

*Proposed Revised and Redrafted International
Standard on Auditing*

ISA 200, Overall Objective of the
Independent Auditor, and the Conduct
of an Audit in Accordance with
International Standards on Auditing



International Federation
of Accountants

REQUEST FOR COMMENTS

The International Auditing and Assurance Standards Board (IAASB), an independent standard-setting body within the International Federation of Accountants (IFAC), approved the exposure draft, proposed International Standard on Auditing (ISA) 200 (Revised and Redrafted), “Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing,” for publication in April 2007. The proposed ISA may be modified in light of comments received before being issued in final form.

Please submit your comments, preferably by e-mail, so that they will be received by **September 15, 2007**. All comments will be considered a matter of public record. Comments should be addressed to:

International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, New York 10017 USA

Comments should be emailed to Edcomments@ifac.org. They may also be faxed to +1-212-286-9570 or mailed to the above address.

Copies of the exposure drafts may be downloaded free-of-charge from the IFAC website at <http://www.ifac.org>.

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EXPLANATORY MEMORANDUM

Introduction

This memorandum provides background to, and an explanation of, the proposed International Standard on Auditing (ISA) 200 (Revised and Redrafted), “Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing,” approved for exposure by the International Auditing and Assurance Standards Board (IAASB) in April 2007.

Background

The amended “Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services” (Preface)¹ contains statements about the authority attaching to ISAs, the conventions used by the IAASB in drafting ISAs, and the obligations of auditors who follow those Standards. Because the amended Preface may not be reproduced or adopted in certain jurisdictions, the IAASB is proposing revisions to extant ISA 200, “Objective and General Principles Governing an Audit of Financial Statements” to incorporate the provisions of the amended Preface relevant to ISAs. As part of the revision process, the IAASB considered the most appropriate presentation of the material derived from the amended Preface, and the need for further explanation of that material, in this new context. The title of ISA 200 has been changed to reflect the introduction of the relevant provisions of the amended Preface.

The IAASB considered it equally important that proposed ISA 200 (Revised and Redrafted) contains an adequate discussion of the premises on which an audit is conducted (consistent with proposed ISA 580 (Revised and Redrafted), “Written Representations”), and a brief summary of the nature of an audit of financial statements in order to introduce related concepts. An understanding of the concepts is necessary for a proper understanding of the conduct of an audit so as to achieve its objective, the overall objective of the independent auditor, and the objectives and requirements stated in the ISAs.

The IAASB believes that proposed ISA 200 (Revised and Redrafted) provides a clearer explanation of relevant concepts which should be helpful to auditors and others with an interest in audits and auditing standards. The proposed ISA has been drafted in accordance with IAASB’s clarity conventions.

Extant ISA 200 includes guidance on determining the acceptability of the financial reporting framework. This has been moved to ISA 210, “Terms of Audit Engagements” and amended. Extant ISA 200 also includes guidance on expressing an opinion on the financial statements, which has been revised. These changes reflect conforming amendments agreed by the IAASB in 2006 arising from ISA 800 (Revised), “Special Considerations—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement.”² Except as described below and

¹ The amended Preface was approved by the IAASB in 2006, and is available on the IAASB website at https://web.ifac.org/download/IAASB_Preface.pdf. The IAASB staff-prepared document, *Basis for Conclusions: Clarity* (also available on the IAASB website), summarizes the more significant issues raised by respondents to the proposed amended Preface exposed in October 2005, and how the IAASB addressed them.

² Close off document approved in October 2006.

where necessary as part of the revision process, there are no other substantive changes to the content of extant ISA 200.

Significant Proposals

Preface Provisions

Proposed ISA 200 (Revised and Redrafted) incorporates relevant provisions of the amended Preface having regard to the context of an ISA and the clarity drafting conventions adopted by the IAASB. Accordingly, the provisions of the amended Preface have been reflected as appropriate within either:

- The Objective and Requirements sections of the proposed ISA, when they related to the obligations of the auditor in conducting an audit in accordance with ISAs. For example, proposed ISA 200 (Revised and Redrafted) establishes as requirements that the auditor shall consider the entire text of an ISA to understand its requirements, and shall comply with the requirements of an ISA in all cases where such requirements are relevant.
- The Application and Other Explanatory Material section of the proposed ISA, as guidance to related requirements, when they described or provided explanation of the content or structure of the ISAs.

Except as explained below, and where necessary for purposes of presentation, proposed ISA 200 (Revised and Redrafted) reproduces the wording contained in the amended Preface.

Obligation Attaching to Objectives

Paragraph 15 of the amended Preface states the following:

“...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.”

Subsequent to the release of the amended Preface, it was represented to the IAASB by some regulators that the wording ‘aim to achieve’ suggested that the actual achievement of the objectives might be optional. This interpretation drew support from the final sentence of paragraph 15 of the amended Preface which refers not only to cases where an objective ‘cannot be achieved,’ but also to where it ‘has not been achieved.’ At the IAASB Consultative Advisory Group meeting in April 2007, the IAASB received strong advice that this impression, which was not intended by the IAASB, should be eliminated.

The reasons for the IAASB’s approach in the amended Preface are explained in the IAASB staff-prepared document, *Basis for Conclusions: Clarity*, available on the IAASB website. The IAASB considers that the amended Preface reflected the IAASB’s intention, but having regard to the advice received it is concerned to avoid any misinterpretation of the position.

The IAASB therefore proposes that the obligation in the amended Preface be clarified in proposed ISA 200 (Revised and Redrafted), through restating the obligation as follows: (see paragraph 24)

“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 consequence of a failure to achieve an objective in a relevant ISA is unchanged in principle from the amended Preface (see last sentence of paragraph 15 of the amended Preface). However, the wording ‘has not been or cannot be achieved’ has been changed to ‘cannot be achieved,’ in response to the point made above. In addition, proposed ISA 200 (Revised and Redrafted) makes clear that in most cases the failure to achieve an objective will prevent the achievement of the overall objective of the auditor. This reflects the fact that the objectives stated in the majority of the ISAs are clearly related to the overall objective of the auditor. The proposed ISA also makes clear that the failure to achieve an objective represents a significant matter requiring documentation in accordance with proposed ISA 230 (Redrafted), “Audit Documentation.” (See paragraph 25.)

In developing this proposal, the IAASB reconfirmed its view that the auditor cannot be subjected to an absolute obligation to achieve an objective, because of the inherent nature of an objective and the possibility that there may be circumstances that prevent its achievement. However, the IAASB accepted that it must be clear that the auditor shall either achieve the objectives or, where in the circumstances this is not possible, take appropriate action. The IAASB believes that the proposed ISA achieves this.

To enhance the understanding of the requirements derived from the amended Preface, proposed ISA 200 (Revised and Redrafted) contains further explanation of the following:

- The role and purpose of objectives, including the relationship between objectives and requirements.
- The auditor’s consideration of objectives, including the need for the auditor to have regard to the interrelationship amongst the ISAs.
- The consequence of a failure to obtain sufficient appropriate audit evidence.
- The consequence of a failure to achieve an objective.

Proposed ISA 200 (Revised and Redrafted) and its Relationship to the Amended Preface

Because proposed ISA 200 (Revised and Redrafted) incorporates the provisions of the amended Preface relevant to ISAs, the IAASB intends to remove them from the amended Preface. Instead, the amended Preface would refer readers to ISA 200 (Revised and Redrafted) for the authority attaching to ISAs.

Obtaining Sufficient Appropriate Audit Evidence

The IAASB is of the view that the overarching bold type requirement in paragraph 2 of extant ISA 500, “Audit Evidence” for the auditor to obtain sufficient appropriate audit evidence is a fundamental audit requirement, appropriate for inclusion as a requirement in proposed ISA 200 (Revised and Redrafted). Further, the IAASB believes that including this requirement in the

proposed ISA provides the appropriate context for the requirement that the auditor use objectives to consider whether sufficient appropriate audit evidence has been obtained. Accordingly, the requirement for the auditor to obtain sufficient appropriate audit evidence has been moved from extant ISA 500 to proposed ISA 200 (Revised and Redrafted). The repositioning of this requirement from extant ISA 500 is consistent and appropriate with the scope of proposed ISA 500 (Redrafted), “Considering the Relevance and Reliability of Audit Evidence”³ as a result of redrafting that ISA in accordance with IAASB’s clarity conventions.

An Audit of Financial Statements, and Related Concepts

To provide the basis for the proper understanding of the overall objective of the auditor and the objectives and requirements of the ISAs, proposed ISA 200 (Revised and Redrafted) discusses the premises on which an audit is conducted, the nature of an audit of financial statements, and related concepts. The following highlights matters relevant to certain of the concepts described in the proposed ISA.

Reasonable Assurance

The IAASB has concluded that the definition of reasonable assurance should remain consistent with that included in the Glossary of Terms in the *Handbook of International Auditing, Assurance, and Ethics Pronouncements* published by IFAC, being ‘...a high, but not absolute, level of assurance ...,’ and that that definition should feature in proposed ISA 200 (Revised and Redrafted). The IAASB has agreed that any significant amendment to the discussion of reasonable assurance in proposed ISA 200 (Revised and Redrafted) would necessarily involve a re-examination of the concept. However, the IAASB has previously agreed that work on a conceptual framework (and by implication on such concepts as reasonable assurance) should not form part of the Clarity project or current workload. Further, any further consideration would have to be undertaken in consultation with national standard setters, regulators and other stakeholders through a systematic and broader-based study. This is beyond the scope of the project to clarify and revise extant ISA 200.

The IAASB has therefore not undertaken to change the definition of reasonable assurance. It proposes, however, to amplify some aspects of the discussion of reasonable assurance in proposed ISA 200 (Revised and Redrafted) to help explain further the concept, while not altering its meaning.

Inherent Limitations of an Audit

The IAASB is of the view that users’ understanding of the nature of an audit, and of the auditor’s overall objective of obtaining reasonable assurance, would be enhanced through a fuller discussion of the inherent limitations of an audit. Further, certain commentators have encouraged the IAASB to include discussion of limitations only in ISA 200 and to eliminate discussion of limitations elsewhere. The IAASB agrees that the discussion of limitations in ISA 200 should be comprehensive (in the sense of referring to the principal limitations), so that it should not be necessary to introduce new limitations in other ISAs. However, while the IAASB intends to avoid reference to limitations within other ISAs to the extent possible, there are certain topics to which limitations are especially

³ The IAASB approved in April 2007 the Exposure Draft, proposed ISA 500 (Redrafted). This Exposure Draft is available on the IAASB website at <http://www.ifac.org/Guidance/EXD-Details.php?EDID=0080>.

relevant (for example, fraud and related parties). Accordingly, in certain ISAs it is necessary to provide further explanation of limitations that are of particular relevance in the context of those ISAs.

The IAASB is of the view that it would be neither appropriate nor practicable to provide a complete list of inherent limitations.

Proposed ISA 200 (Revised and Redrafted) describes the inherent limitations of an audit, in the context of the following principal sources that give rise to them:

- 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.

Sufficiency and Appropriateness of Audit Evidence

Proposed ISA 200 (Revised and Redrafted) addresses the sufficiency and appropriateness of audit evidence as part of its discussion of the concepts relevant to an audit of financial statements. Because this concept is fundamental to the conduct of an audit in accordance with ISAs, the IAASB believes that the benefits of emphasizing it in both the context of proposed ISA 200 (Revised and Redrafted) and proposed ISA 500 (Redrafted) outweigh the disadvantages of repetition.

Professional Judgment

The IAASB understands that there is some concern about the potential for professional judgment to be used as a justification for decisions for which no other explanation need be given. The IAASB therefore believes that proposed ISA 200 (Revised and Redrafted) should indicate that professional judgment is something that can be challenged. Proposed ISA 200 (Revised and Redrafted) explains that the exercise of professional judgment may be regarded as reasonable if other experienced auditors can agree that the exercise of professional judgment in any particular case was reasonable based on the facts and circumstances known at the time the judgment was made.

Effective Date

The current timetable envisages that all ISAs will have been revised and redrafted, or redrafted only, by late 2008 and the IAASB has provisionally agreed that the complete set of ISAs will be effective for audits of financial statements for periods beginning on or after December 15, 2008. This date will depend on satisfactory progress being made, and will be amended to a later date should that prove necessary. The IAASB believes that it is in the interest of auditors and others who use the ISAs that the standards should be released as soon as they are approved so as to facilitate their implementation.

Guide for Respondents

The IAASB welcomes comments on all matters addressed in the exposure draft. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent

agrees with proposals in this exposure draft (especially those calling for change in current practice), it will be helpful for the IAASB to be made aware of this view.

Comments on Other Matters

Recognizing that the proposed revised ISA will apply to audits of all sizes and in all sectors of the economy, the IAASB is also interested in comments on matters set out below.

Special Considerations in the Audit of Small Entities

Respondents are asked to comment on whether, in their opinion, considerations in the audit of small entities have been dealt with appropriately in the proposed ISA. Reasons should be provided if not in agreement, as well as suggestions for alternative or additional guidance.

Special Considerations in the Audit of Public Sector Entities

Respondents are asked to comment on whether, in their opinion, special considerations in the audit of public sector entities have been dealt with appropriately in the proposed ISA. Reasons should be provided if not in agreement, as well as suggestions for alternative or additional guidance.

Developing Nations

Recognizing that many developing nations have adopted or are in the process of adopting the ISAs, the IAASB invites respondents from these nations to comment, in particular, on any foreseeable difficulties in applying the proposed ISA in a developing nation environment. Reasons should be provided, as well as suggestions for alternative or additional guidance.

Translations

Recognizing that many respondents intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues noted in reviewing the proposed ISA.

Supplement to the Exposure Draft

To assist respondents in tracking changes, IAASB staff has prepared an analysis of how the material in the amended Preface relevant to ISAs has been reflected in proposed ISA 200 (Revised and Redrafted).

In addition, IAASB staff has prepared a summary of the objectives for all of the ISAs, in draft or final form as the case may be as of April 2007, to assist respondents in considering the provisions of the proposed ISA. The IAASB is not seeking comments on the objectives included in this staff-prepared document, but as individual exposure drafts are issued will welcome comments on whether the objectives proposed therein are appropriate.

These staff-prepared documents are available on the IAASB website at <http://www.ifac.org/Guidance/EXD-Details.php?EDID=0079>. They are for information purposes only and do not form part of the exposure draft.

To be considered, responses should be emailed to Edcomments@ifac.org . They may also be faxed to +1-212-286-9570 or mailed to 545 Fifth Avenue, 14th Floor, New York, NY 10017, USA.

PROPOSED INTERNATIONAL STANDARD ON AUDITING 200

(REVISED AND REDRAFTED)

**OVERALL OBJECTIVE 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 [date])^{*}

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^{*} See footnote 1.

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) establishes the independent auditor's overall responsibilities when conducting an audit in accordance with ISAs.
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.

Effective Date

3. This ISA is effective for audits of financial statements for periods beginning on or after [date].¹

Overall Objective of the Independent Auditor

4. The objective of an audit of financial statements is to enable the auditor to express an opinion² whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.
5. In conducting the audit so as to achieve its objective, the overall objective of the independent auditor³ 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. (Ref: Para. A1)
6. 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.

Preparation of the Financial Statements

7. 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 oversight from those charged with governance,⁴ with the auditor engaged for purposes of forming and expressing an opinion on them. The audit of the financial statements does not

¹ This date will not be earlier than December 15, 2008.

² The form of opinion will depend upon the applicable financial reporting framework and any applicable law or regulation. Where the applicable financial reporting framework is a fair presentation framework, as is generally the case for general purpose financial statements, the opinion is on whether the financial statements give a true and fair view, or are presented fairly, in all material respects – see ISA 700 (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.

³ Referred to hereafter and in the ISAs as “the auditor” unless the context requires emphasis of independence.

⁴ The terms “management” and “those charged with governance” are described in [proposed] ISA 260 (Revised and Redrafted), “Communication with Those Charged with Governance.”

relieve management and those charged with governance of their responsibilities. The auditor is also entitled to expect that management and those charged with governance will make available to the auditor all the information the auditor requires for the purposes of the audit.

8. 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 audits are conducted, on the premises that management and, where appropriate, those charged with governance:
 - (a) Acknowledge and understand their responsibility for preparing and presenting the financial statements in accordance with the applicable financial reporting framework (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
 - (c) Will provide complete information to the auditor.

An Audit of Financial Statements, and Related Concepts

9. 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. 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.
10. 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.
11. The ISAs are designed to support the auditor in obtaining reasonable assurance. They require that the auditor exercise professional judgment and skepticism throughout the planning and performance of the audit; and:
 - Identify and assess risks of material misstatement.
 - 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.
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. The auditor is subject to independence and other ethical requirements, which ordinarily comprise Parts A and B of the International Federation of Accountants' Code of Ethics for Professional Accountants related to an audit of financial statements together with national requirements that are more restrictive.
15. The concept of independence refers both to the state of mind of the auditor and independence in appearance. The 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.

Definitions

16. 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 in preparing and presenting 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 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 audit opinion is based.

- (c) Audit risk – The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated.⁵
- (d) 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.
- (e) Financial statements – A structured representation of historical financial information, which ordinarily includes related explanatory notes, intended to communicate an entity’s economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The term ordinarily refers to a complete set of financial statements, but can also refer to a single financial statement.⁶
- (f) 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.
- (g) 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.

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

⁵ 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.

⁶ 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) Risk of material misstatement – The risk that the financial statements are materially misstated. This consists of two components, described as follows at the assertion level:
 - (i) Inherent risk – The susceptibility of an assertion to a misstatement that could be material, either individually or when aggregated with other misstatements, assuming that there are no related controls.
 - (ii) Control risk – The risk that a misstatement that could occur in an 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.

Requirements

Ethical Requirements Relating to an Audit of Financial Statements

- 17. The auditor shall comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. (Ref: Para. A41)

Professional Skepticism

- 18. 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. A42)

Sufficient Appropriate Audit Evidence

- 19. 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.

Conduct of an Audit in Accordance with ISAs

Complying with ISAs Relevant to the Audit

- 20. 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. A43-A47)
- 21. The auditor shall consider the entire text of an ISA to understand its requirements. The nature of the ISAs requires the auditor to exercise professional judgment in applying them. (Ref: Para. A48-A52)
- 22. The auditor shall not represent compliance with ISAs unless the auditor has complied with all 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 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. (Ref: Para. A53-A56)

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.
25. 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." (Ref: Para. A57-A60)

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 28, the auditor shall comply with 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 ISA is not relevant; or
 - (b) The circumstances envisioned in the requirement do not apply because the requirement is conditional and the condition does not exist. (Ref: Para. A61-A62)
28. In exceptional circumstances, the auditor may judge it necessary to depart from a relevant requirement 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. 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. A63)
29. The auditor shall apply the requirements in the context of the other material included in the ISA.

* * *

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.

Preparation of the Financial Statements (Ref: Para. 8(a))

- A2. As part of its responsibility for preparing and presenting the financial statements, management⁷ is responsible for identifying the applicable financial reporting framework, in the context of any relevant law or regulation. Management is also responsible for preparing and presenting the financial statements in accordance with that framework, and adequately describing that framework in the financial statements. 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.
- A3. 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").
- A4. 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

⁷ With oversight from those charged with governance.

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.

- A5. 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.
- A6. 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).
- A7. 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.
- A8. ISA 210, “Terms of Audit Engagements” establishes requirements and provides guidance on determining the acceptability of the applicable financial reporting framework. ISA 800 (Revised), “Special Considerations—Audits of Special Purpose Financial Statements and

Specific Elements, Accounts or Items of a Financial Statement”⁸ contains additional considerations for special purpose frameworks.

An Audit of Financial Statements, and Related Concepts

Materiality (Ref: Para. 13(a))

- A9. 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, but is not responsible for the detection of misstatements that are not material to the financial statements taken as a whole. 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. 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.

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

- A10. 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. Assessment of risks is a judgment rather than a precise measurement. Reasonable assurance is obtained by reducing audit risk to an acceptably low level.

Risks of Material Misstatement

- A11. The risks of material misstatement may exist at two levels: at the overall financial statement level, and, in relation to classes of transactions, account balances, and disclosures, at the assertion level.
- A12. 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.
- A13. Risks of material misstatement at the class of transactions, account balance, and disclosure level 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 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 that objective.⁹

⁸ Close off document approved in October 2006.

⁹ 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.

- A14. 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.
- A15. 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 influence the inherent risk related to a specific assertion. These latter factors include, for example, a lack of sufficient working capital to continue operations or a declining industry characterized by a large number of business failures.
- A16. Control risk is a function of the effectiveness of the design and operation of internal control in achieving the entity's objectives relevant to preparation of the entity's financial statements. Some control risk will always exist because of the inherent limitations of internal control.
- A17. 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.

Detection Risk

- A18. 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. The greater the risks of material misstatement the auditor believes exists, the less the detection risk that can be accepted. Conversely, the less risks of material misstatement the auditor believes exist, the greater the detection risk that can be accepted.
- A19. 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 adequate planning, proper assignment of personnel to the engagement team, the application of professional skepticism, and supervision and review of the audit work performed.

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

- A20. 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 and a firm's quality control procedures for client acceptance and continuance. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. Most of the auditor's work in forming the audit opinion consists of obtaining and evaluating audit evidence.
- A21. Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the risks of misstatement (the higher the 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.
- A22. Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for, 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.
- A23. 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 audit opinion, is a matter for the auditor to determine using professional judgment.

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

- A24. 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.

- A25. 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.

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

- A26. Professional skepticism is an attitude that involves the critical assessment, with a questioning mind, of the validity of audit evidence obtained. It includes recognizing that circumstances may exist that cause the financial statements to be materially misstated, and being alert to audit evidence that contradicts or brings into question the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. 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, of over generalizing when drawing conclusions from audit observations, and of using faulty assumptions in determining the nature, timing and extent of the audit procedures and evaluating the results thereof.
- A27. Maintaining an attitude of professional skepticism is necessary to the critical assessment of audit evidence. However, an audit rarely involves the authentication of documents, nor is the auditor trained as or expected to be an expert in such authentication. 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.

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

- A28. 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 at a reasonable cost.
- A29. 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.

- A30. 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.”
- 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.

Financial Reporting and Business Processes

- A32. 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.
- A33. 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

- A34. 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.
- 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, 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.

- 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.
- A37. 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 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.

Timeliness of Financial Reporting and the Balance between Benefit and Cost

- A38. 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.¹⁰ 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.
- A39. 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.

¹⁰ 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.

- 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.

Ethical Requirements Relating to an Audit of Financial Statements (Ref: Para. 17)

- A41. ISA 220, “Quality Control for Audits of Historical Financial Information,” sets out the engagement partner’s responsibilities with respect to ethical requirements. ISA 220 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. 18)

- A42. 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 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 important because there may have been changes in circumstances.

Conduct of an Audit in Accordance with ISAs

Nature of ISAs (Ref: Para. 20)

- A43. ISAs, taken together, provide the standards for the auditor’s work in fulfilling the objective of an audit. 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.
- A44. 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.
- A45. 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.

A46. The auditor may also conduct the audit in accordance with both ISAs and auditing standards of a specific jurisdiction or country. When the auditor conducts the audit in accordance with ISAs and auditing standards of a specific jurisdiction or country, in addition to complying with each of the ISAs relevant to the audit, it may be necessary for the auditor to perform additional audit procedures in order to comply with the relevant standards of that jurisdiction or country.

Considerations Specific to Audits in the Public Sector

A47. 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.

Contents of ISAs (Ref: Para. 21)

A48. In addition to objectives and requirements, an ISA contains 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 ISA, and definitions.

A49. 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, 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. 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.

A50. 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.

A51. 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.

A52. 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 description of other terms found in ISAs to assist in common and consistent interpretation and translation.

Objectives (Ref: Para. 24)

- A53. 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.
- A54. 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.
- A55. 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 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 315 (Redrafted) and 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.
- A56. 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):
- 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.

Achievement of Objectives and the Overall Objective of the Auditor (Ref: Para. 25)

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.

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.

Compliance with Relevant Requirements

Relevant Requirements (Ref: Para. 27)

A61. A requirement is relevant when the ISA is relevant in the circumstances of the engagement. In some cases, an ISA may not be relevant in the circumstances. For example, in a continuing engagement, nothing in ISA 510, "Initial Engagements—Opening Balances," is relevant. Similarly, ISA 800 (Revised) would not be relevant to an audit of general purpose financial statements.

A62. 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, any conditionality of a requirement will be explicit (e.g., the requirement to modify the auditor's opinion where there is a limitation of scope). In some cases, it may be implicit (e.g., the communication of material weaknesses in internal control identified during the audit to management and with those charged with governance, which depends on the existence of identified material weaknesses).

Departure from a Requirement (Ref: Para. 28)

A63. [Proposed] ISA 230 (Redrafted) establishes documentation requirements in those exceptional circumstances where the auditor departs from a requirement.



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