

IAASB CAG REFERENCE PAPER

IAASB CAG Agenda (March 2008)

Agenda Item C.3.1.1

Clarity—ISA 200 (Revised and Redrafted) – Issues Paper – March 2008 IAASB Agenda Item 7-A

ISSUES PAPER

Exposure Draft (ED), Proposed ISA 200 (Revised and Redrafted)

Introduction

1. Respondents generally supported proposed ISA 200 (Revised and Redrafted), with a significant majority supporting the incorporation of provisions of the amended Preface¹ in the ISA. Respondents also supported the IAASB's basis for changing from the 'aim to achieve' wording with respect to the obligation attaching to individual objectives, and many noted that the proposed obligation is an improvement on the Preface. (Consequential changes to the Preface will be presented with the draft ISA for approval in June.) In addition, the majority of respondents supported the inclusion of the overarching bold type requirement in paragraph 2 of extant ISA 500² for the auditor to obtain sufficient appropriate audit evidence.³
2. The significant issues raised by respondents related to the following:
 - **Overall objectives of the auditor** – The clarity and general structure of the 'Overall Objective' section, the elements of the overall objective of the auditor and the consequence of failure to achieve them.
 - **Obligation attaching to objectives stated in ISAs** – Whether the auditor's obligations in respect of individual objectives and a failure to achieve an objective are clear and appropriate.
 - **Inherent limitations of an audit** – The balance and tone of the discussion, its placement, and its completeness and accuracy.
 - **Professional judgment and professional skepticism** – The emphasis given to these concepts in the ISA, and the balance and tone of the discussion.
 - **ISAs' application and other explanatory material** – Whether the authority of, and the responsibilities of the auditor in connection with, such material are clear.

¹ Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services.

² ISA 500, "Audit Evidence."

³ A small minority of respondents (ACAG, CICA, EYG, IdW) to ED-ISA 200 felt that it was inappropriate to split the guidance explaining the concept of sufficient appropriate audit evidence between two ISAs, and several respondents to ED-ISA 500 suggested that ISA 500 should contain a requirement and discussion similar to that in ISA 200 despite the repetition that would arise. These matters are further discussed in the IAASB March 2008 Agenda Item on ISA 500 (Redrafted).

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3. Respondents also commented on the conforming amendments to ISA 200 arising from proposed ISA 580 (Revised and Redrafted)⁴. These comments paralleled those received on ED-ISA 580 which were discussed by the IAASB at its September and December 2007 meetings, and accordingly are not repeated here. The enclosed draft ISA 200 incorporates the agreed conforming amendments arising from the approval of ISA 580 (Revised and Redrafted).

Significant Issues

A. Overall Objectives of the Auditor

A.1 CLARITY AND STRUCTURE OF THE SECTION

4. ED-ISA 200 included a section headed ‘Overall Objective of the Independent Auditor’, consisting of paragraphs 4-6 on the objective of an auditor and of the audit; 7-8 on the responsibility of management for the financial statements; 9-13 describing an audit and listing related concepts; and 14-15 on auditor independence. A number of aspects of the structure and contents of this section caused concern.
5. Nearly half of all respondents were unhappy with ED paragraphs 4-6. They noted significant confusion arises from having two objectives stated (i.e., one for the audit and another for the auditor) and were not convinced of the need for discussion of both in the ‘Overall Objective’ section of the ISA. The majority of these respondents⁵ were of the view that the ISA should focus only on the overall objective of the auditor. A few of the respondents⁶ suggested that the focus should only be on the objective of an audit, or that the objectives be combined.
6. The majority of respondents expressed other concerns about the structure of this section of the ISA. It was unclear to many how to interpret the various sub-sections (e.g., auditor independence, preparation of the financial statements) in relation to the overall objective. Further, the general inconsistency in how material was treated created a lack of clarity (e.g., some matters were discussed partially in each of the objective, concepts, requirements and application material sections). Respondents also questioned the logic of the introduction and flow of the concepts listed in ED paragraphs 7-8 and 13-15 as well as the placement and completeness of the discussion of the audit risk model in ED paragraph 11.
7. The Task Force believes that a number of these concerns could be resolved, and the overall clarity of the ISA improved, by restructuring the “Introduction” and “Overall Objective of

⁴ Proposed ISA 580 (Revised and Redrafted), “Written Representations” included proposed conforming amendments to ISA 200 relating to the premises on which an audit is conducted and management’s responsibilities with respect to internal control and for providing complete information to the auditor.

⁵ APB, Basel, BT, CEBS, CIPFA, EFAA, ICAEW, ICAS, IOSCO, IRBA, OAG, NAO, OAG

⁶ BDO, FEE, IBR-IRE, KPMG-SA, KPMG-IFRG

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the Independent Auditor” sections of the ISA. The Task Force’s proposal is shown in **paragraphs 3-13** in Agenda Item 7-B.

8. The proposed restructuring has the following benefits. First, it provides a description of the nature and purpose of an audit as necessary context for the objectives of the auditor. The description gives greater prominence to matters such as the public interest purpose of an audit and certain essential concepts (e.g., reasonable assurance), which a number of respondents felt should be included in the introductory section of the ISA.
9. Secondly, it avoids presenting two objectives – one for the audit and another for the auditor –, thereby providing greater focus on the overall objectives of the auditor. This allows ED paragraph A1, which sought to reconcile the two objectives but was found to be confusing by respondents, to be deleted.
10. Thirdly, it eliminates the need for a list of concepts and allows the related application material to be built into the discussion of the related requirements. This avoids discussion of similar matters in different places.
11. Finally, it brings the structure in line with that used in other clarified ISAs.

A.2 ELEMENTS OF THE OVERALL OBJECTIVE

12. Several respondents questioned the appropriateness of the elements of the overall objective of the auditor in ED paragraph 5 and made various suggestions to enhance its clarity. These included:
 - Deleting the ‘reporting’ element of the objective, as it is covered by the explanation of an audit.
 - Incorporating the definition of reasonable assurance in the objective, and making reference to the public interest as the basis for the objective.
 - Focusing the objective solely on the expression of an opinion.
13. The Task Force believes that both the elements of (a) obtaining reasonable assurance and (b) reporting are needed and should be appropriately identified in the overall objectives of the auditor. Combining them, or excluded one or the other, would not be appropriate; for example, to delete the ‘reporting’ element from the objectives would create a gap with the ISAs dealing with reporting and communication.
14. The Task Force has, however, redrafted the overall objective of obtaining reasonable assurance so as to confirm its role as the basis for the auditor’s opinion on the financial statements.
15. The Task Force also notes that the wording in the ED paragraph 5 “...to report on the financial statements in accordance with the auditor’s findings” may in fact be too narrow. Accordingly, it has deleted the phrase “on the financial statements” to allow the objectives

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to encompass other reporting and communication responsibilities covered by the ISAs, and to avoid suggesting that the auditor in all cases must express an opinion on the financial statements. The Task Force has also introduced further explanation of the general reporting and communication responsibilities of the auditor, to convey what that element of the objectives was meant to cover.

16. See **paragraphs 9-10 and 12** in Agenda Item 7-B.
17. Related to the above, one respondent⁷ suggested that the ISA should present separate objectives covering audits relating to both fair presentation frameworks and compliance frameworks. The Task Force has not adopted this suggestion, in order to avoid complicating significantly the structure to the ISA. It has, however, brought forward material in paragraphs 3 and 8 of Agenda Item 7-B to emphasize the applicability of the ISAs to fair presentation frameworks.

A.3 CONSEQUENCE OF FAILURE TO ACHIEVE THE OVERALL OBJECTIVES

18. A few respondents⁸ questioned whether the paragraph that immediately followed the overall objective and which explained that a failure to achieve that objective would in all cases lead to a modified opinion or withdrawal from the engagement (the ‘consequence paragraph’ – ED paragraph 6) was logical and consistent with the overall objective. In addition, a few respondents⁹ were concerned in the public interest with the option of withdrawing from the engagement when the overall objective cannot be achieved (as opposed to issuing the appropriate audit report), and with the fact that in some jurisdictions withdrawal is not legally permitted.
19. The Task Force is of the view that the original ‘consequence paragraph’ did in fact have some logic issues:
 - It suggested that a failure to obtain reasonable assurance would require modification to the auditor’s report. However, this would have been the action taken if the auditor complied with second overall objective to report in accordance with the auditor’s findings.
 - It is a perfectly valid outcome of the audit for the auditor to obtain reasonable assurance that a misstatement does in fact exist (and report accordingly). However, the reference to modification to the auditor’s report as a ‘consequence’, in general terms, may suggest to some something different.
 - The ISAs do envisage circumstances that prevent the auditor from reporting. Accordingly, the link to the reporting element of the overall objectives may have been slightly unclear.

⁷ APB.

⁸ CEBS, EC, EFAA, IOSCO

⁹ EC, ICPAS, OAG, SNAO

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20. The Task Force believes that the ‘consequence paragraph’ should focus on those circumstances where reasonable assurance cannot be obtained and a qualified opinion is insufficient to articulate the gravity of the circumstances. In such cases a disclaimer or withdrawal is necessary.
21. See **paragraph 13** in Agenda Item 7-B.

Matters for IAASB Consideration

The IAASB is asked whether it agrees with:

- (a) The proposed restructuring of the “Introduction” and “Overall Objectives of the Independent Auditor” sections of ED-ISA 200¹⁰; and
- (b) The proposed changes to the overall objectives of the auditor and the explanation of the consequence of failure to achieve those objectives.

B. The Auditor’s Obligation in respect of Objectives Stated in ISAs

B.1. RELATIONSHIP OF OBJECTIVES AND REQUIREMENTS

22. ED paragraph 24 stated:

“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.”

23. Several respondents¹¹ were concerned about the tone of the second part of ED paragraph 24, in particular the statement that “The proper application of the requirements of the ISAs will ordinarily provide a sufficient basis for the auditor’s achievement of the objectives.” They were of the view that if ISAs only include those requirements that are applicable on

¹⁰ The IAASB is asked to note that the matter of the content and placement of the discussion of inherent limitation of an audit is addressed in Issue C below.

¹¹ APB, Basel, CEBS, EC, IOSCO, KPMG, PCAOB

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virtually all audits, they will not include requirements relevant to specific circumstances that do not exist in virtually all audits; it is important that auditors consider such circumstances. Further, it was suggested that the sentence could be read as implying that the auditor's responsibility is limited to satisfying the requirements of the ISAs.

24. In addition, one respondent¹² was of the view that it is not appropriate to suggest that the auditor completes the requirements set out in the ISAs before considering whether further procedures need to be performed in pursuance of the objectives.
25. The Task Force agrees with these observations and, accordingly, it has redrafted ED paragraphs 23, 24 and A53 so that the role of the objectives in relation to the requirements of an ISA is clear. In addition, the Task Force has changed the statement in ED paragraph 24 that the auditor uses the objective "...having complied with relevant requirements" to state that the objectives be used "in planning and performing an audit."
26. **See paragraphs 22 and A66** in Agenda Item 7-B.

B.2 USING OBJECTIVES AND THE NEED TO PERFORM OTHER PROCEDURES

27. A few respondents¹³ were of the view that it is only when sufficient appropriate audit evidence has not been obtained that other audit procedures need to be performed; accordingly the word connecting ED paragraph 24(a) and 24(b) (see paragraph 22 above) should be "or". It was argued that there are only a few ISAs that do not relate directly to obtaining audit evidence (e.g., ISA 230), and it is difficult to envisage circumstances when the auditor would determine that complying with requirements in those ISAs can fail to achieve the individual objective therein. In any event, it was suggested that ED paragraph 24 be reconsidered to better explain under what circumstances other procedures will need to be performed and whether it is or is not expected to be a common occurrence.
28. The Task Force does not believe it appropriate to limit the auditor's use of the objectives solely to evaluating whether sufficient appropriate audit evidence has been obtained in the context of the overall objectives of the auditor (i.e., to retain only ED paragraph 24(a)). ED paragraph 24(b) draws the auditor's consideration to whether more needs to be done in the context of the subject of a particular ISA irrespective of whether that ISA is directly linked to the obtaining of sufficient appropriate audit evidence. This reinforces the strength of the obligation attaching to the objectives which are intended to be effective in all ISAs.
29. However, to improve the clarity of the requirement, the Task Force has reversed the order of ED paragraph 24 (a) and (b) (thereby making the flow of the requirement more logical)

¹² APB

¹³ AICPA, BT, KPMG, PwC. It should also be noted that a number of other respondents (APB, FEE, CNCC and IBR-IRE) stated that they agreed with the requirement as proposed, though in paraphrasing the requirement in their comment letters, they used the following description: 'obtain sufficient appropriate audit evidence or perform other procedures.'

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and improving the wording and cross-referencing of the requirement. Further, it has introduced new application material that clarifies that in the circumstances of an engagement, there may be particular matters that require the auditor to consider further the audit procedures necessary to meet the objectives specified in the ISAs.

30. See **paragraphs 22(a) and (b) and A69** in Agenda Item 7-B.

B.3 FAILURE TO ACHIEVE AN OBJECTIVE AND DOCUMENTATION

31. Several respondents¹⁴ expressed strong concern about the statements in ED paragraph 25 that “Failure to achieve an objective represents a significant matter requiring documentation in accordance with [proposed] ISA 230 (Redrafted)¹⁵”, and the related application material in A60. Whilst these respondents accepted that matters of such significance that an objective would not be met would generally be documented in the working papers as significant matters, they noted that such documentation would not be in the context of a failure to meet a particular objective. It was explained that any particular audit step performed may support the achievement of one or more objectives, with the key decision being whether a significant matter identified during the audit affects the audit opinion – not which objective it relates to. Further, difficulty in practice will arise since audit methodologies are generally elaborated on the basis of the requirements of the ISAs and audit files are structured around the subject matter; neither is built using the achievement of individual ISAs or their objectives. The implication is the creation of new checklists that do not add value to the audit but in fact could have a negative impact on audit quality.
32. Further, some respondents¹⁶ did not feel it appropriate for ED paragraph 25 to state that “In most cases, the failure to achieve an objective will prevent the achievement of the overall objective of the auditor.” Some viewed that this would depend on the circumstances of the particular engagement and overemphasizes the importance of the objectives compared to the achievement of the overall objective. Other respondents also noted their approval that the ISA recognized that there may be circumstances where failure to achieve an individual objective does not necessary result in a failure to achieve the auditor’s overall objective.
33. In contrast, two respondents¹⁷ were of the view that the ISA should be clear on the point that non-achievement of any objective, while still issuing an unmodified report, would be a very exceptional matter. Accordingly, it was suggested that an explicit statement should be made requiring the documentation of why an objective could not be achieved and, if it were the case, how the auditor was able to determine that the overall objective of the auditor was

¹⁴ BT, CNCC, DFCG, EYG, ICAEW, ICAS, JICPA, PwC

¹⁵ ISA 230 (Redrafted), “Audit Documentation.”

¹⁶ CNCC, DTT, EYG, CNCC, IRBA, JICPA

¹⁷ CPAB, IOSCO

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still met. Further, a few respondents¹⁸ felt that it is inappropriate to single out in the application material (ED paragraph A58) a few ISAs as containing objectives which, if not achieved, may nevertheless not prevent the auditor from achieving the overall objective.

34. The Task Force notes that the majority of those who commented on the requirement to document the failure to meet an objective were content with the draft, and considers that such a failure should be ascertainable from the proper use of the objectives as required by the ISA. Accordingly, the Task Force is of the view that the original wording contained in ED-ISA 200 is broadly appropriate. However, the Task Force agrees that the statement that “In most cases, the failure to achieve an objective will prevent the achievement of the overall objective of the auditor” may represent an unwarranted presumption and that it should be deleted.
35. The Task Force is also of the view that some refinement of the related application material is necessary to provide further clarity. Accordingly, it proposes that the application material state that documentation in accordance with ISA 230 (Redrafted) provides evidence of the auditor’s basis for a conclusion about the achievement of the overall objectives of the auditor; that it is unnecessary to document separately (e.g., in a checklist) that individual objectives have been achieved; but that documentation of a failure to achieve an individual objective is important to the auditor’s consideration of whether such a failure has prevented the auditor from achieving the overall objectives. This would avoid imposing a requirement to document the achievement of each objective, which was not called for by respondents but which some thought might be inferred. In making this clear the Task Force is seeking to avoid imposing unnecessary documentation at a time when auditors are concerned about growing documentation requirements, while retaining the ED’s proposal for documentation when it matters.
36. The Task Force also proposes to introduce application material that helps guide the auditor as to the circumstances or conditions that may give rise to a failure to achieve an objective, and to reposition the obligation after the requirements dealing with compliance with the requirements of ISAs. (This placement appears more logical, given that a possible reason for failing to achieve an objective includes a failure to comply with the relevant requirements of an ISA.)
37. **See paragraphs 25 and A74-A75 in Agenda Item 7-B.**

Matter for IAASB Consideration

The IAASB is asked whether it agrees with the proposed clarification of the obligation attaching to objectives and in particular, the Task Force’s proposed disposition of the issue of documentation.

¹⁸ EC, HKICPA, IOSCO, PCAOB

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C. Inherent Limitations of an Audit

38. The majority of respondents supported the amplification of the discussion of the inherent limitations of an audit in ED-ISA 200. Several respondents,¹⁹ however, found the discussion too extensive and excessively negative, and were of the view that it did not convey a balanced view on limitations versus professional responsibilities. They were concerned that the material may not set the expected high standard for what the auditor should achieve in an audit or may foster perceptions that minimize the value of audits. It was recommended that the IAASB provide a more concise and balanced discussion related to this topic. It was also suggested that inherent limitations be discussed as part of reasonable assurance or explained as part of the audit risk model.²⁰
39. In addition, a few respondents²¹ variously noted that some of the material may not be correct. For example, whether the audit does or does not address reporting on internal control (as referred to in ED paragraph 29) and inherent risk relating to systems of internal control (as referred to in ED paragraph A33) are not inherent limitations of the audit itself.
40. Notwithstanding concerns over length, three respondents²² invited the IAASB to address centrally and comprehensively the inherent limitations, including those specific to other ISAs. One of the respondents²³ was strongly of the view that all discussion of inherent limitations should be centralized in ISA 200 and that individual ISAs not provide further explanation of the limitations even if they are of particular relevance to the subject matter of an ISA.
41. The Task Force agrees with many of the suggestions made by respondents. Accordingly, the Task Force proposes that the ISA be restructured so that the discussion of limitations is presented as part of the discussion of reasonable assurance and the application material relating to the requirement addressing audit risk and the sufficiency and appropriateness of audit evidence. In the context of the overall ISA, the result is a more balanced presentation of the responsibilities of the auditor and matters that influence or further define the limit of those responsibilities. This also has the conceptual benefit of further explaining reasonable assurance, as opposed to explaining why absolute assurance cannot be obtained (as one respondent²⁴ suggested).
42. The Task Force proposes to emphasize that the inherent limitations broadly give rise to the fact that audit evidence can often only be persuasive rather than conclusive. It is this that principally creates the inability to obtain absolute assurance; setting this out thereby allows

¹⁹ AIA, Basel, CEBS, EC, IOSCO, PCAOB

²⁰ A few other respondents (FEE, ICAEW, JICPA) also suggested that a summary of the inherent limitation could be included as part of the introductory section of the ISA, to give it appropriate prominence.

²¹ Basel, DFCG, IOSCO, NIVRA, SNAO

²² EC, IdW, NIVRA

²³ EC

²⁴ IdW

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the discussion of the various limitations to explain why this is so. In addition, the Task Force has also expanded the references to other ISAs that discuss inherent limitations related to particular assertions or subject matters covered by those ISAs. (The Task Force does not recommend that these discussions be removed from the individual ISAs, as they serve to place the requirements of those ISAs into context, as one respondent²⁵ noted.)

43. In addition to the above, the Task Force has made a number of drafting changes and repositioned material that does not directly related to the discussion of the inherent limitations of an audit.
44. **See paragraphs A39-A47** in Agenda Item 7-B.

C.1 REASONABLE ASSURANCE

45. A few respondents²⁶ were strongly of the view that the definition of reasonable assurance should include reference to the inherent limitations of an audit to ensure readers better understand the level of assurance envisioned by an audit. They noted that the ISA already explains that an audit is subject to inherent limitations and thereby extending the definition would neither be a substantive change or inconsistent with the substance of the standard.
46. This matter has been previously deliberated by the IAASB. It was concluded that it is not possible to address adequately the issue of the meaning of reasonable assurance through change to the definition. Nor did the IAASB believe it appropriate to attempt to do so within the scope of this project, as even minor changes to the definition are likely to raise questions about whether there is an intention to change the nature of reasonable assurance, which there is not. The IAASB agreed that to go further in any discussion of reasonable assurance would involve a re-examination of the concept, which would have to be undertaken in consultation with national standard setters, regulators and other stakeholders. This is beyond the scope of the work to clarify ISA 200.
47. The Task Force does not believe the respondents' comment raised new argument sufficient to compel the IAASB to reconsider its position on the matter.

Matters for IAASB Consideration

The IAASB is asked whether it agrees with the proposed changes to discussion of the inherent limitations of an audit.

The IAASB is also asked whether it agrees with the Task Force's recommendation to not amend the definition of reasonable assurance.

²⁵ IdW

²⁶ BT, CIPFA, CNCC, FEE, ICAEW, IdW

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D. Professional Judgment and Professional Skepticism

D.1 DEFINITIONS FOR PROFESSIONAL JUDGMENT AND SKEPTICISM

48. A few respondents²⁷ suggested that definitions should be provided for the terms “professional judgment” and “professional skepticism.” This generally reflected the importance of these aspects of the auditor’s behavior to the conduct of a high quality audit.
49. The Task Force accepts the basis of this suggestion and, accordingly, has drafted proposed definitions. The definition of professional judgment is drawn from the material in ED paragraph A24. The definition of professional skepticism is drawn from the Glossary, though amended to align it with matters addressed in the related application material and to recognize that skepticism is not just in relation to the critical assessment of audit evidence.
50. The Task Force has some reservation about whether it is in fact possible to define professional judgment and professional skepticism. On balance, however, it views the proposed definitions as broadly appropriate for purposes of the ISAs.
51. **See paragraphs 14(k) and 14(l) in Agenda Item 7-B.**

D.2 PROFESSIONAL JUDGMENT

52. Several respondents²⁸ expressed concern that the discussion of professional judgment in ED paragraphs A24-A25 was not sufficiently robust. They were concerned that it places undue emphasis on professional judgment as a ‘personal quality’ rather than as a professional responsibility, and that it gives the impression that disparate judgments between auditors are common. In addition, it was commented that the tone and content of the material do not appear to promote sound and consistent professional judgment and could possibly leave room for the exercise of professional judgment to be used as an excuse for deficient auditing, which was precisely what the material was intended to avoid. Accordingly, several of these respondents recommended that the IAASB make clear that professional judgment is a professional responsibility that is necessary throughout the whole audit, and that this is a matter that should be linked to and emphasized in the requirements of ISA 200.
53. Some respondents also suggested that the IAASB reconsider the ‘test’ of professional judgment which some thought implied that it was sufficient to find any other auditor who agreed with the judgment in order for it to be deemed sound. It was proposed that the test should be one that measures judgments against an objective standard (e.g., a “reasonable auditor” standard), reflecting the professional judgment one would expect other competent auditors to make having access to the same information in the same circumstances. Several

²⁷ Basel, BDO, EC, GAO, JICPA

²⁸ Basel, CEBS, EC, IOSCO, PCAOB

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other respondents²⁹ were also concerned about the guidance on this point in the ED, in that it implies there must be some type of agreement in order for the auditor's professional judgment to be regarded as reasonable. This may inadvertently lead to the use of hindsight to evaluate judgments made, or to more consultation over and documentation of judgment applied to routine audit matters. Some suggested that the relevant guidance be eliminated.

54. The Task Force agrees that the guidance needs amendment to avoid misunderstanding. Accordingly, in addition to incorporating a number of other drafting suggestions by other respondents³⁰, there are three main changes proposed:
- *To specify as a requirement the need for the auditor to exercise professional judgment in planning and performing an audit.* The Task Force also believes that this presents an opportunity to limit references to professional judgment in various other places throughout the ISAs, thereby avoiding the possible interpretation that professional judgment is required only for certain, rather than all, aspects of the audit (as suggested by one respondent³¹). The Task Force considers, however, that it may remain necessary to make reference to professional judgment in some cases in order to emphasize where such judgment is likely to be particularly important to the proper application of a requirement.
 - *To clarify the 'test' of professional judgment, based on respondents' suggestions.*
 - *To make clear that professional judgment is not to be used as the justification for decisions that are not otherwise supported by sufficient and appropriate audit evidence.*
55. See **paragraphs 18 and A48-A51** in Agenda Item 7-B.

D.3 PROFESSIONAL SKEPTICISM

56. A few respondents³² expressed concern about the statement in ED paragraph A27 that 'an audit rarely involves the authentication of documents' (which is consistent with the extant ISA and ISA 240 (Redrafted)). Whilst it was accepted that the auditor is not expected to be a forensic auditor, the IAASB was encouraged to emphasize the need for the auditor always to be on the alert for possible indicators of misstatements or evidence that may not be reliable.
57. This matter was previously discussed by the IAASB both in connection with the development of this ISA and ISA 240 (Redrafted). The conclusion was that it would be inappropriate to expand the auditor's responsibility to verify the authenticity of documents

²⁹ APB, BT, EYG, GTI, ICAEW, PCAOB, PwC, NAO

³⁰ For example, to include reference to the need to consult on difficult or contentious matters during the course of the audit (as suggested by IdW) and for significant professional judgments to be evidenced (as suggested by IOSCO and APB).

³¹ PCAOB

³² EC, IOSCO, Mazars, PCAOB

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used as audit evidence unless warranted in the circumstances. Although the Task Force agrees with that conclusion, it believes that the discussion in ISA 200 could be amplified to emphasize, but not extend, the responsibilities of the auditor. This has been done principally through examples that reference to requirements in other relevant ISAs and that illustrate circumstances where there may be a need for heightened skepticism, as suggested variously by a few respondents³³.

58. See paragraphs A17-A20 in Agenda Item 7-B.

Matters for IAASB Consideration

The IAASB is asked whether it agrees with:

- (a) The proposal to establish definitions for professional judgment and professional skepticism, and the definitions themselves;
- (b) The proposal to establish a requirement for the auditor to exercise professional judgment in an audit; and
- (c) The proposed changes to the application material relating to professional judgment and skepticism respectively.

E. ISAs' Application and Other Explanatory Material

59. A few respondents³⁴ urged the IAASB to clarify the requirement for the auditor to consider the entire text of an ISA to understand its requirements (ED paragraph 21). In addition, one respondent³⁵ questioned the adequacy of the explanation in ED paragraph A49 of the authority of the application and other explanatory material in the ISAs, and the auditor's responsibilities regarding consideration of the procedures described therein.
60. The Task Force agrees that it is important to be as clear as possible about the status, and to set the right tone for the authority, of such material. If the responsibility is described too loosely, the IAASB would be doing a disservice to auditors in underplaying the usefulness and relevance of the guidance established in the ISAs.
61. The Task Force has made a number of small changes to the wording in ISA 200 to help clarify the authority of the application material. In particular, the Task Force clarified the fact that the application material can define more precisely what a requirement means or is intended to cover (that is, the material does not create a requirement, but it can specify it). This is an important matter in terms of those circumstances where application material elaborates on a requirement but such material is not placed as part of a requirement itself in

³³ EC, IOSCO

³⁴ APB, BT, PCAOB

³⁵ PCAOB

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order to maintain its clarity. Further, in respect of examples of procedures, the application material indicates that the auditor may find many of them appropriate in the circumstances.

62. See **paragraphs 20 and A57-A58** of Agenda Item 7-B.

Matter for IAASB Consideration

The IAASB is asked whether it agrees with the proposed changes to the description of the authority of the application and other explanatory material in the ISAs.

Other Matters

63. The following highlights for IAASB's consideration certain matters arising from the Task Force's considerations when revising ED-ISA 200, but not raised by respondents on ED-ISA 200 as significant issues.

F.1 DEFINITION OF 'AUDITOR'

64. The Task Force notes that ED-ISA 200 did not include a definition for the term 'auditor' and, accordingly, it has included the Glossary definition of the term in **paragraph 14(d)** of Agenda Item 7-B.
65. The Task Force is however concerned about the clarity of that definition. It also notes that ED-ISA 220 defines "engagement partner", "engagement team" and "firm".³⁶ One possibility therefore may be to revise the definition of the term "auditor" as being a generic term used in describing the person or persons responsible for the conduct of the audit, where such person or persons are usually the engagement partner and engagement team, and in some cases, the firm.
66. The Task Force has not yet concluded on a recommendation to put forward to the Board. However, it is concerned about any unintended consequences arising from a change to the current definition. The Board's views on the appropriateness of the current definition and any proposal to change it are welcome as input to the Task Force's further consideration.

F.2 DEFINITIONS OF 'MANAGEMENT' AND 'THOSE CHARGED WITH GOVERNANCE'

67. The Task Force believes that it is appropriate to include definitions of "Management" and "Those charged with governance" in ISA 200, as well as in ISA 260 (Revised and Redrafted)³⁷. However, the Task Force believes that it would be appropriate to delete from those definition material that refers to their respective responsibilities in light of the

³⁶ Proposed ISA 220, "Quality Control for an Audit of Financial Statements," paragraphs 6(a), (d) and (e), respectively.

³⁷ ISA 260 (Revised and Redrafted), "Communication with Those Charged with Governance."

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changes made in ISA 580 (Revised and Redrafted) and ED-ISA 210 (Redrafted)³⁸. The proposed changes to the definitions in ISA 260 (Revised and Redrafted) are as follows:

“Management” – The person(s) with executive responsibility for the conduct of the entity’s operations. For some entities in some jurisdictions, management includes some or all of those charged with governance, for example, executive members of a governance board, or an owner-manager. ~~Management is responsible for the preparation of the financial statements, overseen by those charged with governance, and in some cases management is also responsible for approving the entity’s financial statements (in other cases those charged with governance have this responsibility).~~

“Those charged with governance” – The person(s) or organization(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager. ~~In some cases, those charged with governance are responsible for approving the entity’s financial statements (in other cases management has this responsibility).~~

See **paragraphs 14 (h) and (o)** in Agenda Item 7-B.

F.3 DESCRIPTION OF ‘SMALLER ENTITIES’

68. The Task Force notes that ED-ISA 200 did not include a description of the term ‘smaller entities’ and, accordingly, it has brought forward relevant material from paragraphs 6-8 of IAPS 1005³⁹. It has also included a paragraph to explain the applicability of the term ‘smaller entities’ to listed entities (and accordingly the relevance of material included in sections in the application material of ISAs under the heading ‘Considerations Specific to Smaller Entities’). This material is shown in **paragraphs A63-A65** of Agenda Item 7-B.

³⁸ Proposed ISA 210 (Redrafted), “Agreeing the Terms of Audit Engagements.”

³⁹ International Auditing Practice Statement (IAPS) 1005, “The Special Considerations in the Audit of Small Entities.”