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Basis for Conclusions: ISA 230 (Revised), Audit Documentation

*Prepared by the Staff of the International Auditing and Assurance
Standards Board*



**International Federation
of Accountants**

**BASIS FOR CONCLUSIONS:
ISA 230 (REVISED), AUDIT DOCUMENTATION**

This Basis for Conclusions has been prepared by staff of the International Auditing and Assurance Standards Board (“IAASB”) and has not been discussed by the IAASB. It does not form part of the revised ISA 230.

Background

1. The IAASB considered and approved a project to revise the extant ISA 230, *Documentation*, in December 2002 for a number of reasons, including:
 - The need to introduce greater rigor and consistency in auditors’ preparation of audit documentation, in line with the more stringent quality control requirements established in the revised ISA 220, *Quality Control for Audits of Historical Financial Information*, and the related ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements*;
 - The need for clearer guidance on auditors’ responsibilities regarding deletions and other changes to audit documentation after the date of the auditor’s report; and
 - The need to respond to developments in practice and in the regulatory environment, particularly in relation to the greater use of technology in the preparation of audit documentation, and in external inspections of audit work.
2. The IAASB issued an exposure draft of the proposed revised ISA 230 (“ED 230”) in September 2004, with a comment deadline of January 31, 2005. The IAASB received 42 comment letters from a variety of respondents, including regulators, IFAC member bodies, and firms. As a result of these comments, the IAASB implemented a number of changes to ED 230 in finalizing the text of the revised ISA 230. The following summarizes the more significant issues raised by respondents, and how the IAASB addressed them.

Main Objectives of Audit Documentation (Paragraph 2)¹

3. ED 230 proposed that the main objectives of audit documentation should be to provide a record of the basis for the auditor’s report, and to demonstrate that the audit was performed in accordance with ISAs and applicable legal and regulatory requirements. A number of respondents questioned the intended meaning of the second objective. They indicated that this could be interpreted as a requirement to document compliance with all the basic principles and essential procedures of all the ISAs, and suggested that this would unnecessarily increase the volume of audit documentation to the detriment of audit quality. In addition, they thought that the word “demonstrate” placed more emphasis on the audit documentation showing how the auditor complied with ISAs and applicable legal and regulatory requirements, than on how it helps to support the audit opinion. These respondents suggested that such an approach could result in an attitude that would

¹ Paragraph numbers refer to the final revised ISA 230.

give more importance to compliance with auditing procedures than to a thoughtful approach to auditing.

4. In promulgating this objective, the IAASB intended that the audit documentation prepared by the auditor should reflect the fact that the auditor performed the audit in accordance with ISAs and applicable legal and regulatory requirements. It was not the intention that the documentation should specifically demonstrate, as might be done by a checklist, compliance with each and every requirement of ISAs and applicable law or regulation. To make this clear, the IAASB decided to provide guidance in paragraph 4 of the ISA to state that compliance with the requirements of the ISA and the specific documentation requirements of other relevant ISAs would ordinarily be sufficient to achieve the objectives set out in paragraph 2.

Documentation of Departures from a Basic Principle or an Essential Procedure (Paragraph 21)

5. The proposal in ED 230 that the auditor should document the reasons for a departure from a basic principle or an essential procedure in an ISA elicited a wide range of comments from respondents, including the following:
 - Audit failures have not been, or could not be, prevented by requiring auditors to document departures from requirements of auditing standards. The requirement could, instead, create a great deal of additional work for the auditor without corresponding benefit to audit quality. The requirement could also discourage auditors from departing from basic principles or essential procedures even if the alternative procedures would improve audit quality.
 - The proposed requirement would be unduly onerous for audits of smaller entities or other non-public interest entities.
 - The auditor should be required to document how the alternative procedures performed achieve more effectively the objective of the audit.
 - The proposal should be specifically linked to demonstrating how the alternative procedures more effectively achieved the objective of the basic principle or essential procedure, as opposed to the objective of the audit.
 - There should be no need to document why the auditor departed from a requirement if the documentation of the alternative procedures performed demonstrates how the objective has been met.
 - The requirement, as worded, was too broad as it could be interpreted as an obligation to document departures from every basic principle or essential procedure, regardless of its relevance to the audit.
6. In putting forward this documentation requirement, the IAASB believed that it would further the public interest, as it would lead to greater rigor and consistency in auditors' performance of ISA audits. While recognizing that this proposal would cause the auditor to think more carefully about departing from a basic principle or an essential procedure,

BASIS FOR CONCLUSIONS:
ISA 230 (REVISED), AUDIT DOCUMENTATION

the IAASB did not believe that it would take away the auditor's responsibility to judge the best course of action in the circumstances to achieve a high quality of audit performance. Departures from relevant ISA requirements in the circumstances permitted are expected to be rare. As such, in formulating this proposal, the IAASB concluded that it would not result in an onerous documentation burden, nor did it believe that this was an appropriate area for different standards for public and non-public interest audits.

7. ED 230's requirement on the documentation of departures reflected the condition for a departure set out in the *Preface to the International Standards on Quality Control, Auditing, Assurance and Related Services*. During discussion of the responses, the IAASB concluded that the condition for a departure should be revised, as it is logically incorrect to permit departure from a requirement only when it was necessary to do so to achieve the objective *more effectively*. The correct test should be that a departure should only be permitted when it is necessary because the specified requirement did not in fact meet its objective in the particular circumstances. Accordingly, the final requirement focuses on documenting how the alternative procedures performed achieve the objective of the audit, and the reasons for the departure (if not otherwise clear).
8. In finalizing this requirement, the IAASB discussed whether it was appropriate to link the departure with whether the alternative procedure met the objective of the audit, or the objective of the basic principle or essential procedure it was designed to replace. The IAASB agreed that the latter was more appropriate and would be more effective in ensuring that a departure was necessary and an appropriate alternative was substituted. Pending further refinement of the test for departures as a result of the Clarity project, the IAASB decided to add further explanatory guidance in paragraph 20 to clarify that the basic principles and essential procedures in ISAs are designed to assist the auditor in meeting the overall objective of the audit. The requirement therefore involves documenting how the alternative procedures performed were sufficient and appropriate to replace the basic principle or essential procedure not performed.
9. Finally, in response to the comments raised, the IAASB decided to clarify the term "relevant in the circumstances" as it relates to a basic principle or essential procedure. Thus, paragraph 22 explains that the requirement to document departures applies only where the basic principle or essential procedure is in fact relevant, and gives some examples to illustrate what this means.

Completing the Assembly of the Final Audit File (Paragraph 25)

10. ED 230 proposed new guidance to emphasize the need for the auditor to complete the assembly of the final audit file without undue delay after the date of the auditor's report. To provide an indication of time limit, the guidance also stated that such assembly would ordinarily be completed not more than 60 days after the date of the auditor's report.
11. While respondents supported the introduction of this guidance in the public interest, they expressed wide-ranging views regarding the starting point and the time interval for the time limit. Some respondents suggested that the ISA should focus on the principle of

completing file assembly without undue delay, thus leaving it to jurisdictions or firms to determine appropriate time limits.

12. Given the wide range of views expressed on what should be an appropriate time limit, the IAASB concluded that it would be difficult to achieve full consensus on a specified time period, and that it was unnecessary to do so. The IAASB was, however, persuaded by the suggestion that the ISA should establish only the principle that file assembly should be completed without undue delay.
13. This approach enabled the IAASB to strengthen the proposal in two ways:
 - (a) By establishing a new principles-based requirement in the ISA, while allowing local law or regulation in each jurisdiction to establish time limits if that were considered appropriate; and
 - (b) By introducing a new requirement in ISQC 1 for firms to establish appropriate policies and procedures for the completion of file assembly.

The revised approach allows firms to adopt policies that are compatible with any regulatory requirements to which they might be subject. Furthermore, it allows firms to set appropriate time limits for completing file assembly for different types of engagements depending on their circumstances.

14. Accordingly, paragraph 25 of the ISA establishes the requirement for the auditor to complete the assembly of the final audit file on a timely basis after the date of the auditor's report, and paragraph 74 in ISQC 1 introduces a new requirement for firms to establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been finalized. To link these two requirements, the IAASB also decided to add an appropriate cross-reference to ISQC 1 in paragraph 26 of the ISA.
15. Additionally, to provide clear guidance on what would be considered an appropriate time limit in the case of audits, the IAASB decided to retain in paragraph 26 of the ISA the reference to the 60-day period after the date of the auditor's report. In retaining this guidance, the IAASB concluded that it would be appropriate to use the date of the auditor's report as the starting point for the time limit as this date was simple to ascertain and unambiguous.

Changes to Audit Documentation After the Date of the Auditor's Report (Paragraphs 27-28 & 30-31)

16. While respondents generally agreed with the spirit of the proposed requirements and guidance in ED 230 relating to changes to audit documentation after the date of the auditor's report, a number of them suggested that the structure of this subsection needed clarification, as it appeared to be a mixture of the routine and the exceptional.
17. The IAASB agreed to restructure the subsection so that the ISA addresses, first, the routine administrative procedures involved during the completion of file assembly after

BASIS FOR CONCLUSIONS:
ISA 230 (REVISED), AUDIT DOCUMENTATION

the auditor's report has been finalized, and then the exceptional circumstances that lead to changes to audit documentation after the date of the auditor's report. In addition, the IAASB concluded that the proposed guidance in ED 230 regarding documentation of new information received after the date of the auditor's report, was unnecessary, as it overlapped with ISA 560, *Subsequent Events*.

18. With regard to the administrative process of completing the assembly of the final audit file, some respondents asked whether it was appropriate to indicate that the auditor may document, after the date of the auditor's report, audit evidence obtained, discussed and agreed with relevant members of the audit team prior to that date. Their concern was that this could be interpreted as permitting extensive backfilling of documentation that could and should have been prepared at an earlier date, which they suggested would be inappropriate.
19. The IAASB did not envisage that this guidance would be treated as permission to undertake backfilling of audit documentation after the date of the auditor's report or to delay the preparation of such documentation. Instead, the IAASB recognized that circumstances could arise in practice when, because of tight reporting deadlines or other reasons, the auditor is unable to complete writing up all the necessary audit documentation before finalizing the auditor's report, even though all appropriate audit evidence has been cleared with relevant team members (e.g., the engagement quality control reviewer). ISAs require that the auditor date the report no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the opinion. The IAASB did not believe that the guidance was inconsistent with that principle.

Experienced Auditor and the Reviewability Principle (Paragraphs 6 & 9)

20. ED 230 proposed that audit documentation should be sufficient for the purposes of an experienced auditor's review, and defined an experienced auditor as someone (whether internal or external to the firm) who has a reasonable understanding of audit processes and of auditing and financial reporting issues relevant to the industry in which the entity operates. While respondents generally welcomed this principle, several of them suggested further refinements to the definition of an experienced auditor.
21. The IAASB accepted suggestions on refining the definition of experienced auditor. The IAASB accepted that a link to an understanding of ISAs, applicable law and regulation, and the entity's business environment would be appropriate. The IAASB decided, however, that it would be inappropriate to relate the definition to someone who possesses the competencies and skills to perform the audit, as this would be a level of experience equivalent to that of an engagement partner, which would establish a threshold for review competence that would be too high (resulting in correspondingly too little documentation).
22. A number of points were also made about the structure of this section of ED 230, which the IAASB has taken account of in finalizing the ISA.

Documentation of Significant Matters (Paragraphs 9, 14 & 16)

23. Some respondents thought that there was an insufficient emphasis on the need to document significant matters in ED 230. They suggested that it would be more appropriate to establish a bold letter principle requiring the auditor to document significant matters, the actions taken to address them, the audit evidence obtained and the conclusions reached. This would obviate the need to have a specific requirement to document conclusions reached on significant matters as part of the reviewability principle. They also suggested that the ISA provide a fuller discussion of what would be significant matters.
24. The IAASB agreed that a specific emphasis on significant matters would be appropriate. Accordingly, paragraph 9 now requires the auditor to prepare the audit documentation so as to enable an experienced auditor to understand the significant matters arising during the audit and the conclusions reached thereon.
25. When issuing ED 230, the IAASB had also debated whether it would be appropriate to include a definition of significant matters in the ISA. Given the wide range of matters that could be considered significant, however, and the need to apply professional judgment in the circumstances, the IAASB had concluded that it would be difficult to reach consensus on a definition or a description that would be concise and acceptable in all circumstances. The IAASB had agreed, instead, that guidance as provided in paragraph 14 was appropriate as it retained the emphasis on the professional judgment necessary in the circumstances. Further, the IAASB had concluded that this paragraph provided sufficient guidance in terms of examples of the types of significant matters the auditor might encounter. The IAASB reconsidered this rationale in light of the comments received and concluded that its original view remained appropriate.
26. In relation to the documentation of discussions of significant matters with management and others, ED 230 had proposed guidance in gray text explaining that the auditor documents on a timely basis (a) oral discussions of significant matters with management, and (b) management's responses. Some respondents stated that this guidance was appropriate but argued that it should be further emphasized. The IAASB agreed that this guidance was of sufficient importance to be elevated to a requirement. Accordingly, paragraph 16 now requires the auditor to document discussions of significant matters with management and others on a timely basis.

Documentation of Review (Paragraph 23)

27. Several respondents asked for clarification of the proposed requirement in ED 230 that the auditor should record who reviewed specific audit documentation and the date of such review. They thought that the requirement could be interpreted as requiring either evidence of review to be recorded on each piece of specific audit documentation, or evidence of who reviewed particular categories of working papers.
28. In establishing this requirement, the IAASB did not intend that the auditor should record evidence of review on each working paper. Instead, the focus was on recording who

BASIS FOR CONCLUSIONS:
ISA 230 (REVISED), AUDIT DOCUMENTATION

reviewed specified elements of the audit work. The IAASB therefore decided to clarify this by explanatory guidance in paragraph 24 to indicate that the requirement does not imply a need for each specific working paper to include evidence of review.

29. The IAASB also considered the relationship between the requirement to document evidence of review and the requirement in ISA 220 for the auditor to review the audit documentation, and decided to footnote a cross-reference to ISA 220 to link the two. For completeness, the IAASB also decided to footnote an additional cross-reference to ISA 220, which describes the nature of a review of work performed. Finally, to be consistent with the guidance in ISA 220, which states that the engagement partner documents the extent and timing of the reviews, the IAASB decided to establish a further requirement for the auditor to record the extent of the review.

Engagement Completion Document (Paragraph 15)

30. Several respondents suggested that there should be a requirement for the auditor to prepare an engagement completion document that summarizes the significant findings or issues, or that would otherwise include cross-references to relevant audit documentation that contains such information.
31. The IAASB acknowledged that there could be benefits in having such a completion document, especially in facilitating effective reviews prior to finalizing the audit and, from the regulatory perspective, in facilitating inspections. The IAASB, however, concluded that this should not be a requirement for all audits as such a document might be unnecessary for smaller audits or audits that are otherwise uncomplicated. The review of an engagement completion document on its own cannot discharge the auditor from his or her responsibility under ISA 220 to conduct an appropriate review of the audit documentation before finalizing the auditor's report. The IAASB therefore decided to provide guidance in paragraph 15 to indicate that the auditor may consider it helpful to prepare a summary of significant matters for the reasons stated above.

Placement of Guidance on Confidentiality, Safe Custody, Retention and Ownership of Audit Documentation (ISQC 1, Paragraphs 77-85)

32. A number of respondents asked whether it would be more appropriate to place the guidance on confidentiality, safe custody, retention and ownership of audit documentation within the quality control standards. They indicated that ISA 230 should focus solely on matters related to the effective conduct of the audit, and that such guidance relates more to quality control elements of the audit.
33. After considering these comments, the IAASB decided to move this section to ISQC 1. To be consistent with the wider scope of ISQC 1, the scope of this guidance has been expanded to cover not only audits, but also other engagements addressed by ISQC 1.

Effective Date (Paragraph 33)

34. ED 230 proposed that the effective date of the ISA should be for periods commencing on or after December 15, 2005. Some respondents noted that the IAASB would not approve

BASIS FOR CONCLUSIONS:
ISA 230 (REVISED), AUDIT DOCUMENTATION

ISA 230 as a final standard until September 2005, which would leave little time for translation and implementation.

35. The IAASB agreed that it was important to set the effective date so that practitioners would implement the new requirements and guidance at the earliest opportunity in the public interest. At the same time, the IAASB recognized the need to allow a reasonable time for implementation. The IAASB determined that the ISA should be effective for audits for financial periods beginning on or after June 15, 2006.