

IAASB CAG PAPER



International Federation of Accountants

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Agenda Item

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Committee: IAASB Consultative Advisory Group

Meeting Location: Toronto

Meeting Date: September 11-12, 2006

Clarity

Objectives of Agenda Item

1. To provide a brief report back on the May 2006 proposals of Representatives on aspects of IAASB's Clarity project.
2. To obtain the views of Representatives on the Task Force's proposed list of objectives and related issues.
3. To consider any other matters that may be identified.

May 2006 CAG Proposals

Below are extracts from the proposed minutes of the May 2006 CAG meeting¹ and an indication of how the IAASB Task Force or the IAASB responded to the Representatives' comments.

Representatives' comments	IAASB task force/IAASB response
Requirements	
Mr. Popham noted that the IAASB explained why present tense statements were not elevated, but it did not explain why present tense statements were elevated, which suggested a presumption that elevation was to be the norm. He was of the view that proportionality is important – there should not be too many requirements for low risk areas. This will have a negative effect on audit focus. He suggested that the “stand back” proposed by the Task Force also include considering whether the number of requirements is proportionate with the risk to be addressed by the standard.	The Task Force and IAASB have considered carefully the proposed requirements in the four redrafted ISAs to be satisfied that the requirements, individually and collectively, are appropriate and proportionate to the subjects addressed by the ISAs. In doing so, they gave specific consideration to whether each of the proposed new requirements is in fact necessary, and whether the requirements focus too much on the ‘how to’ instead of the question of whether a matter has been considered and appropriately addressed (see July 2006 IAASB Agenda Item 6).
He noted that it is not clear from the structure of the standards that requirements need not be undertaken if	The Task Force has deliberated the issue of the clarity of the use of the phrase ‘...relevant in the

¹ The minutes will be approved at the September 11-12, 2006 IAASB CAG meeting.

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there is no risk.	circumstances' in the Preface and the ISAs. The Task Force's proposals are outlined in paragraphs 12-16 of Agenda Item P.1. With respect to the specific question of whether a requirement need not be undertaken if there is no risk, the Task Force concluded that it would not be appropriate to state that a requirement applying to a matter that has no associated risk of misstatement is not relevant in the circumstances. The Task Force is of the view that the application of a proper risk assessment would lead the auditor to an appropriate conclusion about the nature and extent of work required in complying with the requirements of the ISA.
Ms. De Beer was of the view that...the main issue is how to apply the ISAs in SME audits. She was of the view that the Clarity Project can deal with this by going further than what is currently intended. The application material should not only highlight the fact that an SME environment may be less complex, but should also explain what the auditor should do in such an environment.	The Task Force and IAASB agree with the general point. In revising the four redrafted ISAs exposed in October 2005, the Task Force, with the assistance of the UK Auditing Practices Board's small and medium sized entity task force, gave specific consideration to whether more of a specific nature could be said that would contribute to a better understanding of how a requirement might be applied in an audit of an SME. The IAASB agreed at its July meeting changes proposed by the Task Force to make the guidance relating to SME consideration more specific, where this was possible (see July 2006 IAASB Agenda Item 6).
Implementation	
Ms. Koski-Grafer notedthat she will be concerned if the acceleration [of the implementation timetable] gives rise to comments by the IAASB that there is not enough time to improve the standards. IOSCO had noted in its comment letter that the process of redrafting the standards for clarification may lead to the identification of gaps, which need to be addressed within the accelerated timetable. If not addressed as part of the accelerated timetable, it may be a long time before the IAASB addresses them....Mr. Edwards was of the view that gaps directly related to the improvement of the standards should be	The IAASB remains of the general view that the process of redrafting the ISAs, if it is to be completed by 2008, should be directed at the clarification of existing material, rather than addressing new issues. However, it agrees that as an exception, new material could be added, or existing material amended, to address matters covered by the ISA but which are at present unclear and could be dealt with by brief amendment to the ISA. IAASB task forces have been encouraged to consider whether there is a major gap in the ISAs allocated to them for redrafting. It is, of course, not expected that

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addressed, but that the IAASB should remain conscious of the resources necessary to achieve the 2008 target date.	there would be such gaps, but the point needs to be considered. If any major gaps are identified, the IAASB will consider whether such matters can be dealt with as part of clarification, or whether they should be noted for the next major revision of the relevant ISA. It has been stressed to the task forces, however, that this is not an invitation to propose substantive changes to the ISAs which would be outside the scope of the project.
Objectives	
<p>Mr. Morris was of the view that the overall objective is too self serving. Management is preparing financial statements to convey financial information to investors. Management hires the auditor to make sure that there is no mistake in such information. The overall objective should be rewritten to reflect this focus.</p> <p>Ms. Koski-Grafer noted that, although not incorrect and maybe well understood by experienced auditors, the objectives of ISAs are often expressed in terms such as “reduce audit risk to an acceptably low level” that are auditor-focused and not oriented to the needs of the users of financial statements. She believed such statements are jargon that is not easily understood by others outside the standards setting environment. She referred to previous discussions about objectives based on audit process vs. objectives based on auditor expectation. She was of the view that these should not be mutually exclusive and that perhaps the goals and objectives of audits could be communicated better by talking “about” objectives in a section at the beginning of each ISA rather than trying to reduce the objectives to a single statement. What is expected by the users of the financial statements should be delivered by the audit process and executed by the auditor. Mr. Van Der Plaats supported the view that the overall objective for the auditor was written in a</p>	<p>The Task Force has developed material in the draft revised ISA 200 (see Exhibit IV of Agenda Item P.2) to explain the relationship between the objective of an audit and the overall objective of the auditor, and the respective roles of management and the auditor. The Task Force does not consider it necessary to revise the objective of the audit, which is, in any case, a matter beyond the scope of the Clarity project.</p> <p>The Task Force agrees to some extent with this observation, while noting that the ISAs are technical documents written primarily for the direction of auditors. Accordingly, it has removed reference to ‘reducing audit risk to an acceptably low level’ from the list of objectives for all the ISAs and the text of the four redrafted ISAs under consideration by the IAASB, and focused on the obtaining of sufficient appropriate audit evidence. It has, however, retained the concept, and the link with evidence, within draft revised ISA 200 as part of the explanation of the concept of reasonable assurance.</p> <p>Further, the Task Force has developed additional guidance in draft revised ISA 200 to help clarify the role of the objectives in light of the objective of an audit.</p>

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<p>too audit esoteric manner. The World Bank is of the view that terms such as “reducing audit risk to an acceptably low level” do not promote public understanding of the objective of an audit.</p> <p>Mr. Rabine reminded the Task Force that the... auditor’s responsibilities are set out in law or regulation. The ISAs should set out how those responsibilities should be implemented. Mr. Van Der Plaats supported this view, noting that it would be helpful if this point could be clarified in the overall objective.</p>	<p>The Task Force has revised the proposed overall objective of the auditor and is satisfied that it restates the objective of an audit in a way that can more readily be related to the auditor’s work and responsibilities and the requirements of ISAs. There is nothing that should be inconsistent with law or regulation, though such may impose further responsibilities.</p>
<p>Mr. Scicluna was of the view that the overall objective of the audit / for the auditor could be better described as the overall objective of the ISAs (the handbook).</p>	<p>The Task Force and IAASB believe that the focus of the objectives should on the outcomes expected of the auditor, thereby: (a) emphasizing the need for appropriate action and behavior in achieving an audit of high quality; and (b) retaining the focus on benchmarks of performance, rather than on the vehicle that establishes those benchmarks.</p>
<p>Mr. Rabine noted that... the terminology used in the objectives are integral to certain concepts. The ISA Subgroup of the European Group of Audit Oversight Bodies indicated that it is necessary to better understand these concepts before redrafting the ISAs.</p>	<p>The Task Force agrees with the general point. While included in the Preface, the role of objectives and their authority will be incorporated in ISA 200 in which there will be explanation of relevant concepts.</p>
<p>Messrs. Pickeur, Popham, Rabine, Roussey, and Van Der Plaats and Mmes. Rand and Sucher were of the view that every ISA should have an objective.</p>	<p>The IAASB agrees in principle with the views of the Representatives and accordingly, the Task Force has worked on the basis that every ISA should have an objective.</p>
<p>Mr. White was concerned about the language of the redrafted obligation. He was not sure whether, from a lawyer’s standpoint, it will fully achieve placing the liability of the auditor in an appropriate context. The obligation is in terms of the auditor, while the qualification is in terms of the process. The fact that the auditor is expected to apply reasonable due care should be in the qualification. Mr. Roussey supported Mr. White’s comment. He found the redrafted obligation confusing. Mr. Popham suggested that the</p>	<p>The Task Force has revised the proposed obligation attaching to objectives to: (a) separate the overall objective of the auditor from the objectives specified in the individual ISAs; and (b) focus the obligation attaching to the overall objective on obtaining reasonable assurance. The latter embeds the qualification within the objective itself rather than as a separate consideration in terms of the process, and established the benchmark against which the auditor</p>

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IAASB obtain legal advice before finalizing the obligation as the use of "must" results in the assumption that the auditor failed in case of an enquiry...	is to be judged in the case of an audit failure. The Task Force does not consider it practicable to seek legal advice in light of the varying legal frameworks globally, and considers that the obligation is more reasonably stated than was the case in the ED.
Mr. Van Der Plaats was concerned about the fact that, even though the auditor complies with the requirements, he or she may conclude that the objectives have not been achieved. This may imply that the ISAs are not good enough; that is, the ISAs do not lead to achieving its own objectives. The question is what an auditor is expected to do in these circumstances. Another question is whether the auditor can depart from a requirement because based on his professional judgment he or she is of the view that the objective can be achieved in a more effective and efficient way.	The Task Force does not expect that there will be a general requirement to do more than specified in the ISAs in every audit, such that the ISAs are regarded as inadequate. However, it accepts that the ISAs cannot anticipate every circumstance. Further, they allow for professional judgment in the implementation of requirements and consideration of the objective is relevant to that judgment. The question of whether the possibility of a more effective or efficient procedure should be allowed as a basis for departure from a requirement was debated by the IAASB in finalizing the October 2005 Clarity EDs. It was noted that whether a procedure is as effective or more effective than that specified in the ISA is highly subjective, and such a test may encourage departures from requirements in more instances than intended. The Task Force is not convinced that new or persuasive arguments have been raised that require the IAASB to reconsider its conclusion. Accordingly, no change has been recommended.

List of Objectives

Acknowledging the views expressed by Representatives at the May 2006 CAG meeting, the IAASB agreed in principle at its July 2006 meeting that each ISA should specify an objective or objectives. This was subject to, however, further consideration of the following:

- The obligation that is to attach to the objectives;
- The nature of the related documentation requirements, if any; and
- The form of the objectives.

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OBLIGATION

The proposed obligation attaching to objectives exposed in October 2005 stated that the auditor must achieve the objectives stated at the beginning of each ISA that is relevant in the circumstances of the audit. This idea was carried forward in the proposed obligation, revised in response to respondents' comment, tabled with the IAASB in July on the basis that the majority of respondents to the exposure draft supported this type of obligation.

In July, the IAASB noted that the obligation, if interpreted as requiring a conclusion on each objective and assuming that each ISA would have an objective, would appear to superimpose the structure of the ISAs into the audit process. This may not be consistent with the way in which audits are conducted, with specific methodologies or the way in which evidence is obtained and evaluated. Further, this would not reflect the differing natures of, and interrelationships among the ISAs, and may inadvertently emphasize considerations in relation to the form of the ISAs, rather than their substance.

The issue is therefore one of finding a solution that responds to these concerns while retaining to retaining the strengths of the original proposal supported by many respondents.

The Task Force's proposal, the basis thereof and related discussion, with respect to the obligation to attach to the objectives is explained in paragraphs 2-11 of Agenda Item P.1. Wording of the proposed obligation is shown in paragraphs 16-18 and 20-21 of the revised Preface in Exhibit I in Agenda Item P.2.

Matters for Consideration by the IAASB CAG:
The Representatives are asked for their views on the proposed obligation attaching to objectives, in particular whether they view it as robust and consistent with the intended roles of the objectives.

DOCUMENTATION

Some stakeholders (particularly those from the regulatory community) have noted that it is important for there to be a link between objectives and documentation. Counter to this view, some Board members expressed concern about overburdening auditors with documentation that does not serve to enhance audit quality. In any case, because a need for documentation may be implied or perceived in the proposed obligation attaching to objectives, the IAASB needs to be clear whether there is a related documentation requirement and if so, the nature of that requirement.

In addition, it has been raised in previous CAG discussions whether ISA 230 (Revised), "Audit Documentation" is clear in setting out whether or not auditors are expected to document compliance with each and every requirement in the ISAs.

The Task Force's proposal, the basis thereof, with respect to documentation expected in relation to objectives and requirements is explained in paragraphs 27-29 of Agenda Item P.1. Related proposed amendments to ISA 230 are shown Exhibit II in Agenda Item P.2.

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Matters for Consideration by the IAASB CAG:

The Representatives are asked for their views on the proposed amendments to ISA 230, in particular whether they agree with the proposed emphasis on documenting the reasons for conclusions relating to areas where significant judgment has been applied.

(Kindly note that the proposed amendments to ISA 230 do not include changes necessary to redrafted it in accordance with the Clarity drafting conventions.)

FORM OF OBJECTIVES

In July, in its review of the proposed revised four redrafted ISAs exposed in October 2005, the IAASB reiterated its support for the view that the objectives should feature prominently the outcomes expected of the auditor, and take a less procedural form than that included in the EDs.

The Task Force considered the following three elements of the objectives as matters requiring resolution:

- The linkage between, and coherence of, the overall objective of the auditor and the objectives specified in the individual ISAs;
- The general form to be used for the objectives specified in individual ISAs; and
- The interrelationship and differing natures of the ISAs.

Each of the above elements and the Task Force's proposals are explained in paragraphs 36-42 of Agenda Item P.1.

Exhibit III of Agenda Item P.2 contains the Task Force's recommended list of draft ISA objectives. The Task Force is satisfied that they represent a set of objectives that can be passed to the relevant IAASB task forces working on the redrafting or revision of individual ISAs, for their further consideration.

Matters for Consideration by the IAASB CAG:

The Representatives are asked for their views on the wording of the objectives, and to consider what further matters, if any, should feature therein.

Other Matters

Related to the issue of objectives, the Task Force has prepared a first draft of revised ISA 200 to illustrate how elements of the Preface, and the proposed overall objective of the auditor and its relationship with the objective of an audit, may be included in the body of the ISAs.

The Task Force is of the view that establishing the auditor's overall objective in ISA 200 requires the ISA to discuss more fully the concepts embedded therein and underlying an audit of financial statements, in particular reasonable assurance and the inherent limitations of an audit, and the

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relationship between reasonable assurance, sufficient appropriate audit evidence and the reduction of audit risk to an acceptably low level.

Exhibit IV of Agenda Item P.2 contains the Task Force's first draft of proposed revised ISA 200.

Matters for Consideration by the IAASB CAG:
The Representatives are asked for their views on proposed paragraphs 4-8 and A1-A31 of the preliminary draft revised ISA 200 in Exhibit IV of Agenda Item P.2.

Material Presented – IAASB CAG PAPERS

Agenda Item P.1 Issues Paper (September 2006 IAASB Agenda Item 2-A)

Agenda Item P.2 Proposed Revised Preface, Amendments to ISA 230, List of Objectives, and Draft Revised ISA 200 (September 2006 IAASB Agenda Item 2-B)

In view of the importance of the subject, all the documents for Agenda Item P are CAG papers.

Please note that Agenda Item P.2 contains the list of proposed objectives.