

# IAASB CAG PAPER



International Federation of Accountants

545 Fifth Avenue, 14th Floor, New York, NY 10017 USA

Tel +1 (212) 286-9344 Fax +1 (212) 286-9570 www.ifac.org

## Agenda Item

# D.2

**Committee:** IAASB Consultative Advisory Group

**Meeting Location:** Dubai

**Meeting Date:** March 9 – 10, 2009

### **Report Back—IAASB Clarity Project ISAs 210, 220 and ISQC 1, 501, 520, and 710**

#### **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 September 4-5, 2008 CAG meeting.

#### **Report Back – September 4 - 5, 2008 CAG Proposals**

2. Below are extracts from the minutes of the September 4 - 5, 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.

Representatives' Comments	Task Force/IAASB Response
AGREEING THE TERMS OF AUDIT ENGAGEMENTS – ISA 210 (REDRAFTED)	
Mr. Hallqvist asked how the ISA dealt with the auditor's responsibility to ensure they have complete information.	Point accepted.  In developing the revised draft of ISA 210 (Redrafted), the Task Force and IAASB noted that respondents to the exposure draft had expressed concern that the responsibility of management to provide complete information to the auditor should not be expressed in such a way as to suggest that the auditor has no responsibility to be proactive in seeking the information needed for the audit. The draft ISA had been amended to take account of that concern. <b>See paragraph 6(b)(iii) of Updated Agenda Item 3-A for the text of the ISA as approved by the IAASB.</b>

<sup>1</sup> The minutes will be approved at the March 9 – 10, 2009 CAG meeting.

## IAASB CAG PAPER

### IAASB CAG Agenda (March 2009)

#### Agenda Item D.2

#### Report Back—Clarity – ISAs 210, 220 and ISQC 1, 501, 520 and 710

<p>Mr. Robberecht noted the EC’s initial support of the new direction in the ISA and said that the Member States would be discussing the ISA in the near future.</p> <p>He questioned whether the difference between the preconditions to an audit and the premise was sufficiently clear.</p> <p>He was also unsure about the current draft’s indication that management needs to “provide the auditor with additional information that the auditor may request of management”; this may suggest that the auditor can ask for any information they desire, whether relevant to the financial statements or not.</p>	<p>Point taken into account.</p> <p>At the meeting, Mr. Kellas explained that the preconditions to the audit are that the financial reporting framework is acceptable and that the premise has been accepted. The Task Force and IAASB concurred with this view, noting that the definition of “preconditions for an audit” in the ISA makes this point clear.</p> <p>The IAASB, however, found the Task Force’s proposal to separate management’s responsibility for internal control from its responsibility for the preparation of the financial statements and other elements of the premise may contribute to some misunderstanding about what constitutes the premise. It therefore agreed to restructure the wording of the premise, and the requirement in ISA 210 (Redrafted) pertaining to the preconditions for an audit, to make clear their individual elements. <b>See paragraph 6 of ISA 210 (Redrafted), and conforming amendments to paragraphs 13(j) and A2 of ISA 200 (Revised and Redrafted,<sup>2</sup> in Updated Agenda Item 3-A for the text as approved by the IAASB.</b></p> <p>Point accepted.</p> <p>At the meeting, Mr. Kellas expressed the view was that it was unlikely an auditor would request information that is not relevant to the audit. The Task Force and IAASB concurred with this view in principle. The IAASB agreed, however, that the wording of the draft could be further clarified by stating that management acknowledges and understands its responsibility to provide the auditor with “...additional information that the auditor may request from management <i>for the purpose of the</i></p>
--	--

<sup>2</sup> ISA 200 (Revised and Redrafted), “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing.”

## IAASB CAG PAPER

**IAASB CAG Agenda (March 2009)**

**Agenda Item D.2**

**Report Back—Clarity – ISAs 210, 220 and ISQC 1, 501, 520 and 710**

	<i>audit.” See paragraph 6(b)(iii) of Updated Agenda Item 3-A for the text of the ISA as approved by the IAASB.</i>
<p>Mr. White questioned how the auditor would deal with circumstances in which the internal control system is insufficient and the auditor cannot obtain sufficient appropriate audit evidence to conduct the audit. At the meeting, Mr. Kellas was of the view that this would lead to a qualification or disclaimer of the opinion unless management decided to revise the internal control system prior to the audit. Mr. White noted that paragraph A18 of the ISA may suggest that an auditor could obtain a representation that management understands its responsibilities and that no further action would be needed. However, based on Mr. Kellas’ explanation, a disclaimer would be a possibility. He suggested further application material be added to address this circumstance.</p>	<p>Point taken into account.</p> <p>The IAASB considered several options in relation to this point, including alternative wording to try to avoid the implication that whatever management does would be acceptable. After due consideration of the options – each drawing some reservation by IAASB members – the IAASB concluded that the proposed words of the premise in relation to management’s responsibility for internal control were appropriate.</p> <p>In connection with the suggestion for further application material to be added, it was noted that paragraphs A100-A101 of ISA 315 (Redrafted)<sup>3</sup> provide guidance on the circumstances envisioned by Mr. White, and that they need not be repeated in ISA 210 (Redrafted). The IAASB agreed, however, that it would be appropriate to explain in the ISA that the agreement by management about its responsibility for internal control does not imply that the auditor will find that internal control maintained by management has achieved its purpose or will be free of deficiencies. <i>See paragraph A17 of Updated Agenda Item 3-A for the text of the ISA as approved by the IAASB.</i></p>

### Material Presented – IAASB CAG REFERENCE PAPERS ONLY

Updated Agenda Item 3-A - Final wording of ISA 210 (Redrafted) as approved by the IAASB in December 2008 <http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=4437>

Related conforming amendments as approved by the IAASB in December 2008 <http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=4438>

<sup>3</sup> ISA 315 (Redrafted), “Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment.”

# IAASB CAG PAPER

IAASB CAG Agenda (March 2009)

Agenda Item D.2

Report Back—Clarity – ISAs 210, 220 and ISQC 1, 501, 520 and 710

Representatives' Comments	Task Force/IAASB Response
QUALITY CONTROL (ISA 220 (REDRAFTED)) <sup>4</sup> AND ISQC (REDRAFTED) <sup>5</sup>	
<i>Mr. Cowperthwaite asked for views about the proposed revised objectives. The Representatives commented as follows:</i>	
Ms. Sucher noted that IOSCO was among those who viewed the use of “reasonable assurance” in the objectives as inappropriate. It was her understanding that the June 2008 IAASB meeting material had indicated that the term was eliminated from the objective stated in ISA 220 (Redrafted) and retained in ISQC 1 (Redrafted). However, she questioned why this was no longer the case in the material for discussion by the IAASB in September. Ms. Sucher thought referring to reasonable assurance in relation to the audit and quality control was confusing, a point supported by Mr. Robberecht.	<p>Point not accepted.</p> <p>The IAASB concluded that it is appropriate to retain the concept of reasonable assurance in both ISA 220 (Redrafted) and ISQC 1 (Redrafted) as it underpins the aim of many of the requirements in the extant standards; that is, reasonable assurance defines the objective of the obligations imposed by the standards and is consistent with the focus of the extant standards. The IAASB also re-affirmed its view that reference to reasonable assurance in the objectives is important as it clarifies that a system of quality control and quality control procedures at the engagement level do not, and cannot be designed to, provide absolute assurance. This is consistent with the standard definition of internal control (see below).  <b>See paragraph 6 of ISA 220 (Redrafted) and paragraph 11 of ISQC 1 (Redrafted).</b></p>
Ms. Koski-Grafer suggested use of the phrase “high but not absolute level of assurance” in place of “reasonable assurance,” since that was the definition of reasonable assurance in the context of an audit.	<p>Point not accepted.</p> <p>During the meeting, Mr. Kellas noted the use of “reasonable assurance” is consistent with the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) discussion that internal control is designed to give reasonable assurance. The IAASB concurred with this view. Further, the IAASB noted that to use a different term for reasonable assurance (which it is generally understood must be read in context of the subject matter to which it relates), even though a new term</p>

<sup>4</sup> ISA 220 (Redrafted), “Quality Control for an Audit of Financial Statements.”

<sup>5</sup> ISQC 1 (Redrafted), “Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements.”

## IAASB CAG PAPER

**IAASB CAG Agenda (March 2009)**

**Agenda Item D.2**

**Report Back—Clarity – ISAs 210, 220 and ISQC 1, 501, 520 and 710**

	<p>could retain the same definition, may suggest there is a change in substance, which there is not. <b>See paragraph 6 of ISA 220 (Redrafted) and paragraph 11 of ISQC 1 (Redrafted).</b></p>
<p><i>Mr. Cowperthwaite noted that some respondents were of the view that within ISA 220 (Redrafted) it would be appropriate to remove references to ISQC 1 (Redrafted). The IAASB discussed this at its June meeting and concluded that a strongly linkage between ISA 220 (Redrafted) and ISQC 1 (Redrafted) is essential, though it may be possible to allow some limited flexibility for differences in jurisdictions that do not adopt ISQC 1 (Redrafted). The Task Force’s proposal, therefore, is to highlight in ISA 220 (Redrafted) that the ISA is premised on the condition that the audit firm has established and maintained an appropriate system of quality control. Such a system is one that complies with ISQC 1 (Redrafted), or one that is based on relevant national requirements that impose obligations on the firm that achieve the aims of the requirements set out in ISQC 1.</i></p> <p><i>The Representatives commented as follows:</i></p>	
<p>Mr. Edwards expressed some concern about the possible perception that the IAASB is moving away from ISQC 1 by allowing an equivalent system to be followed. In his view, the principles-based requirements in ISQC 1 are fundamental to achieving the objective of a robust system of quality control. He also noted many firms have embraced ISQC 1. Mr. Johnson agreed, citing improvements in quality control systems and audit quality as a consequence of ISQC 1.</p> <p>Mr. Diomeda questioned whether, as drafted, the ISA was meant to require firms to adopt ISQC 1 or an exact equivalent. He questioned what the effect would be if the EC does not adopt ISQC 1 (Redrafted). Mr. Pickeur questioned the effect of a national jurisdiction with no requirements similar to ISQC 1 (Redrafted).</p>	<p>The differing viewpoints were taken into account. The IAASB recognizes and agrees with the concerns of the Representatives.</p> <p>The IAASB concluded that a strong link between ISA 220 (Redrafted) and ISQC 1 (Redrafted) is essential, for several reasons. Firstly, there is a strong public interest to have a firm’s system of quality control work effectively with ISA 220 (Redrafted). ISQC 1 (Redrafted) is fully compatible with ISA 220 (Redrafted). The compatibility of quality control systems at the firm and engagement levels, however, may not exist were the firm to follow a different system of quality control.</p> <p>Secondly, there is a strong public interest to encourage firms to establish a robust system of quality control, thereby reinforcing the need for quality control and an appropriate “tone at the top” supporting what the auditor needs to do at the engagement level. This is particularly important when engagement teams are entitled to rely on that system. The linkage in ISA 220 (Redrafted) to ISQC 1 (Redrafted) supports this aim.</p> <p>Thirdly, if there is no link to ISQC 1 (Redrafted), there is a potential for firms to adopt systems of</p>

## IAASB CAG PAPER

IAASB CAG Agenda (March 2009)

Agenda Item D.2

Report Back—Clarity – ISAs 210, 220 and ISQC 1, 501, 520 and 710

	<p>quality control that are not as robust as that required under ISQC 1.</p> <p>Finally, the extant ISA 220 was written, and its effectiveness premised, on the basis that firms have established a quality control system in accordance with ISQC 1. ISA 220 and ISQC 1 were intended to co-exist, and ISA 220 was never intended to be read on a stand-alone basis. There is a potential risk, therefore, that removing the link to ISQC 1 (Redrafted) would weaken the relevant requirements of ISA 220 (Redrafted) as the auditor's quality control responsibilities in an audit of financial statements are specifically based on the quality control framework established by ISQC 1.</p> <p>Nevertheless, the IAASB agreed that, subject to appropriate conditions, it is not in the public interest to create unnecessary barriers to the adoption of ISAs by restricting jurisdictions to the adoption of ISQC 1, or limiting possible development of ISQC 1, for example where a jurisdiction believes additional requirements are appropriate in the circumstances. Accordingly, the IAASB concluded that some limited flexibility is appropriate to allow for a system that meets the aims of all the requirements of ISQC 1 (Redrafted), while not undermining the notion that the system needs to be effective and that the requirements of ISQC 1 (Redrafted) provide that which is necessary for that purpose.</p> <p>The IAASB therefore agreed to retain reference to ISQC 1 (Redrafted) in ISA 220 (Redrafted), but to do so in a more flexible manner that indicates that the ISA is premised on the basis that the firm is subject to ISQC 1 (Redrafted) or to national requirements that are <i>at least as demanding as ISQC 1</i>. ISA 220 (Redrafted) explains that national requirements that deal with the firm's responsibilities to establish and maintain a system of quality control are at least as demanding as ISQC 1 (Redrafted) when they address all the elements of a quality control system referred to in ISQC 1 (Redrafted) and impose obligations on the</p>
--	--

## IAASB CAG PAPER

**IAASB CAG Agenda (March 2009)**

**Agenda Item D.2**

**Report Back—Clarity – ISAs 210, 220 and ISQC 1, 501, 520 and 710**

	<p>firm that achieve the aims of the requirements set out in ISQC 1 (Redrafted). <i>See paragraphs 2-4 and A1 of ISA 220 (Redrafted).</i></p>
<p>Mr. Robberecht supported the revised wording. However, he suggested that the phrase “aim of the requirements” should be replaced by wording used in the objective of ISQC 1 (Redrafted).</p>	<p>Point not accepted.</p> <p>The IAASB concluded that reference to the “aims of the requirements set out in ISQC 1 (Redrafted)” should be retained in order to maintain a strong link between ISA 220 (Redrafted) and ISQC 1 (Redrafted). In taking this view, the IAASB noted that a system based on relevant national requirements that achieve the objective of ISQC 1 only could result in a situation where national requirements impose significantly different requirements than imposed on the firm by ISQC 1 (Redrafted), thereby reducing consistency in practice. This would also be inconsistent with IAASB’s view that the requirements it has established in ISQC 1 (Redrafted) are those that it believes are essential to the achievement of the objective of that standard. The IAASB also noted that most of the requirements of ISQC 1 are for the establishment of policies and procedures that are designed to achieve certain aims. <i>See paragraph A1 of ISA 220 (Redrafted).</i></p>
<p>Ms. Koski-Grafer said she could personally support the revised wording. However, she emphasized that IOSCO’s position is that it is only possible for the engagement partner to fulfill the requirements of ISA 220 (Redrafted) regarding reliance on an audit firm’s quality control system if the audit firm has also met the requirements of ISQC 1 (Redrafted) and has an effective system in place.</p>	<p>Point not accepted.</p> <p>The IAASB did not believe it appropriate to limit the engagement partner’s reliance on a firms’ quality control system to the conditions suggested. To do so would imply an obligation on the auditor to evaluate the firm’s system of quality control or the firm’s compliance with ISQC 1 (Redrafted). This would be impractical and goes beyond the extant ISA. Further, it would suggest that a deficiency in the firm’s system of quality control precludes the auditor from claiming compliance with ISA 220 (Redrafted), which may not necessarily be appropriate. The IAASB therefore agreed that ISA 220 (Redrafted) should be consistent with the extant ISA in making clear that the engagement team has a responsibility to implement quality control procedures at the engagement level,</p>



## IAASB CAG PAPER

**IAASB CAG Agenda (March 2009)**

**Agenda Item D.2**

**Report Back—Clarity – ISAs 210, 220 and ISQC 1, 501, 520 and 710**

	within the context of the firm’s system of quality control, and that it is entitled to rely on the firm’s system of quality control unless information provided by the firm or other parties suggests otherwise. <i>See paragraphs 3-4 and A1-A2 of ISA 220 (Redrafted).</i>
Ms. Koski-Grafer suggested that perhaps ISQC 1 (Redrafted) could be included as an appendix to ISA 220 (Redrafted) while also remaining a separate standard, so that there would be a close tie between the two.	Point not accepted.  The IAASB noted that ISA 220 (Redrafted) and ISQC 1 (Redrafted) impose obligations on different groups and that the clarity of the standards may be diminished if the two standards were presented along the lines suggested. Further, there is a clear and explicit link between the two standards, and they are reproduced in and available from the same sources (IFAC Handbook and IAASB website).
Mr. Sekiguchi inquired as to the reference to the “auditor” rather than “engagement partner.”	Point taken into account.  The IAASB noted since the term “auditor” is defined as partners and personnel, the use of the term auditor within the ISA is meant to cover both. The IAASB reviewed the usage of both terms in ISA 220 (Redrafted) and ISQC 1 (Redrafted) and found no exceptions requiring redrafting.
Ms. Blomme commended the Task Force for the changes it had made to ISQC 1 (Redrafted) [as compared to the exposure draft] to make it more principles-based, as this will make the standard easier to apply for SMEs.	Noted.

### Material Presented – IAASB CAG REFERENCE PAPERS ONLY

Final version of ISA 220 (Redrafted) as issued by the IAASB in December 2008

<http://www.ifac.org/Store/Details.tmpl?SID=1229365067610460&Cart=1229371027613490>

Final version of ISQC 1 (Redrafted) as issued by the IAASB in December 2008

<http://www.ifac.org/Store/Details.tmpl?SID=1229365787610779&Cart=1229371027613490>



# IAASB CAG PAPER

IAASB CAG Agenda (March 2009)

Agenda Item D.2

Report Back—Clarity – ISAs 210, 220 and ISQC 1, 501, 520 and 710

Representatives' Comments	Task Force/IAASB Response
AUDIT EVIDENCE—SPECIFIC CONSIDERATIONS FOR SELECTED ITEMS - ISA 501 (REDRAFTED)	
<p>Mr. Kocktvedgaard suggested the IAASB should look closely at whether there is a need for this particular standard. He also encouraged the IAASB to eliminate any material that is covered by other ISAs; in his view, this is part of the purpose of the Clarity project.</p>	<p>Point taken into account, and additional clarification of the scope of the ISA and its interrelationship with other ISAs was made.</p> <p>The IAASB concluded that it would not be appropriate to eliminate this ISA or reposition its content to other relevant ISAs, for example ISA 330 (Redrafted)<sup>6</sup> or ISA 500 (Redrafted).<sup>7</sup> To do so would have the effect of reducing the generality of these ISAs. The purpose of the extant ISA is to draw the auditor's attention to the selected financial statement account balances and disclosures, and to establish requirements relevant to obtaining sufficient appropriate audit evidence about them. As such, the IAASB concluded that it is appropriate to establish an objective of the auditor and to retain ISA 501 (Redrafted) as a separate standard. The IAASB also did not note any material that is unnecessarily duplication of other ISAs. (It is worth noting, however, that the exposure draft included the proposal that the section of the extant ISA 501 dealing with "long-term investments" be deleted, and that this was accepted by respondents.)</p> <p>The IAASB agreed, however, that the scope of the ISA should make clear that it deals with specific considerations by the auditor in obtaining sufficient appropriate audit evidence in accordance with ISA 330 (Redrafted), ISA 500 (Redrafted) and other relevant ISAs, with respect to certain aspects of inventory, litigation and claims involving the entity, and segment information in an audit of financial statements. <b>See paragraph 1 of ISA 501 (Redrafted).</b></p>

<sup>6</sup> ISA 330 (Redrafted), "The Auditor's Responses to Assessed Risks."

<sup>7</sup> ISA 500 (Redrafted), "Audit Evidence."

## **IAASB CAG PAPER**

**IAASB CAG Agenda (March 2009)**

**Agenda Item D.2**

**Report Back—Clarity – ISAs 210, 220 and ISQC 1, 501, 520 and 710**

**Material Presented – IAASB CAG REFERENCE PAPERS ONLY**

Final version of ISA 501 (Redrafted) as issued  
by the IAASB in December 2008

<http://www.ifac.org/Store/Details.tpl?SID=1229365351610584&Cart=1229371027613490>

## IAASB CAG PAPER

IAASB CAG Agenda (March 2009)

Agenda Item D.2

Report Back—Clarity – ISAs 210, 220 and ISQC 1, 501, 520 and 710

Representatives' Comments	Task Force/IAASB Response
ANALYTICAL PROCEDURES – ISA 520 (REDRAFTED)	
Mr. Johnson noted that the prior day's presentation by CPAB indicated that four oversight bodies had observed that analytical review was an area of weakness in practice. He suggested that further guidance may be necessary if firms are not undertaking appropriate procedures identified by the oversight bodies.	<p>Point noted for further consideration.</p> <p>The IAASB concluded that it would not be appropriate to revise existing, or develop new, guidance in the ISA as this would be outside the scope of the project to redraft extant ISA 520.</p> <p>At the meeting, however, Mr. Kellas suggested that this topic could be covered at IAASB's 2009 national standard setters meeting; in his view, the concerns are likely to be that analytical review is not of sufficient quality and that auditors may not be determining tolerances in advance. This matter has been included as part of the suggested discussion topics at IAASB's April 2009 national standard setters meeting.</p>

### Material Presented – IAASB CAG REFERENCE PAPERS ONLY

Final version of ISA 520 (Redrafted) as issued  
by the IAASB in December 2008

<http://www.ifac.org/Store/Details.tmpl?SID=1229365552610710&Cart=1229371027613490>

## IAASB CAG PAPER

IAASB CAG Agenda (March 2009)

Agenda Item D.2

Report Back—Clarity – ISAs 210, 220 and ISQC 1, 501, 520 and 710

Representatives' Comments	Task Force/IAASB Response
COMPARATIVE INFORMATION – CORRESPONDING FIGURES AND COMPARATIVE FINANCIAL STATEMENTS – ISA 710 (REDRAFTED)	
Mr. Robberecht supported the rephrasing in paragraph 18 <sup>8</sup> of the ISA. He noted that, should the IAASB revert to the language in the exposure draft, the phrase “where not prohibited by law or regulation” would need to be added to acknowledge that, in some jurisdictions, changing financial statements that have been approved by shareholders is not permitted.	The text included in paragraph 18, as supported by Mr. Robberecht, was retained in the final ISA. <b>See paragraph 18 of ISA 710 (Redrafted).</b>

### Material Presented – FOR IAASB CAG REFERENCE PURPOSES ONLY

Final version of ISA 710 (Redrafted) as issued by the IAASB in December 2008

<http://www.ifac.org/Store/Details.tmpl?SID=1229365694610744&Cart=1229371027613490>

<sup>8</sup> Paragraph 18 of the ISA as presented to the CAG stated: “If the auditor concludes that a material misstatement exists that affects the prior period financial statements on which the predecessor auditor had previously reported without modification, the auditor shall communicate the misstatement with the appropriate level of management and those charged with governance and request that the predecessor auditor be informed. If the prior period financial statements are amended, and the predecessor auditor agrees to issue a new auditor’s report on the amended financial statements of the prior period, the auditor shall report only on the current period.”