...

Professional Skepticism

12. In accordance with ISA 200 (Revised and Redrafted), the auditor shall maintain an attitude of professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor’s past experience of the honesty and integrity of the entity’s management and those charged with governance...

A7. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence. Maintaining an attitude of professional skepticism requires an ongoing questioning of whether the information and audit evidence obtained suggests that a material misstatement due to fraud may exist. It includes considering the reliability of the information to be used as audit evidence and the controls over its preparation and maintenance where relevant. Due to the characteristics of fraud, the auditor’s attitude of professional skepticism is particularly important when considering the risks of material misstatement due to fraud.

A8. 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, the auditor’s attitude of professional skepticism is particularly important in considering the risks of material misstatement due to fraud because there may have been changes in circumstances…
ISA 260 (Revised and Redrafted), “Communication with Those Charged with Governance”

Definitions

6. For purposes of the ISAs, the following terms have the meanings attributed below:

(a) 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. In some cases, those charged with governance are responsible for approving the entity’s financial statements (in other cases management has this responsibility). For discussion of the diversity of governance structures, see paragraphs A5-A12.

(b) 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. Management is responsible for the preparation of the financial statements, overseen by those charged with governance, and in some cases management is also responsible for approving the entity’s financial statements (in other cases those charged with governance have this responsibility)…

Those Charged with Governance (Ref: Para. 7)

A5. Governance structures vary by jurisdiction and by entity, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics. For example:

- In some jurisdictions a supervisory (wholly or mainly non-executive) board exists that is legally separate from an executive (management) board (a “two-tier board” structure). In other jurisdictions, both the supervisory and executive functions are the legal responsibility of a single, or unitary, board (a “one-tier board” structure).

- In some entities, those charged with governance hold positions that are an integral part of the entity’s legal structure, for example, company directors. In others, for example, some government entities, a body that is not part of the entity is charged with governance.
In some cases, some or all of those charged with governance are involved in managing the entity. In others, those charged with governance and management comprise different persons.

In some cases, those charged with governance are responsible for approving the entity’s financial statements (in other cases management has this responsibility)....

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As described at paragraph [A43] of [proposed] ISA 700, (Redrafted), “The Independent Auditor’s Report on General Purpose Financial Statements,” having responsibility for approving in this context means having the authority to conclude that all the statements that comprise the financial statements, including the related notes, have been prepared.

See footnote 1.

As described at paragraph [to be inserted] of ISA 700, (Redrafted), “Forming an Opinion and Reporting on Financial Statements,” having responsibility for approving in this context means having the authority to conclude that all the statements that comprise the financial statements, including the related notes, have been prepared.

All Final Clarified ISAs

Phrases

“attitude of professional skepticism”

- ISA 250 (Redrafted), paragraph 8.
- ISA 540 (Revised and Redrafted), paragraph A40.
- ISA 550 (Revised and Redrafted), paragraph A9.

“affected by the inherent limitations of inherent to internal control”

- ISA 315 (Redrafted), paragraph A42.