



International Federation of Accountants

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Agenda Item E.2

Committee: IAASB Consultative Advisory Group

Meeting Location: New York

Meeting Date: April 2-3, 2007

IAASB Clarity Project:

Application of the Clarity Conventions to Date, and Proposed Redrafted ISAs Discussed at the February 2007 IAASB Meeting

Objective of Agenda Item

1. The objective of this Agenda Item are to obtain the views of Representatives on:
 - (I) Aspects of the application to date of the IAASB's Clarity conventions to the ISAs; and
 - (II) Matters relating to proposed redrafted ISAs discussed by the IAASB at its February 2007 meeting.

I. Application to Date

REQUIREMENTS

Specification of Requirements Arising from Review of the Present Tense

2. A general concern noted at the outset of IAASB's work in applying the Clarity conventions was the potential for the elimination of the present tense to increase very substantially the number of requirements in the ISAs, thereby resulting in over-prescriptive standards.
3. The IAASB acknowledged these concerns, and the importance of retaining the principles-based nature of the ISAs. Accordingly, it has sought to determine the requirements of the ISAs (in particular, the elevation (or not) of material in the present tense as requirements), through the consistent application of the following general guidelines for determining the requirements of a Standard:
 - The requirement is necessary to achieve the objective stated in the Standard;
 - The requirement is expected to be applicable in virtually all engagements to which the Standard is relevant; and
 - The objective stated in the Standard is unlikely to have been met by the requirements of other Standards.

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4. The following table, compiled by IAASB staff for information purposes, gives an approximate¹ indication of the result of clarifying 14 of the ISAs that have been finalized or exposed as of March 2007:

	Extant and closed-off ISAs	Final and in-Exposure Revised and Redrafted, or Redrafted only, ISAs	
No. of Requirements (of which, conditional)	250 (80)	380 (160)	1.6 times increase (2.0 times increase)
No. of present tense and other statements considered	460	-	Approx. 1/3 taken up as requirements

5. The above indicates, as expected, an increase in the number of requirement as a result of applying the Clarity conventions. However, the increase appears to be of reasonable magnitude, and is likely to be manageable. Many of the recently revised ISAs (e.g., the audit risk ISAs, which generally contained more application material than older ISAs that have not recently been revised) are included in the above; accordingly, it is anticipated that the above trend would continue for the entire suite of redrafted ISAs.

Conditional Requirements

6. The table in paragraph 4 indicates a higher increase in conditional requirements in relation to the overall increase in requirements. This reflects, in part, the IAASB's efforts to identify, where applicable, any conditionality attaching to new and extant requirements, thereby making clear any limits to their relevance and applicability.²
7. More significantly, however, the increase reflects the existence of a number of present tense sentences that provided guidance to the auditor when facing some specific situations, which exist more often in subject-specific ISAs (e.g., ISA 570, "Going Concern") than in ISAs that address broader aspects of the audit (e.g., ISA 315). Subject-specific ISAs represent the

¹ The figures shown in the table are approximate figures only. For purposes of the count of the number of requirements, each significant action within a requirement of an ISA, whether or not preceded directly by the word "shall" or "should", was counted as an individual requirement. However, where "shall" or "should" preceded a list of matters requiring consideration, these were counted as a single requirement unless significant actions were evident therein. Differences in count may arise depending on how aspects of the requirements are interpreted.

² In conducting an audit in accordance with ISAs, the auditor is required to comply with the requirements of an ISA in all cases where such requirements are relevant in the circumstances of the audit. A requirement is not relevant if the ISA is not relevant in the circumstances, or if the circumstances envisioned do not apply because the requirement is conditional and the condition does not exist. The auditor is not required to apply a requirement that is not relevant in the circumstances of the audit; this does not constitute a departure from the requirement.

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majority of the ISAs remaining to be redrafted; accordingly, the IAASB will increasingly face the issue of whether, and on what basis, conditional guidance should be elevated as requirements.

8. The IAASB specifies conditional requirements based on elevations of present tense sentences when it believes it appropriate to do so to ensure that auditors, when confronted with certain circumstances, act appropriately, or at least in a consistent manner – that is, when their absence may adversely affect the quality or consistency of audits having regard to the international context. This has been the case even though the general guidelines set for determining requirements include the following condition:

“The requirement is expected to be applicable in virtually all engagements in which the ISA is relevant”.

9. The IAASB has not debated, as a separate issue, the basis for determining when to specify a conditional requirement. However, the approach adopted might be expressed as being that a requirement may be specified to address circumstances that are reasonably likely to exist or arise in an engagement where such requirements are considered necessary to the consistent application of the ISA, and the action specified in relation to the circumstance envisioned is expected to be appropriate in virtually all such circumstances. Such cases would be distinguishable from what might be mere examples of the application of a requirement to particular circumstances.

Matters for Consideration by the IAASB CAG:

The Representatives are asked for their views on:

- Whether the present tense statements in the extant ISAs have been appropriately dealt with, having regard to the criteria identified by the IAASB for determining whether a requirement should be specified³.
- The IAASB’s approach to specifying conditional requirements. In particular, are there other considerations that the IAASB should take account of as it redrafts material in the ISAs of a conditional nature?

For purposes of considering these matters, the Representative may wish to refer to the material in **Agenda Item E.2.1.**

³ See paragraph 3 of this Paper.

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Material Presented – IAASB CAG REFERENCE PAPER

Agenda Item E.2.1 Extracts of IAASB Exposure Drafts of Redrafted ISAs 230 (Audit Documentation), 560 (Subsequent Events), 570 (Going Concern), 610 (Internal Audit) and 720 (Other Information) (specifically, the Introduction through to the Requirements sections), Together with the Staff-Prepared Analysis of Dispositions of the Present Tense in the Related Extant ISAs

II. Proposed Redrafted ISAs Discussed by the IAASB at its February 2007 Meeting

10. This portion of the IAASB CAG session deals with matters relating to proposed redrafted ISAs discussed by the IAASB at its February 2007 meeting. Except as noted, the relevant IAASB CAG Reference Documents identified below and listed in paragraph 17 of this paper were circulated to the Representatives on February 20, 2007.

Matters for CAG Consideration

A. PROPOSED ISA 570 (REDRAFTED), “GOING CONCERN”⁴

11. The main issues arising as part of the redrafting of ISA 570 related to the elevation (or not) of present tense statements in the guidance of the extant ISA as requirements or conditional requirements in redrafted ISA 570. These matters are discussed in Section I of this Paper.
12. Other than the following, there are no specific matters to which the CAG’s attention is drawn.

Matters for Consideration by the IAASB CAG:
The Representatives are asked for their views on whether the objectives to be achieved by the auditor, stated in the proposed ISA 570 (Redrafted), are appropriate. Refer to paragraph 9 in Appendix III of Agenda Item E.2.1.

B. PROPOSED REDRAFTED REPORTING ISAs⁵ – COMPLIANCE FRAMEWORKS AND THE EVALUATION OF WHETHER FINANCIAL STATEMENTS ARE MISLEADING

⁴ The approach adopted by the IAASB for purposes of implementing its Clarity project distinguishes revision and redrafting. For this purpose, ISA 570 has been revised in the last few years and is in principle in no need of further revision. It is therefore subject to redrafting to reflect only the IAASB Clarity conventions and matters of clarity generally. Proposed ISA 570 (Redrafted) was approved by the IAASB in February as an Exposure Draft.

⁵ The reporting ISAs comprise: ISAs 700 (Auditor’s Report), 705 (Modifications to the Auditor’s Opinion), 706 (Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs), 800 (Audits of Special Purpose Financial Statements), and 805 (Summary Financial Statements). For purposes of implementing its Clarity project, ISA 700 has been revised in the last few years and is in principle in no need of further revision. It is therefore subject to redrafting to reflect only the IAASB Clarity conventions and matters of clarity generally. ISAs 705,

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13. Paragraph A3 of proposed ISA 700 (Redrafted) “The Independent Auditor’s Report on General Purpose Financial Statements” explains that it will be extremely rare for the auditor to consider financial statements that are prepared and presented in accordance with a compliance framework (which the auditor has determined to be acceptable) to be misleading. Paragraph 14 of proposed ISA 700 (Redrafted) deals with the auditor’s actions in the extremely rare circumstances when, in the auditor’s professional judgment, such financial statements are misleading. **Refer to paragraph 14 and A3 of IAASB February 2007 Agenda Item 4-A.**
14. The ISAs, however, do not include a requirement for the auditor to evaluate whether financial statements prepared and presented in accordance with a compliance framework are not misleading; while paragraph 11 of proposed ISA 700 (Redrafted) requires the auditor, when forming an opinion on financial statements prepared and presented in accordance with a fair presentation framework, to evaluate and conclude whether those financial statements achieve fair presentation. The Task Force questioned whether there should a parallel requirement for compliance frameworks, particularly in view of the proposed changes to ISA 550 (Revised and Redrafted), “Related Parties.”⁶
15. To provide a hook for the related requirement in proposed ISA 550 (Revised and Redrafted) and other similar requirements in the ISAs, the Task Force proposed that the IAASB consider whether to include in proposed ISA 700 (Redrafted) a requirement for the auditor, when forming an opinion on financial statements prepared and presented in accordance with a compliance framework, to be satisfied that the financial statements are not misleading in the circumstances. The IAASB agreed that a requirement should be drafted for consideration at the July 2007 IAASB meeting. It was also agreed that there should be greater alignment of the auditor’s actions when the financial statements do not achieve fair presentation (paragraph 13) and when the financial statements are misleading (paragraph 14). **Refer to paragraphs 13 and 14 of IAASB February 2007 Agenda Item 4-A.**

Matters for Consideration by the IAASB CAG:
The Representatives are asked for their views on this matter.

C. PROPOSED REDRAFTED REPORTING ISAS – OBJECTIVES

706, 800 and 805 are at present subject to full revision and have been exposed. They have been ‘closed off’ in the old style, and will be redrafted and exposed for comments on the effect of redrafting. The IAASB is scheduled to approve revised versions of these proposed redrafted ISAs as exposure drafts at its July 2007 meeting.

⁶ According to proposed ISA 550 (Revised and Redrafted), for example, one of the auditor’s objectives is to obtain an understanding of the entity’s related party relationships and transactions sufficient to be able to form the auditor’s opinion, in accordance with ISA 700, on whether the financial statements achieve fair presentation (for fair presentation frameworks) or are not misleading (for compliance frameworks), even if the applicable financial reporting framework establishes minimal or no related party requirements.

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16. The IAASB considered the proposed objectives for each of the proposed redrafted reporting ISAs. Based on the comments received at the February IAASB meeting, the proposed revised objectives are as follows:

ISA 700 (Redrafted), “The Independent Auditor’s Report on General Purpose Financial Statements”

The objectives of the auditor are to:

- (a) Form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and
- (b) Express clearly that opinion through a written report that explains the basis of the opinion.

ISA 705 (Revised and Redrafted), “Modifications to the Opinion in the Independent Auditor’s Report”

The objective of the auditor is to express clearly and appropriately the modified opinion on the financial statements that is necessary:

- (a) When the auditor concludes that the financial statements are not free from material misstatement; or
- (b) When the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements are free from material misstatement.

ISA 706 (Revised and Redrafted), “Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor’s Report”

The objective of the auditor is to include in the auditor’s report a communication in appropriate form and placement:

- (a) When a matter disclosed in the financial statements is of such importance to users’ understanding of the financial statements as a whole that it would be appropriate to draw their attention to it; or
- (b) When the auditor considers it necessary to use the auditor’s report as a means of communicating information relating to matters other than those that are presented and disclosed in the financial statements.

ISA 800 (Revised and Redrafted), “Special Considerations—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement”

The objective of the auditor is to apply the other ISAs by (a) addressing the special considerations that are relevant to the appropriate acceptance, and planning and performance of, and reporting on the audit of special purpose financial statements or an element, account or item of a financial statement, and (b) in the case of an audit of an element, account or item of a financial statement, adapting the other ISAs as necessary in the circumstances.

(The IAASB asked the Task Force to whether (b) is necessary, as proposed ISA 200 (Revised and Redrafted), “Overall Objective of the Independent Auditor, and Concepts Relevant to an Audit of Financial Statements” deals with the adaptation of the ISAs.)

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ISA 805 (Revised and Redrafted), “Engagements to Report on Summary Financial Statements”

The objective of the auditor is to express an opinion whether the summary financial statements are a fair summary of the audited financial statements in accordance with the applied criteria.

Matters for Consideration by the IAASB CAG:

The Representatives are asked for their views on whether the draft objectives above are appropriate?

C. PROPOSED REDRAFTED REPORTING ISAs – REQUIREMENTS

Matters for Consideration by the IAASB CAG:

The Representatives are asked for their views on whether the present tense statements in the extant reporting ISAs have been appropriately dealt with? **Refer to IAASB February 2007 Agenda Items 4-B, 3-C, 3-F, 2-B, and 2-D.**

Material Presented – IAASB CAG REFERENCE PAPERS

17. The following identifies specific reference material relevant to the Representatives consideration of the above matters. This material was circulated to the Representatives on February 20, 2007.

Available at
<http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0089&ViewCat=0704>

IAASB February 2007 Agenda Item 4-A
(Draft Proposed ISA 700 (Redrafted))

Available at
<http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0089&ViewCat=0704>

IAASB February 2007 IAASB Agenda
Item 4-B (ISA 700 – Proposed
Disposition of the Present Tense)

See also related ISA 700 (Redrafted)
Mapping Documents

Available at
<http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0089&ViewCat=0703>

IAASB February 2007 IAASB Agenda
Item 3-B (Draft Proposed ISA 705
(Revised and Redrafted))

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Available at
<http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0089&ViewCat=0703>

IAASB February 2007 IAASB Agenda
Item 3-C (ISA 705 – Proposed
Disposition of the Present Tense)

See also related ISA 705 (Revised and
Redrafted) Mapping Documents

Available at
<http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0089&ViewCat=0703>

IAASB February 2007 IAASB Agenda
Item 3-E (Draft Proposed ISA 706
(Revised and Redrafted))

Available at
<http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0089&ViewCat=0703>

IAASB February 2007 IAASB Agenda
Item 3-F (ISA 706 – Proposed Disposition
of the Present Tense)

See also related ISA 706 (Revised and
Redrafted) Mapping Documents

Available at
<http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0089&ViewCat=0702>

IAASB February 2007 IAASB Agenda
Item 2-A (Draft Proposed ISA 800
(Revised and Redrafted))

Available at
<http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0089&ViewCat=0702>

IAASB February 2007 IAASB Agenda
Item 2-B (ISA 800 – Proposed
Disposition of the Present Tense)

See also related ISA 800 (Revised and
Redrafted) Mapping Documents

Available at
<http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0089&ViewCat=0702>

IAASB February 2007 IAASB Agenda
Item 2-C (Draft Proposed ISA 805
(Revised and Redrafted))

Available at
<http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0089&ViewCat=0702>

IAASB February 2007 IAASB Agenda
Item 2-D (ISA 805 – Proposed
Disposition of the Present Tense)

See also related ISA 805 (Revised and
Redrafted) Mapping Documents