



Committee: IAASB Consultative Advisory Group

Meeting Location: London

Meeting Date: September 20-21, 2007

IAASB Clarity Project - Proposed Redrafted ISA Exposure Draft, and Final Redrafted ISAs for Approval

Objective of Agenda Item

1. The objective of this Agenda Item is to obtain the views of Representatives on matters relating to:
 - Proposed ISA 210 (Redrafted), “Agreeing the Terms of Audit Engagements” (*Exposure draft (ED) for approval at the September IAASB meeting*);
 - Proposed final ISA 230 (Redrafted), “Audit Documentation” (*Review of comments received on exposure and final ISA for approval at the September IAASB meeting*);
 - Proposed final ISA 260 (Revised and Redrafted), “Communication with Those Charged with Governance” (*Review of comments received on exposure and final ISA for approval at the September IAASB meeting*);
 - Proposed final ISA 720 (Redrafted), “The Auditor’s Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements” (*Review of comments received on exposure and final ISA for approval at the September IAASB meeting*);
 - Proposed final ISA 560 (Redrafted), “Subsequent Events” (*Review of comments received on exposure and final ISA for approval at the December IAASB meeting*); and
 - Proposed final ISA 610 (Redrafted), “The Auditor’s Consideration of the Internal Audit Function” (*Review of comments received on exposure and final ISA for approval at the December IAASB meeting*).
2. The approach adopted by the IAASB for purposes of implementing its Clarity project distinguishes revision and redrafting. Each of the above ISAs is subject to redrafting to reflect only the IAASB Clarity conventions and matters of clarity generally. Except for ISA 230 (Redrafted) and ISA 260 (Revised and Redrafted) which have been revised in 2005, the above ISAs have not been recently revised but are generally considered acceptable.
3. The Representatives are also asked to note that the Task Forces responsible for proposed ISAs 560 (Redrafted) and 610 (Redrafted) have not yet completed their deliberations on the comments received on those EDs. Accordingly, the matters highlighted below in respect of these ISAs are based only on staffs’ and the respective Task Forces’ initial considerations of the

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responses received. The Representatives are therefore cautioned that the analysis of issues and proposed treatments may change.

Matters for CAG Consideration

A. PROPOSED ISA 210 (REDRAFTED), “AGREEING THE TERMS OF AUDIT ENGAGEMENTS”

Introduction

4. The CAG considered proposed ISA 210 (Redrafted) at its April 2007 meeting, prior to the IAASB’s discussion of the draft. During the discussions at the IAASB April and July meetings, the Board agreed some restructuring of the requirements to improve the understandability of the draft.

Unacceptable Financial Reporting Frameworks and prescribed forms of opinion

5. The July 2007 draft version of proposed ISA 210 (Redrafted) included the following requirement:

“17. In some cases, law or regulation prescribes the wording of the audit opinion in terms that are significantly different from the requirements of the ISAs. In these circumstances the auditor shall evaluate:

- (a) Whether users might misunderstand the assurance obtained from the audit of the entity’s financial statements; and if so*
- (b) Whether additional explanation in the auditor’s report (see [proposed] ISA 706 (Revised and Redrafted) can mitigate possible misunderstanding.*

If the auditor concludes that additional explanation in the auditor’s report cannot mitigate possible misunderstanding [as a result of a specified form of report], the auditor shall not accept the audit engagement, unless prohibited by law or regulation from doing so. An audit which the auditor is thereby required to accept is not an audit conducted in accordance with the ISAs.” [Emphasis added]

6. The IAASB expressed concern that this requirement would seem to imply that an auditor could accept an engagement to report on financial statements prepared in accordance with an unacceptable financial reporting framework using a specified fair presentation form of opinion with no warning being given about the unacceptability of that framework (as would be required by an ISA audit).
7. Part of the concern appears to be that the requirement quoted above was thought to override other related requirements of the ISA in respect of unacceptable frameworks, and in particular the need for further explanation in the financial statements and an emphasis of matter in the audit report. The ISA 210 Task Force has responded in the proposed ISA by reordering paragraphs 14-17 under a new heading *Additional Considerations in Engagement Acceptance* and strengthening the last sentence in paragraph 14 (previously 17) to require the auditor not to refer, in the audit report, to the audit as being one conducted in accordance with the ISAs.

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8. In addition, a new explanatory paragraph has been introduced in the Application Material (A26)—in these circumstances the ISAs do not apply; however, the new guidance paragraph advises the auditor to consider including a statement in the auditor’s report that the audit is not conducted in accordance with the ISAs in order to avoid possible misunderstanding. Also, paragraph A29 has been added as explanation to make clear that the requirement relating to prescribed forms of opinion applies in addition to the auditor’s reporting considerations when required to accept an audit where the required framework is unacceptable and law or regulation requires a fair presentation form of opinion. **(Refer to paragraphs 14-17 and A26 and A29 of September 2007 IAASB Agenda Item 12-B)**

Matters for Consideration by the IAASB CAG:
The Representatives are asked for their views on the proposed material in paragraphs 14-17 and A26 and A29 of proposed ISA 210 (Redrafted).

Proposed ISA 210 (Redrafted) Material Presented – IAASB CAG REFERENCE PAPER

Available at
<http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0092>

Proposed ISA 210 (Redrafted) (September 2007
IAASB Agenda Item 12-B)

B. PROPOSED FINAL ISA 230 (REDRAFTED), “AUDIT DOCUMENTATION”

Documentation of Compliance with ISAs

9. Many respondents to ED-ISA 230 (Redrafted) welcomed the clarification that paragraphs A6 and A7 **(Refer to paragraphs A6 and A7 of September 2007 IAASB Agenda Item 5-B)** have brought into the ISA regarding the issue of documentation needing to provide evidence that the audit was performed in accordance with ISAs. Several of them, however, asked that the guidance further stress that it is neither necessary nor practicable for the auditor to document how the auditor has complied with *every requirement* in the ISAs.
10. The ISA 230 Task Force accepts that this suggestion is intended to prevent the extreme case of auditors documenting compliance with each and every requirement of the ISAs, whether relevant or not, but thinks that it could potentially be misinterpreted to imply that compliance with relevant requirements *sometimes* need not be demonstrated in the audit documentation. The Task Force believes that the negative consequences of this potential outcome would far outweigh the perceived benefits of making the suggested emphasis. The Task Force also believes that this statement would be unnecessary given the proposed clarification in paragraph 2(b) **(Refer to paragraph 2 (b) of September 2007 IAASB Agenda Item 5-B)** that compliance with the documentation requirements of this ISA and the specific documentation requirements of other relevant ISAs provides evidence that the audit was planned and performed in

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accordance with ISAs. Accordingly, the Task Force proposes that the respondents' suggestion not be accepted.

Matter for Consideration by the IAASB CAG:

The Representatives are asked for their views on whether it would be appropriate for the ISA to emphasize that it is neither necessary nor practicable for the auditor to document how the auditor has complied with <i>every requirement</i> in the ISAs.
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Documentation of Significant Professional Judgments

11. Paragraph A10 of ED-ISA 230 (Redrafted) (**Refer to paragraph A10 of September 2007 IAASB Agenda Item 5-B**) drew a relatively large number of comments from respondents. A number of them were concerned about the use of the word “would” in the first line of the paragraph (i.e. “Examples of circumstances in which it *would* be appropriate to prepare audit documentation relating to ...”). They suggested that the verb “would” in that context could cause confusion as to whether the examples listed were intended to be requirements or not.
12. The Task Force was not convinced that the use of “would” in the application material should cause difficulties. The Task Force believes that the perception of an issue arises more from a misunderstanding. The IAASB discussed the issue when finalizing the exposure draft and agreed that using “would” in the application material was appropriate. This is because the examples are so drafted as to represent cases where a specific requirement applies, and not as examples of what might be done out of a number of possibilities to fulfill a specific requirement. Consequently, in the circumstances set out in paragraph A10 of the application material, documentation *is* required by the ISA. The Task Force did not agree with the suggestion from one of the respondents that “would” in this case should be replaced by the word “may” as this would incorrectly suggest that documentation might not be mandatory in the circumstances. Accordingly, the Task Force proposes that no change be made to that wording.
13. The second bullet in paragraph A10 of the ED indicated that it would be appropriate to document the basis for the auditor’s conclusions where the auditor considered it necessary to obtain further audit evidence by performing significant further audit procedures in addition to those necessary to meet the requirements of an ISA. Two respondents argued that in most circumstances, the ISAs are written to require the auditor to design further audit procedures to respond to assessed risks. They therefore questioned whether it would be easy to identify when the auditor has performed procedures beyond those necessary to meet the requirements of an ISA. They noted that documentation requirements in other ISAs already ensure that documentation will be prepared to demonstrate how further audit procedures performed are sufficient to appropriately respond to the assessed risks. Accordingly, they suggested that this bullet be deleted.
14. The Task Force sees the scope for confusion, and also considers that this may suggest a need to document decisions to do further work beyond that clearly flowing from the requirements of the ISAs. This may provide a disincentive to auditors to do what they think is necessary, and if it

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were to have this effect it would be against the public interest. The Task Force therefore proposes that this bullet be deleted.

Matters for Consideration by the IAASB CAG:

The Representatives are asked for their views on:

- (a) Whether the use of the verb “would” in the application material is appropriate to represent cases where a specific requirement applies; and
- (b) Whether it would be appropriate to delete the second bullet of paragraph A10 of the ED.

The Representatives are also welcome to express views on any other matter discussed in the IAASB agenda paper. **(Refer to September 2007 IAASB Agenda Item 5-A)**

Proposed final ISA 230 (Redrafted) Material Presented – IAASB CAG REFERENCE PAPERS

Available at
<http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=3297>

Proposed final ISA 230 (Redrafted) – Issue Paper
(September 2007 IAASB Agenda Item 5-A)

Available at
<http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=3298>

Proposed final ISA 230 (Redrafted) (September 2007 IAASB Agenda Item 5-B)

C. PROPOSED FINAL ISA 260 (REVISED AND REDRAFTED), “COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE”

Objectives

15. ED-ISA 260 (Revised and Redrafted) stated the following objectives:

“The objectives of the auditor are to:

- (a) Communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, and the scope and timing of the audit;*
- (b) Obtain from those charged with governance, information relevant to the audit; and*
- (c) Provide those charged with governance with timely observations arising from the audit that are relevant to their responsibility to oversee the financial reporting process.”*

16. Though most of the respondents who commented on the objectives agreed, or agreed with minor qualification, with the objectives as exposed, several others expressed concern about the way in

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which the idea of “two-way communication” had been reflected in the objectives. In particular, it was noted that:

- The objectives should give more emphasis to effective two way communication **(Refer to paragraph A2(a) of September 2007 IAASB Agenda Item 9-A)**; and
- The proposed reference in the objectives to the auditor obtaining information from those charged with governance (see objective (b) above) is inappropriate in that an auditing standard cannot impose an obligation on those charged with governance to provide information, which is a precondition for the auditor to obtain that information from them. **(Refer to paragraph A2(b) of September 2007 IAASB Agenda Item 9-A)**

17. The ISA 260 Task Force is of the view that the obligation imposed on the auditor with respect to objectives, as described in proposed ISA 200 (Revised and Redrafted), “Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing”¹ appropriately reflects the 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.”² This view allows for the addition of a reference to two-way communication in the objectives, as proposed in the revised draft ISA 260 (Revised and Redrafted). **(Refer to paragraph 5 of September 2007 IAASB Agenda Item 9-C)** Without detracting from the primacy of the matters mentioned in objectives (a) to (c), this reference makes it clear that two-way communication is important, as acknowledged in paragraphs 3, 17 (and related application material), and A1. It also allows for the possibility of an objective that states a desired outcome over which the auditor cannot exercise absolute control, as is the case with objective (b).

Matters for Consideration by the IAASB CAG:
The Representatives are asked for their views on the Task Force’s proposed revised wording for the objectives.
The Representatives are also welcome to express views on any other matter discussed in the IAASB agenda paper. (Refer to September 2007 IAASB Agenda Item 9-A)

Proposed final ISA 260 (Revised and Redrafted) Material Presented – IAASB CAG

REFERENCE PAPERS

Available at
<http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=3312>

Proposed final ISA 260 (Revised and Redrafted) –
Issues Paper (September 2007 IAASB Agenda
Item 9-A)

¹ Available from <http://www.ifac.org/Guidance/EXD-Details.php?EDID=0079>

² See Explanatory Memorandum to ED-ISA 200 (Revised and Redrafted).

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Available at
<http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=3314>

Proposed final ISA 260 (Revised and Redrafted)
(September 2007 IAASB Agenda Item 9-C)

D. PROPOSED FINAL ISA 720 (REDRAFTED), “THE AUDITOR’S RESPONSIBILITY IN RELATION TO OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS”

Objective

18. ED-ISA 720 (Redrafted) stated the following objective:

“The objective of the auditor is to avoid being associated with other information that may undermine the credibility of the audited financial statements, through:

- (a) Reading the other information and responding appropriately to identified material inconsistencies with the audited financial statements; and*
- (b) Responding appropriately to misstatements of fact in the other information that are unrelated to matters appearing in the audited financial statements and of which the auditor becomes aware when reading the other information for the purpose of identifying material inconsistencies.”*

19. The form of this objective is consistent with IAASB’s view that though the objective should reflect the outcome that the ISA is directing the auditor to achieve, setting it at too high a level may make it ineffective. Accordingly, the IAASB agreed that the objective needed to be specific enough to assist the auditor in: determining what is to be accomplished; understanding how the objectives and requirements relate; deciding what more, if anything, needs to be done; and evaluating whether they have been met. That is, the objective is the desired end result, but in this case it may be necessary to state the means to make the objective more effective.

20. The majority of respondents to the ED were of the view that the objective is inappropriate. Many were concerned with the use of the expression “avoid being associated with”, in that it is not proactive in terms of protecting the users of the financial statements and the other information”. Further, many respondents objected to the inclusion of the sub-paragraphs (a) and (b) in the objective. They contended that these sub-paragraphs are too procedural, make the objective too long or duplicate the requirements.

21. The ISA 720 Task Force recommends that the objective be modified to both delete the reference to “auditor association” and to delete the sub-paragraphs (a) and (b), and to redraft the objective as follows (taking account of working suggested by a number of respondents):

“The objective of the auditor is to respond appropriately when documents containing audited financial statements include other information that could undermine the credibility of those financial statements and the auditor’s report thereon.”

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(Refer to paragraphs 11-14 of September 2007 IAASB Agenda Item 4, and paragraph 4 of September 2007 IAASB Agenda Item 4-A)

Matters for Consideration by the IAASB CAG:

The Representatives are asked for their views on the Task Force's proposed revised wording for the objective, taking account of the general form that is desirable for the ISAs and the specific concerns raised by respondents.

The Representatives are also welcome to express views on any other matter discussed in the IAASB agenda paper. ***(Refer to September 2007 IAASB Agenda Item 4)***

Proposed final ISA 720 (Redrafted) Material Presented – IAASB CAG REFERENCE PAPERS

Available at
<http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=3295>

Proposed final ISA 720 (Redrafted) – Cover Sheet
(September 2007 IAASB Agenda Item 4)

Available at
<http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=3293>

Proposed final ISA 720 (Redrafted) (September
2007 IAASB Agenda Item 4-A)

E. PROPOSED FINAL ISA 560 (REDRAFTED), “SUBSEQUENT EVENTS”

The Restriction of Subsequent Events Procedures and Dual Dating of the Auditor's Report for Amended Financial Statements

22. Paragraphs 11, 16 and 17 of extant ISA 560, “Subsequent Events” include guidance that, when management has revised the financial statements due to facts discovered after the date of the auditor's report, the auditor would provide management with, or issue, a new auditor's report; the auditor would extend the subsequent events procedures referred to in paragraph 5 of the ISA to the date of the new auditor's report. Furthermore, paragraph 17 requires that the new auditor's report include an emphasis of matter paragraph referring to the note in the financial statements that more extensively discusses the reason for the revision of the previously issued financial statements and to the earlier report issued by the auditor.
23. However, paragraph 17 of extant ISA 560 also provides for an exception by allowing the auditor to restrict the subsequent events procedures regarding the revised financial statements to the effects of the subsequent event that necessitated the revision, when local regulations in the country permit this and the new auditor's report contains a statement to that effect.
24. In developing the ED-ISA 560 (Redrafted), some IAASB members took the view that this exception allows auditors to limit their subsequent events procedures in cases when dating the report both as at the date of the original report and as at the date of the amendments (“dual

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dating”) is not prohibited by local regulations. Some other IAASB members contended that paragraphs 11 and 16 do not permit the restriction of subsequent events procedures to amendments of the financial statements and such “dual dating” of the auditor’s report unless specifically provided for by local regulations. The majority of the IAASB took the former view.

25. The IAASB agreed to make this clearer in the course of redrafting the ISA; this involved turning some guidance into a requirement. Further, rather than allow the exception to be based on local regulations, the IAASB chose to base the exception on whether the financial reporting framework allows management to restrict the amendment of the financial statements to the effects of subsequent events causing the amendment and whether those responsible for approving the amended financial statements are permitted to restrict their approval to that amendment. As local regulations to which the financial statements are subject are encompassed within the definition of the applicable financial reporting framework, this would not limit the effects of local regulation on this matter.
26. As the IAASB’s interpretation of the extant ISA, and the manner in which this was clarified, may be perceived by some as a substantive change from the extant ISA, the IAASB sought comments on this issue. **(Refer to paragraphs 10, 11-12, and 16-17 of ED-ISA 560 (Redrafted))**
27. Though the majority of respondents to ED-ISA 560 (Redrafted) expressed support for the proposed treatment, a few took the view that certain of the proposed changes to ISA 560 (in particular, dual dating) are substantive in nature – i.e., beyond clarity. A few respondents suggested the text of extant ISA 560 referring to local regulation should be retained rather than changed to refer to the financial reporting framework.
28. Others noted that dual dating would be confusing to users and auditors because it is not clear what “dual dating” is.

Preliminary Proposed Disposition

29. Since there were different views on whether the extant ISA allowed dual dating, it is apparent that the extant ISA was unclear on the point. Clarification can only be achieved by making a decision to allow or disallow dual dating. Hence, the ISA 560 Task Force views this as clarification albeit that it may be seen by some as a substantive change.
30. With respect to the proposed elevation of guidance material to a requirement, the Task Force notes that the majority of respondents did not disagree with the treatment and that elevation was necessary to make clear that dual dating is permitted.
31. With respect to suggestions that the drafting should revert to the reference to local legislation as opposed to the financial reporting framework, the Task Force notes that a number of financial reporting frameworks, such as US GAAP, Canadian GAAP and the German Principles of Proper Accounting, contain the relevant requirements, rather than law or regulation of those jurisdictions. Were this standard not to permit dual dating, where the financial reporting framework allows management to restrict its procedures to specific amendments, the auditor

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would have additional responsibilities beyond those of management. To respond to the comments that local regulation should be retained, although as indicated above this may not strictly be necessary, the Task Force proposes to amend the text of paragraph 11 of the redrafted ISA 560 to read "...when law, regulation or the financial reporting framework allows management ..."

Matters for Consideration by the IAASB CAG:
The Representatives are asked for their views on the Task Force's preliminary proposed treatment of the "dual dating" issue.

Application of the Requirements of ISA 560 to Securities Offering Documents

32. The first sentence of paragraph 20 of extant ISA 560 includes the following bold-lettered sentence:

"In cases involving the offering of securities to the public, the auditor should consider any legal and related requirements applicable to the auditor in all jurisdictions in which the securities are being offered."

33. Furthermore, paragraph 20 of extant ISA 560 includes additional guidance on the application of subsequent events procedures in relation to such documents.
34. Through the clarification process, the IAASB has identified a number of other ISAs that address matters in relation to securities offering documents, including, for example, ISA 720, "Other Information in Documents Containing Audited Financial Statements." The auditor's responsibilities in relation to such securities offering documents are ordinarily set forth in local securities laws and regulations. Such responsibilities may therefore vary significantly among different jurisdictions. The IAASB questioned whether it would be appropriate for the ISAs to retain the references to auditor's responsibilities in relation to such documents without having undertaken a specific project to understand the nature and scope of these responsibilities in various jurisdictions. Consequently, the first sentence of the bold lettered paragraph 20 of extant ISA 560, together with its accompanying guidance, has been redrafted and included in the application material of ED-ISA 560 (Redrafted). The IAASB sought comments on its proposed treatment of this issue. **(Refer to ED-ISA 560 (Redrafted))**
35. Many respondents expressed support for the proposed treatment, and none suggested that text relating to securities offering documents be retained as a requirement. Some respondents, whilst they agreed that paragraph 20 of extant ISA 560 should not be treated as a requirement, suggested it be deleted altogether. A few respondents took the view that there is a need for international standards on investment circular reporting. One respondent agreed with the disposition of the matter into the application guidance on the condition that a new, high-priority project be commenced on this issue.

Preliminary Proposed Disposition

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36. The Task Force agrees that the ISAs govern audits, but not other engagements in relation to financial information. However, the text of paragraph A2 of ED ISA 560 (Redrafted) (**Refer to paragraph A2 of ED-ISA 560 (Redrafted)**) merely draws attention, by means of an example, to potential considerations that might otherwise be overlooked. As such, this guidance serves to alert auditors only and is useful. Deletion might be argued to go beyond the Clarity Project and the Task Force recommends that it be deferred until the IAASB can complete a project covering investment circular reporting, as is requested by some. The Task Force notes that, given the plurality of support for the proposed treatment and the suggestion for a new project, the guidance should be retained.

Matters for Consideration by the IAASB CAG:
The Representatives are asked for their views on the preliminary proposed disposition of the application of the requirements of proposed ISA 560 (Redrafted) to securities offering documents.

Proposed final ISA 560 (Redrafted) Material Presented – IAASB CAG REFERENCE PAPERS

Available at
<http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0092>

Exposure Draft, Proposed ISA 560 (Redrafted)

F. PROPOSED FINAL ISA 610 (REDRAFTED), “THE AUDITOR’S CONSIDERATION OF THE INTERNAL AUDIT FUNCTION”

37. In developing ED-ISA 610 (Redrafted), some IAASB members and IAASB CAG Representatives indicated that ISA 610 would benefit from a full revision in the future. While accepting that ED-ISA 610 (Redrafted) is a result of the Clarity project and that it falls in the category subject to limited redrafting to reflect only the conventions and matters of clarity generally, a number of respondents to the ED also expressed the same view.
38. Accordingly, the draft proposed Consultation Paper, *IAASB Strategy 2009-2011*, has identified the revision of ISA 610 as one possible action to implement the proposed strategy. (**Refer to CAG Agenda Item E.1**)