



**Committee:** IAASB Consultative Advisory Group

**Meeting Location:** Toronto

**Meeting Date:** September 4-5, 2008

**Report Back—IAASB Clarity Project**  
**ISAs 250, 320, 450, 500, 510, 530, 570 and 610**

**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 IAASB Clarity projects 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 meeting<sup>1</sup> related to the discussions on IAASB's Clarity projects, and an indication of how the IAASB Task Forces or the IAASB responded to the Representatives' comments.

<i>Proposed ISA 250 (Redrafted), "Consideration of Laws and Regulations in an Audit of Financial Statements"</i>	
<p>The Representatives commented as follows:</p> <ul style="list-style-type: none"><li>• Mr. White and Ms. Sucher agreed with the revised objectives. Ms. Sucher was of the view that part (c) of the objective creates a reasonable expectation. (Part (c) states that the objective of the auditor is to respond appropriately to identified or suspected noncompliance with laws and regulations that has come to the auditor's attention during the course of the audit.)</li><li>• Mr. Ray, however, was concerned that the phrase "that has come to the auditor's attention during the course of the audit" implies a passive responsibility that is not be consistent with parts (a) and (b) of the objectives. Ms. Koski-Grafer noted that the members of the IOSCO Standing</li></ul>	<p>The IAASB considered the phrase referred to by Mr. Ray and concluded that it may in fact be too passive. Accordingly, the IAASB revised the objective to eliminate the phrase "that has come to the auditor's attention...." In addition, the IAASB observed that the first objective (paragraph 8(a)) was expressed in</p>

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

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<p>Committee 1 (the auditing subcommittee) did not have an open-ended search in mind, but that they were hoping for something more than the passive responsibility implied by part (c). That is, as part of obtaining an understanding of the entity and assessing the risks of material misstatement of the financial statements, the auditor will look harder in the case of laws and regulations particularly relevant to the business of the entity.</p>	<p>the negative, and concluded that there should be a positive obligation on the auditor. Accordingly, the IAASB revised part (a) to state that the auditor's objective is "to obtain sufficient appropriate audit evidence regarding compliance with provisions of those laws and regulation generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements." The IAASB noted that this treatment is consistent with the extant ISA. <b>See paragraph 10 of ISA 250 (Redrafted).</b></p>
<ul style="list-style-type: none"><li>• Mr. Roussey suggested that the ISA refer to laws and regulations relevant to the industry in which the entity operates.</li></ul>	<p>The Task Force considered this suggestion and concluded that it should not be adopted. While the extant and final ISAs make frequent reference to the need for the auditor to consider the industry in which the entity operates (<b>see, for example, paragraphs 2, 12(a), A1 and A8 of ISA 250 (Redrafted)</b>), it would not be appropriate to equate 'relevant laws and regulations' to industry laws and regulations as some relevant laws may be general and not industry specific. The Task Force believes that this treatment is consistent with how the ISA describes relevant laws and regulation. <b>See paragraph 2 of ISA 250 (Redrafted).</b></p>
<ul style="list-style-type: none"><li>• Mr. Roussey also suggested that the ISA provide for the auditor to enquire about the existence of claims as a result of noncompliance with laws or regulations.</li></ul>	<p>The Task Force considered this suggested but did not feel that change was required. Firstly, it notes that inquiry and other procedures regarding claims are addressed in proposed ISA 501 (Redrafted),<sup>2</sup> Secondly, it believes that a specific procedure to enquire about the existence of claims is unnecessary in light of the requirements in paragraphs 12-17 of the final ISA, and the guidance in paragraph A7 which appropriately directs the auditor to consider, among other procedures, inquiry of management regarding the policies or procedures adopted for identifying, evaluating and accounting for litigation claims.</p>
<ul style="list-style-type: none"><li>• Mr. White noted that the phrases "identified or</li></ul>	<p>The IAASB adopted the phrase suggested by Mr.</p>

<sup>2</sup> Proposed ISA 501 (Redrafted), "Audit Evidence—Specific Considerations for Selected Items."

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<p>possible noncompliance” and “identified or suspected noncompliance” are used interchangeably. He suggested that the phrase “identified or suspected noncompliance” be used.</p> <ul style="list-style-type: none"><li>• Ms. Sucher suggested that the Task Force reconsider the use of the double negative in paragraph 11, which reads as follows: “The auditor shall obtain sufficient appropriate audit evidence that the financial statements are not materially misstated due to noncompliance with laws and regulations ...”</li><li>• Mr. White noted that an entity may not be permitted to share with the auditor correspondence with relevant licensing or regulatory authorities, as is envisaged in paragraph 12(b) of the proposed ISA.</li><li>• Mr. White was of the view that, if his comments could be addressed as part of the application of the clarity conventions, the ISA would not be an obvious candidate for revision. Ms. Sucher, however, noted that IOSCO was of the view that the ISA should be revised because of developments in financial reporting and related laws and regulations, and the growth in compliance functions.</li></ul>	<p>White in all relevant instances in the final ISA.</p> <p>Consistent with the redrafting of the proposed objective to eliminate the double negative therein (see above), the IAASB agreed to redraft the requirement to state: “The auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements.” <b>See paragraph 13 of ISA 250 (Redrafted).</b></p> <p>The Task Force noted that this requirement exists in the extant ISA and, accordingly, it should not be removed in order to avoid any actual or perceived weakening of the ISA. Where the entity is unable to provide the auditor with the necessary information, the auditor would need to perform alternative procedures as necessary to obtain sufficient appropriate audit evidence, or modify the auditor’s opinion as a result of the scope limitation; the need to undertake such actions is clear in the remaining requirements of the ISA and in other relevant ISAs.</p> <p>The IAASB has consulted extensively on its future work program, including the ISAs that it believes require revision. <b>See pages 1-2 of CAG Agenda Item C.3, Report Back—IAASB Strategy and Work Program.</b></p>
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*Proposed ISA 320 (Revised and Redrafted), “Materiality in Planning and Performing an Audit;” ISA 450 (Revised and Redrafted), “Evaluation of Misstatements Identified during the Audit;” ISA 500 (Redrafted), “Audit Evidence;” and ISA 530 (Redrafted), “Audit Sampling”*

The Representatives did not make any significant comments on these proposed ISAs.

#### *Proposed ISA 510 (Redrafted), “Initial Audit Engagements—Opening Balances”*

The Representatives commented as follows:

- Ms. Koski-Grafer noted that the members of the IOSCO Standing Committee 1 debated whether the changes to the extant ISA go beyond the application of the clarity conventions. She noted that the redrafted ISA defines “predecessor auditor” as “the auditor from a different audit firm, who audited the financial statements of an entity in the prior period and who has been replaced by the current auditor.” This definition is different from that in the Glossary of Terms. In addition, the Glossary of Terms explains that the term “auditor” is used to describe either the engagement partner or the audit firm.
- Ms. Koski-Grafer also noted that they debated whether the terms “split opinion” and “piecemeal opinion” have different meanings. They did not understand the term “piecemeal opinion,” and were concerned that it would be difficult to translate.
- Ms. Koski-Grafer noted that the requirement in paragraph 5(a) of the ISA for the auditor to

At the meeting, Ms. Hillier explained that the proposed change is necessary to clarify the scope of the ISA. Although not stated explicitly, the requirements in extant ISA 510 address the situation when the audit firm is new to the engagement. When there is a change in the engagement partner only, there is continuity on the engagement team and the firm’s previous year’s audit files document the audit evidence obtained on the closing balances. Proposed ISA 220 (Redrafted)<sup>3</sup> applies in the case of rotation of the partner. The IAASB agreed with the proposals of the Task Force. Accordingly, no further change in this regard was made.

While the IAASB noted that neither term exists in the final ISA, it agreed that the ISA should include illustrative auditor’s reports for both the circumstances where law and regulations prohibit a split opinion and where it is not prohibited when the auditor is unable to obtain sufficient appropriate audit evidence regarding opening balances. **See Illustrations 1 and 2 in the Appendix of ISA 510 (Redrafted).** Further guidance on split opinions and piecemeal opinions is given in ISA 705 (Revised and Redrafted).<sup>4</sup>

The IAASB noted that the extant ISA is specifically focused on the auditor’s consideration of *opening*

<sup>3</sup> Proposed ISA 220 (Redrafted), “Quality Control for Audits of Financial Statements.”

<sup>4</sup> ISA 705 (Revised and Redrafted), “Modifications to the Opinion in the Independent Auditor’s Report.”

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<p>determine whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated is not limited to an initial audit engagement, i.e., it applies to all audits.</p>	<p><i>balances</i> in an initial audit engagement and, accordingly, did not agree that the scope of the ISA should be expanded to include consideration of opening balances in all audit engagements. The work effort defined in the extant ISA is focused on the audit evidence an incoming auditor needs to obtain regarding opening balances in order to form an opinion on the current period's financial statements. The procedures necessary in a continuing engagement would necessarily be different as the auditor would have obtained evidence regarding the opening balances in the prior period's audit. Accordingly, the IAASB believes that guidance for ongoing engagements is better addressed in other ISAs, such as proposed ISA 710 (Redrafted).<sup>5</sup> No change has therefore been made in this regard.</p>
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<i>Proposed ISA 570 (Redrafted), "Going Concern"</i>	
<p>The Representatives commented as follows:</p> <ul style="list-style-type: none"> <li>• Mr. Damant asked whether it was sufficient only to redraft the ISA.</li> <li>• Mr. Diomeda noted that a small entity is often dependent on the continued support of the owner-manager. He asked whether, in the case of an audit of a small entity, the auditor assumes that this condition exists as one that may cast significant doubt on the entity's ability to continue as a going concern.</li> </ul>	<p>At the meeting, Ms. Hillier explained that the comments that go beyond the application of the clarity conventions relate to matters that were debated extensively during the development of the extant ISA. There were not many respondents that were of the view that those debates should be reopened.</p> <p>At the meeting, Ms. Hillier explained that it was not the intention to have an Emphasis of Matter paragraph in all cases where a small entity is managed by its owner. She referred to the flow of the standard – if during the risk assessment the auditor identifies events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, the auditor explores the condition or event and determines whether the entity's response is adequate or whether a significant uncertainty exist. The guidance previously in IAPS 1005<sup>6</sup> on</p>

<sup>5</sup> Proposed ISA 710 (Redrafted), "Comparative Information—Comparative Figures and Comparative Financial Statements."

<sup>6</sup> International Auditing Practice Statement 1005, "The Special Considerations in the Audit of Small Entities."

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	<p>considerations when continued support by owner-managers is important to a smaller entity's ability to continue as a going concern has been incorporated in ISA 570 (Redrafted). The existence of such financial support does not, however, necessarily suggest that a material uncertainty exists regarding the entity's ability to continue as a going concern in the absence of other indicators that the entity is in financial difficulty.</p>
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<p><i>Proposed ISA 610 (Redrafted), "Using the Work of Internal Auditors"</i></p>	
<p>The Representatives commented as follows:</p> <ul style="list-style-type: none"> <li>Mr. Hallqvist was of the view that the external auditors should not be permitted to use internal auditors to do work on their behalf. They may however use the reports of the internal auditors.</li> <li>Ms. Blomme welcomed the definition of "internal audit," but was concerned that it is written at a level that may not assist in practice – particularly in the case of smaller entities, where it may be difficult to establish whether there is an internal audit function. She was of the view that the definition could include some of the matters described in paragraphs A2-A5 of the ISA.</li> <li>Ms. Cox indicated that the IIA would like to be</li> </ul>	<p>At the meeting, Mr. Kellas explained that respondents to the exposure draft had diverse views on this point. Some respondents held views that were in line with that of Mr. Hallqvist, while others thought that the external auditors should consider how they could use internal auditors to reduce audit fees. However, this is a matter to be considered when the ISA is revised.</p> <p>The IAASB agreed that the definition of "internal audit function" and "internal auditor" could be improved by aligning the definition of "internal audit function" with that in the extant Glossary of Terms. Further, it agreed to incorporate the guidance stating that internal auditors may belong to an internal audit department or equivalent function in the definition of "internal auditor," as extant ISA 610 applies not only to traditional internal auditors, but also to those individuals who perform the activities or functions of an internal auditor. These individuals will not always be referred to as "internal auditors," (e.g., compliance function), but the role these individuals play in the organization is important to the external auditor's consideration of risk assessment and the determination of the nature, timing and extent of procedures to be performed. <b>See paragraph 7 of UPDATED Agenda Item 6-C - ISA 610 (Redrafted).</b></p> <p>This has been noted by IAASB Staff.</p>

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involved in the future revision of the ISA.	
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### Material Presented – FOR IAASB CAG REFERENCE PURPOSES ONLY

Final version of ISA 250 (Redrafted) as issued  
by the IAASB in July 2008

[http://www.ifac.org/Members/DownLoads/ISA\\_250\\_Redrafted.pdf](http://www.ifac.org/Members/DownLoads/ISA_250_Redrafted.pdf)

Final version of ISA 510 (Redrafted) as issued  
by the IAASB in July 2008

[http://www.ifac.org/Members/DownLoads/ISA\\_510\\_Redrafted.pdf](http://www.ifac.org/Members/DownLoads/ISA_510_Redrafted.pdf)

Final version of ISA 570 (Redrafted) as issued  
by the IAASB in July 2008

[http://www.ifac.org/Members/DownLoads/ISA\\_570\\_Redrafted.pdf](http://www.ifac.org/Members/DownLoads/ISA_570_Redrafted.pdf)

Final wording of ISA 610 (Redrafted) as  
approved by the IAASB in June 2008

<http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=4073>