



International Federation of Accountants

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Agenda Item

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Committee: IAASB Consultative Advisory Group

Meeting Location: Toronto

Meeting Date: September 4-5, 2008

Report Back— IAASB Clarity Project - ISA 200 (Revised and Redrafted)

Objective of Agenda Item

1. The objective of this Agenda Item is to provide a brief report back on the proposals of Representatives on the proposed ISA 200 (Revised and Redrafted), “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing,” discussed at the March 3-4, 2008 CAG meeting.

Report Back – March 3-4, 2008 CAG Proposals

2. Below are extracts from the minutes of the March 3-4, 2008 CAG meeting¹ related to the discussions on proposed ISA 200 (Revised and Redrafted), and an indication of how the IAASB Task Forces or the IAASB responded to the Representatives’ comments.
3. This Report Back includes reference to two documents:
 - “Agenda Item 4-A” – This is the revised draft of proposed ISA 200 (Revised and Redrafted) tabled at the June 16-20, 2008 IAASB meeting. It shows in marked text changes from the version discussed at the March 3-4, 2008 CAG meeting.
 - “UPDATED Agenda Item 4-A” – This is the IAASB-approved final ISA 200 (Revised and Redrafted). It shows in marked text changes agreed by the IAASB during its June 16-20, 2008 meeting.

<i>Purpose of an Audit and the Overall Objectives of the Auditor</i>	
<p>The Representatives commented as follows:</p> <ul style="list-style-type: none"> • Mr. Roussey expressed concern about the following statement in the revised ISA: “The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements.” He was of the view that an audit has 	<p>The Task Force raised with the IAASB the comments of the Representatives. It recommended to the IAASB, however, that the wording in ED-ISA 200 should be retained. That wording parallels what is</p>

¹ The minutes will be approved at the September 4-5, 2008 CAG meeting.

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a direct purpose (to enhance the credibility of the financial statements) and an indirect purpose (to provide the ability to users of the financial statements to determine how much credibility they want to place on the audited financial statements). The statement appears to address the latter (i.e., indirect purpose). He preferred a statement along the following lines: “An audit is designed to enhance the credibility of the financial statements and, indirectly, to allow users of the financial statements to determine the degree of confidence that they can place on the audited financial statements.” Mr. Ray supported this view. Mr. Scicluna was concerned that such a focus may give rise to questions as to whom the auditor is responsible. Ms. Koski-Grafer suggested that a more appropriate focus in an ISA would seem to be on what it is that auditors do that lends credibility to the financial statements. Ms. Koski-Grafer noted that, in her view, the purpose of the audit is to lend credibility to the financial statements, which in turn promotes confidence in the integrity of financial reporting and supports the effective functioning of the capital markets. She was pleased to see that some changes had been made in response to IOSCO comments on the exposure draft, in particular the changes to this section, and said that she hoped that the changes made by the Task Force would be accepted by the IAASB. Mr. White supported the revised ISA as drafted. He was of the view that it avoids liability traps. Ms. Wood, however, was of the view that the main objective of the auditor is to lend credibility to the financial statements.

- Mr. Ray found it interesting that the objective of the auditor is to obtain reasonable assurance as opposed to rendering an opinion. He thought the

contained in the International Framework for Assurance Engagements,² as well as the IFAC Code of Ethics for Professional Accountants (IFAC Code), and it is desirable that consistency among pronouncements be maintained. Further, the Task Force did not believe that the statement that ‘an audit enhances the credibility of the financial statements’ is fully accurate – a modification to the auditor’s opinion, such as an adverse opinion, would not suggest that the financial statements are credible. Finally, no specific concerns were raised by respondents on exposure. The IAASB agreed with the recommendation of the Task Force. **See UPDATED Agenda Item 4-A, paragraph 3.**

At the meeting, Mr. Kellas responded that the objective includes reference to reasonable assurance as the basis for the auditor’s opinion (the forming of

² Paragraph 7 of the Framework states: “Assurance engagement” means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.”

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<p>objective should focus on forming an opinion on the financial statements, and the requirements should establish the obligation to obtain reasonable assurance in order to have an appropriate basis on which to form that opinion.</p> <ul style="list-style-type: none">• Ms. Blomme was of the view that the standard could elaborate more on the meaning of reasonable assurance.• Mr. Koktvedgaard asked why the objective of the auditor is phrased in terms of “financial statements prepared, in all material respects, ...” as opposed to “financial statements that give a true and fair view ...” Mr. Damant was of the view that the link between the objective of the auditor and the financial reporting framework is clear and logical.	<p>which is also included in the objective). Nevertheless, the Task Force and IAASB agreed that reference to reasonable assurance should also be included in the requirements of the ISA, specifically in connection with the requirement for the auditor to obtain sufficient appropriate audit evidence. See Agenda Item 4-A, paragraph 17.</p> <p>The IAASB deliberated this viewpoint and concluded that introduction to the ISA could elaborate more on meaning of reasonable assurance, in particular in relation to the inherent limitations of an audit. It therefore agreed to clarify how reasonable assurance and the inherent limitations relate, and to draw readers’ attention to where in the ISA the limitations are more fully discussion. See Agenda Item 4-A, paragraph 5. The IAASB did not feel, however, that it could expand the discussion of the meaning of reasonable assurance further; to go further 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.</p> <p>At the meeting, Mr. Kellas responded that the ISAs address both fair presentation and compliance frameworks, and that the Introduction section of the revised ISA contains references that give greater prominence to a fair presentation framework.</p> <p>Nevertheless, the IAASB accepted the need to further clarify the applicability of the ISAs to both frameworks. The IAASB was also of the view that additional explanation of how the phrase “prepared, in all material respects” in the overall objectives of the auditor relates to the different forms of the auditor’s opinion as envisioned in the ISAs (e.g., “presented fairly, in all material respects, or give a true and fair view”) would assist to ensure no misunderstanding about whether an opinion on the</p>
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	<p><i>preparation</i> of the financial statements, in jurisdictions where the applicable financial reporting framework is a fair presentation framework, includes <i>presentation</i> of the financial statements. Accordingly, the IAASB agreed drafting changes that emphasize in the “Introduction” and “Application and Other Explanatory Material” sections of the ISA the applicability of the ISAs to both frameworks. See UPDATED Agenda Item 4-A, paragraphs 3, 8 and 12. The IAASB, however, agreed to retain the phrase “prepared, in all material respects” in the ISA in relation to the purpose of an audit and the overall objectives of the auditor. Even a minor change to this long-standing phrase is likely to raise questions about whether there is an intention to make a substantive change, which there is not.</p>
<i>Inherent Limitations of an Audit</i>	
<p>The Representatives commented as follows:</p> <ul style="list-style-type: none">• Mr. Damant supported a discussion of inherent limitations within the revised ISA, in particular because the public may be unaware that such limitations exist. There was clearly an expectations gap. Mr. Hallqvist did not support the discussion of inherent limitation in the ISAs. He was of the view that such limitations should not exist, because the audit committee, as agent for the owners, could devote the extra resources needed so that sufficient audit work can be performed to overcome them. Ms. Wood was of a similar view, noting that audit committees should be permitted to spend more money to ensure that the audit is designed to detect all material errors and fraud. Mr. Damant noted that a financial statement audit is not a full forensic audit and the challenge is how to judge in advance how much additional work would be necessary in any particular circumstance. Mr. Krantz suggested that the revised ISA distinguish between public and private companies.• Mr. Johnson believed that the content of the	<p>At the meeting, Mr. Sylph responded by noting that many audits are conducted in entities that do not have audit committees. In order to apply to all audits, the ISAs need to address inherent limitations.</p>

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revised ISA is appropriate to bridge the expectations gap. He noted that FEE had done a study in the area of inherent limitations. The study inter alia found that investors expect financial statements to be audited in a reasonable period of time. Mr. Scicluna supported this view, noting that the fundamental aim of the audit was to obtain reasonable assurance.

- Although agreeing with Mr. Johnson that there are inherent limitations in the audit process and that it is appropriate to recognize them in auditing standards, Mr. Ray was concerned that there was still too much emphasis on inherent limitations in the revised ISA. He identified a few areas in the draft in which he thought the balance wasn't quite right (e.g., paragraphs A41 and A43 which deal with the legal and practical limitations on the auditor's ability to obtain audit evidence and the expectations regarding the completion of the audit in a reasonable period of time and at a reasonable cost). Mr. Pickeur and Ms. Sucher had similar concerns. Ms. Sucher noted that the term "expectations gap" may be more suitable than "inherent limitations" and expressed a preference for focusing on what an audit is and what it is not rather than describing inherent limitations. Ms. Todd McEnally acknowledged that inherent limitations exist and should be recognized, but was of the view that the language in the revised ISA continues to be defensive. She also noted that a global survey conducted by the CFA Institute indicates that users of financial statements demand more information in the auditor's report about major judgments made and concerns noted by the auditors during the audit. Mr. Pickeur noted that the discussion of inherent limitations is a significant proportion of the overall ISA and expressed concern that there is a risk that this may inadvertently diminish the perceived value of an audit.
- Ms. Koski-Grafer noted that IOSCO had

At the meeting, Mr. Kellas responded by indicating that the revised ISA should be able to point out the truths about inherent limitations. He noted that, although some may view the discussion of inherent limitations in the revised ISA as lengthy, it relates to all ISAs, the vast majority of whose content concerned the responsibilities of the auditor. Furthermore, the discussion also highlights what the auditor does in light of the inherent limitations. He did not believe that anyone was questioning whether inherent limitations exist, but rather how much emphasis they should receive.

Nevertheless, the Task Force recommended certain changes to the IAASB to make the material more concise and less defensive, particularly in relation to:

- The nature of the financial reporting;
- The legal and practical limitations on the auditor's ability to obtain audit evidence; and
- Limitations with respect to fraud (including the duplication of material on authentication of document that is also contained in the discussion of professional skepticism).

The IAASB accepted the recommended changes and concluded that a good balance has been achieved between factual content and length in the discussion of inherent limitations of an audit, and that the material provides clear explanation of the limitations, their sources and consequences, and the responsibilities established by ISAs that counterbalance the limitations. **See Agenda Item 4-A, paragraphs A44-A51.**

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<p>encouraged the IAASB to have a full and clear discussion of what the audit does and does not do in ISA 200 (Revised and Redrafted), including inherent limitations, and that she was supportive of such a discussion so long as it was balanced and not too negative.</p> <ul style="list-style-type: none"> Mr. Damant asked whether the IAASB could defer the approval of the proposed final ISA to provide the IAASB CAG Member Organizations an opportunity to discuss it. 	<p>The Task Force and the IAASB are of the view that the revised ISA demonstrates responsiveness to the comments received on exposure and that no issues remain of sufficient importance to delay the finalization of the ISA.</p>
<p><i>Application and Other Explanatory Material</i></p>	
<p>The Representatives commented as follows:</p> <ul style="list-style-type: none"> Mr. Damant was of the view that it would be dangerous for jurisdictions to adopt only the objectives and the requirements. Ms. Koski-Grafer supported the changes, though she suggested that paragraph A57³ of the revised ISA be moved to the Requirements section as she believed that this information was essential to having a proper understanding of the requirements. 	<p>At the meeting, Mr. Kellas confirmed that this is the view of the IAASB; however, the requirements and application and other explanatory material may not necessarily be presented in the same place. The proposed requirement specifically sets out the responsibilities of the auditor in relation to other material as a safeguard against their separation.</p> <p>Nevertheless, the IAASB revisited whether ISA 200 (Revised and Redrafted) makes clear the authority of the application guidance and other explanatory material in the ISAs and dispels any notion that consideration of such material is entirely optional. Accordingly, paragraph 19 of ISA 200 (Revised and Redrafted) now states: “The auditor shall have an understanding of the entire text of an ISA, including its application and other explanatory material, to understand its objectives and to apply its requirements properly.” This emphasizes the original intent of the requirement – that the entire text of an ISA is relevant to the understanding required, while not suggesting that the auditor needs to read the ISAs</p>

³ Paragraph A57 of the ISA states: “In addition to objectives and requirements (expressed in the ISAs using “shall”), 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. Accordingly, to understand the objective and to apply the requirements of an ISA properly, it is necessary for the auditor to read and understand all parts of the text of an ISA.”

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	<p>in every audit instance, nor prescribing how the understanding of the entire text is to be obtained. See UPDATED Agenda Item 4-A, paragraph 19. The Task Force and IAASB also concluded that it is important that ISA 200 (Revised and Redrafted) be as clear as possible about the role of the application and other explanatory material of the ISAs. Accordingly, the Task Force and IAASB reflected a number of small changes to the wording in paragraph A58 of the proposed ISA to explain the fact that the application material may explain more precisely what a requirement means or is intended to cover, and may include examples of procedures that may be appropriate in the circumstances. This is an important clarification 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 order to maintain its clarity. See Agenda Item 4-A, paragraph A58.</p>
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Material Presented – FOR IAASB CAG REFERENCE PURPOSES ONLY

Agenda Item 4-A – Version of ISA 200 (Revised and Redrafted) discussed at the IAASB June meeting <http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=4003>

UPDATED Agenda Item 4-A – Final wording of ISA 200 (Revised and Redrafted) as approved by the IAASB in June 2008 <http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=4059>