



## **CONSULTATION PAPER: THE IAASB'S PROPOSED STRATEGY FOR 2015-2019 AND THE IAASB'S PROPOSED WORK PROGRAM FOR 2015-2016**

ICAEW welcomes the opportunity to comment on the consultation paper *The IAASB's Proposed Strategy for 2015-2019* and *The IAASB's Proposed Work Program for 2015-2016* published by IAASB in December 2013, a copy of which is available from this [link](#).

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## MAJOR POINTS

### Summary

1. We make a number of major points below. In summary, we believe that IAASB should seek to:
  - change its own process requirements, including its range of pronouncements, so that they are fit for purpose and enable it to perform essential maintenance work on ISAs as well as the high-level strategic projects it proposes; and
  - bring forward, rather than defer, necessary maintenance work on the ISAs on which its good standing is based.

### IAASB's overall approach in the public interest

2. We welcome the opportunity to comment on IAASB's strategy 2015-19 and work program for 2015-16. IAASB is a mature standard-setter. There are many calls on its time and some genuinely hard decisions to be made. We sympathise with the need for IAASB to be seen to be dealing with the 'big' issues currently at the centre of media and regulatory attention, such as professional scepticism, the audit of financial institutions and some aspects of quality control. We strongly support IAASB's acknowledgement of the importance of innovation and note the need for ISAs to keep up with innovation in auditing practices. But IAASB's ability to address these issues and its legitimacy, are dependent on three things: its hard-won status as a leader among standard-setters, its ability to innovate and adapt, and the extent to which the changes it makes are perceived to be effective.
3. IAASB's status and legitimacy are grounded firmly in the corpus of ISAs it has developed over the last forty years, and we strongly caution against the neglect, however benign, of the maintenance of these foundations. We note below a number of areas that have not made it to the work program at all, and others which have, but which we think need to be brought forward.
4. We strongly support IAASB in its efforts to make changes in the public interest. It is essential that change is, and is seen to be *effective* in responding to the financial crisis. We therefore encourage IAASB to ensure that general calls for unspecified change, as well as calls for very specific changes, are justifiable and are made solely on basis that IAASB believes that they will enhance audit quality. In this context, we note that stakeholder needs are not homogeneous, that even stakeholders within the same groups, such as investors, have varying needs, and that IAASB needs balance the long-term priorities of different stakeholder groups.
5. We urge IAASB not to assume that the interests of one particular stakeholder group, be they regulators, investors in the capital markets or auditors, should automatically take precedence over any other. IAASB should avoid identifying the public interest<sup>1</sup> with any of these groups and we caution against underestimating the importance of SMEs either to the public interest, or to IAASB's legitimacy. No single stakeholder group acts, speaks or represents the public interest exclusively and if IAASB attaches more weight to the views of some stakeholders than to those of others, it should justify that position publicly.
6. We note in particular the fact that the three major projects identified by IAASB - professional scepticism, the audit of financial institutions and some aspects of quality control - are issues of concern to all, but that the more technical projects we identify below as needing to be brought into the timetable or brought forward within it – the risk ISAs, other aspects of ISQC 1,

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<sup>1</sup> In our recent work on the public interest at [www.icaew.com/publicinterest](http://www.icaew.com/publicinterest) we note that while 'the public interest' is used by many to justify a wide range of actions and proposals, it is often unclear what they mean by this, and there can be a natural suspicion that the phrase may be used as a smokescreen to garner support for something that is actually in the advocate's own interests.

documentation, audit and assurance services for smaller entities and group audits - are of more concern to preparers and auditors, including auditors of smaller entities. IAASB neglects the technical needs of auditors and the entities they audit, especially SMPs and SMEs, at its peril.

### Major strategic objectives

7. The strategic objectives of developing and maintaining standards, ensuring relevance by engaging with stakeholders and collaborating with others in the financial reporting supply chain are sound. We encourage IAASB to be bold in its approach to the last of these. Other participants in this chain, particularly accounting standard-setters, have resisted IAASB's attempts to engage in the past but the need to rebuild confidence in financial reporting means that 'auditability' can no longer be ignored. We are aware that this issue makes some preparers nervous but auditors are increasingly concerned about a lack of evidence available to support significant amounts and disclosures in the financial statements.
8. We also note the growth of auditor involvement in non-financial reporting and mixed financial and non-financial reporting, such as integrated reporting. IAASB should therefore consider the need for collaboration with those in the non-financial reporting supply chain.

### Focus on fewer key projects

9. The clarity project was a major milestone in IAASB's history. IAASB is moving into another stage of development and we understand the heavy burden it carries in meeting the expectations of its many stakeholders. IAASB's work requires substantial resource and Board time. We therefore understand the rationale for the proposed focus on fewer key projects. We also believe that a stable platform of ISAs is highly desirable.
10. Nevertheless, we strongly encourage IAASB, and those charged with its governance and oversight, to look again at the number and nature of the projects on its proposed agenda and consider whether its operating arrangements, and those of the other standard-setting boards, which include detailed drafting by a large board, are the right ones going forward. Increasing technical specialisation in IAASB pronouncements – the audit of financial institutions being one example – means that operating arrangements that served well to develop the generality of ISAs need to be re-engineered to meet the demands of IAASB's future work program.
11. IAASB's operating arrangements are inextricably linked to the limited range of pronouncements available to it. With regard to addressing issues through changes to the standards as against other appropriate action by IAASB, we sense that IAASB is reluctant to open standards for change because of the burden of the associated process. The burden of process should not deter change where it is needed, or indeed serve to excuse inactivity when activity is inconvenient. The onerous process requirements that discourage the opening of standards also detract from the value of anything of a lesser status, which leads to paralysis once a standard has been issued. This issue needs to be addressed to avoid stagnation. We note with approval proposals in recent IAASB papers on disclosures to issue Staff Papers that consist of more than a reiteration of existing ISA requirements. Absent this type of development, there is a risk that problems in standards will become accepted, and a tendency to try to fix things at the margins will develop. This is understandable, but it increases the risk of confusion and internal misalignment and for these reasons it is not really the right way forward.
12. To its great credit, even under the existing working methods, IAASB has proved itself nimble in the recent past.<sup>2</sup> Just as much flexibility will be required going forward if IAASB is to maintain its well-deserved position as the world's only truly global auditing and assurance standard-setter. A good case can be made for looking to new ways of handling several projects at one

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<sup>2</sup> The clarity project was originally scheduled to be completed in 2012/2013. IAASB successfully completed it in 2008/9 when requested to bring the deadline forward in order for implementation to take place in Europe.

time. In particular, greater co-operation with national standard-setters should be investigated and alternative arrangements should be considered to deal with on-going staff shortages.

13. IAASB's high standing rests on the quality of the ISAs it has painstakingly developed over a long period. To maintain that standing, it must maintain the ISAs and we note above our concerns about any neglect of these foundations, however benign. Some of these foundations have flaws, not necessarily fatal flaws, but some are important and long-standing. IAASB is fully aware of these and it partially addresses some of them in these proposals.
14. For example, IAASB acknowledges problems with the following:
  - the **risk ISAs** in terms of the consistency of risk assessments and significant risk analyses. We also note issues with control risk assessments for non-significant risks, and with the nature and extent of work on the design and implementation controls for smaller audits in which controls are not tested. Furthermore, the new COSO Framework is likely to have an effect on firm methodologies in due course and it will need to be reflected in ISAs. We are aware that some of these issues are being played out in the context of auditor reporting, but this is the reporting tail wagging the risk analysis dog and it would be better for these issues to be dealt with holistically;
  - proportionality in the **application of ISQC 1 to smaller audits, non-audit assurance and non-assurance engagements**. While ISQC 1 is in IAASB's sights, it is not clear that these aspects of it are. In some parts of Europe, which will be a real test of IAASB's standards, quality control is a novel concept, particularly for smaller audits and unheard of for other engagements. If IAASB does not address the issue, firms and national standard-setters will be unable to adopt IAASB standards for non-audit engagements. Member States may well take the view the ISAs are simply 'too hard' for smaller audits, and/or introduce significant carve-outs in an attempt to operationalise the legislative requirement for proportionality in the application of ISAs to smaller audits. All of this is avoidable but IAASB must take action now;
  - **group audits**: the implementation monitoring project highlighted a number of significant issues that need to be addressed. These included the unintended consequence of entities using the same firm globally, even where this is a less than optimum solution, simply to avoid some ISA 600 requirements regarding involvement in the work of component auditors. We also note continuing problems with auditor understanding of how sub-consolidations are performed, inconsistencies in the approach to the audit of letterbox companies, a need for guidance on the audit of shared services centres in a group context and with the determination of component materiality.
15. While we acknowledge that information-gathering is important, we believe that all of the issues above are sufficiently pressing for IAASB to consider whether deferring commencement of the relevant projects until 2017 is really appropriate. If IAASB's process requirements, including its range of pronouncements, are acting as a drag on these projects, the requirements should change, rather than the projects deferred. Keeping the corpus of ISAs and associated guidance fresh and proportionate to the wide range of entities to which they apply, require either a wider range of pronouncements, or more flexible process requirements.

## Other critical projects

16. We strongly urge IAASB to consider how to deal with two other important issues that have not made its work program at all: documentation and audit and assurance services provided to smaller entities. Both issues are important and are technically and politically difficult to deal with, but they do need to be addressed.
17. **Documentation** is a pervasive and long-standing problem that is getting worse. It affects all auditors and audits and it threatens confidence in the overall integrity of ISAs. To defer consideration of this matter much further will eventually result in ISAs being perceived as technically deficient. Indeed, there is a body of opinion that this may already be the case for smaller audits, but many of the issues boil down to documentation requirements. This would not only be a great shame, it would compromise the very future of IAASB as ISAs are currently perceived as having a very high level of technical integrity - hence their success.
18. Documentation requirements are a perennial source of conflict between regulators and auditors. There is a pressing need for proper discussion of these issues to deal with a growing perception that many of the documentation requirements of ISAs satisfy the demands of regulators but do little to improve real audit quality, and that they may in fact discourage auditors from using their judgement or even exercising professional scepticism.
19. The only hard external test auditors have to pass on a regular basis is the one set by audit regulators. Auditors and regulators may be committed to audit quality and professional scepticism but they are hard to measure, evidence and assess. We fear that determining whether documentation requirements have been met is the relatively easy option in both cases. Audit documentation is a part of audit quality, but it is not a measure of, a proxy for or synonymous with it, and we urge IAASB to facilitate engagement at a high level between standard-setters, regulators, auditors and other stakeholders to establish what can be done to prevent audit documentation becoming an end in itself, taking precedence over all other considerations.
20. We acknowledge that documentation, appropriately supported by explanations as permitted by ISAs, is the principal tool for assessing audit quality at engagement level. Nevertheless, we strongly believe that auditors and regulators need to discuss more frankly:
  - the need for ISAs to be given effect through audit methodologies;
  - how and why the necessary translation of ISAs in some audit methodologies simultaneously appears to audit regulators to involve both under-investment and over-engineering; and
  - some narrow regulatory approaches which focus on compliance with the letter of ISAs and take insufficient, if any, account of the need for and benefit of auditor explanations to support working papers.

These behaviours reinforce each other and IAASB would do well to promote an initiative to break this dysfunctional cycle.

**We re-iterate our late 2013 offer to facilitate a dialogue among all audit stakeholders to discuss what we are trying to achieve through documentation that will enhance audit quality and professional scepticism.** Such a dialogue would help deal with the risk that concerns about audit documentation might harm support for ISAs. We suggested that the purpose of such a dialogue would be to help everyone understand the incentives they face and how these incentives affect behaviours and interactions. We discussed the possibility of a number of roundtables in various countries bringing stakeholders together on a Chatham House basis and that a short set of discussion questions might help participants learn from each other and identify positive steps that they could all take. ICAEW's Audit and Assurance

Faculty would be pleased to host such a discussion and provide further material to serve as background material.

21. As audit exemption levels rise in some jurisdictions and audit requirements are imposed for the first time in others, **audit and assurance services provided by professional accountants to smaller entities are becoming a critical issue for the profession as a whole**. The issue is clearly acknowledged by IFAC. We do not believe this issue can or should be left to IFAC's Small and Medium Practitioners Committee (SMPC). IAASB's mandate to serve the public interest is not synonymous with a mandate to serve the world's capital markets given the contribution of SMEs to global prosperity.

### Timelines

22. In preparation for the development of this response, we reviewed our response to IAASB on its draft Strategy and Plan for 2012-2014, dated March 2011. We noted that three years on, a fair amount of what we wrote then might be repeated verbatim in the current response. This is of course, largely a reflection of the fact that IAASB cleared the decks later in 2011 to focus on ISA 700. However, it demonstrates the fact that external pressures can easily force the best made plans off course and we are concerned about the risk that important projects scheduled to commence in 2017 are likely to slip.
23. While we welcome the extension of the strategic horizon upwards from three years, we think that to five years is just a little too long a period to really focus minds, and we are curious as to why IAASB does not match its horizon with that of IFAC, at four years.

### Work program

24. In its proposed work program for 2015-16, IAASB suggests that it should focus on quality control, professional scepticism and the audit of financial institutions. We fully support this focus, but we strongly suggest that IAASB should, and can afford, to add at least one item to this list regardless of changes to its working arrangements or range or pronouncements. We should first be clear that we strongly believe that stability is important: we see no need at this point or in the foreseeable future, for any new ISAs. But stability is not synonymous with rigidity and a refusal to contemplate any change at all. Innovation aside, change is needed simply to maintain the status quo in a shifting environment. We believe that bringing forward any of the three projects described in paragraph 14 - on the risk ISAs or aspects of ISQC 1 or group audits - is one possibility. Considering a project on documentation or audit and assurance services for smaller entities as described in paragraphs 16-21 is another. IAASB clearly cannot address all of these in one go but we believe that they will all need to be addressed in due course.
25. We do not believe that adding another item to the agenda will significantly delay the completion of the other major projects proposed. Some of our members also believe that even if there were delays, this would be small price for a more rounded agenda, and that at present the high-level agenda needs to be balanced with more granular maintenance work. If IAASB decides not to broaden its agenda, we believe it could complete the proposed work program more quickly than it suggests.
26. We were pleased to note recognition of calls for the development of performance metrics for IAASB, but we are disappointed that there is no commitment to do so.

## RESPONSES TO SPECIFIC QUESTIONS

**Q1 (a) Are the strategic objectives identified are considered appropriate for the period 2015–2019. If not, please explain.**

- 27.** We support the strategic objectives identified are by IAASB for the period 2015–2019. They are sound, if a little vague in the case of the first two (develop and maintain high quality ISAs and ensure their relevance by responding to stakeholder needs). IAASB should set out what measure of success it will use in achieving these objectives. We note in our major points above our belief that IAASB should be bold in pursuing the third objective of collaborating with other contributors to the financial reporting supply chain and that contributors to the non-financial reporting supply chain, such as those involved in integrated reporting, also need to be considered. Some contributors, particularly accounting standard-setters, have paid insufficient attention to the importance of 'auditability' in the recent past. Some preparers are cautious about encouraging standard-setters to take account of auditability. Practitioners, on the other hand, are concerned about the lack of supporting evidence available for some significant figures and disclosures in financial statements on which they are required to opine.
- 28.** We also note in our major points above our concern about the length of the period covered by the Strategy and we suggest that IAASB consider aligning that period with that of IFAC.

**Q1 (b) Do the factors included in Appendix 2 on page 19 represent a reasonable basis for the IAASB to use in developing its Work Programs beyond the *Work Program for 2015–2016*.**

- 29.** The factors to be considered in developing future work programs are unobjectionable but we would have preferred to see a specific reference to the needs of smaller entities, rather than lumping them in with 'entities of all sizes', after the needs of the capital markets. We would like IAASB to consider more carefully what it can do better to meet the changing audit and assurance needs of smaller entities in the public interest, and not simply to refer the matter to the SMPC. The factors refer to the 'perceived urgency in the public interest of the need for change'. We note in our major points above our belief that IAASB should avoid identifying the public interest with particular stakeholder groups, such as investors in the capital markets.
- 30.** We note in our major points above our sense that IAASB is reluctant to open auditing standards for change because of the burden of the associated process, but we note a number of areas within the corpus of ISAs that require attention. We also note IAASB's apparent willingness to open a number of standards to deal with the disclosures project which seems to conflict with its stance on other issues. The environment in which IAASB now operates requires more ever-more flexibility, not less. Staff Papers, while meticulously produced, need to provide something above and beyond what a reasonably diligent reader can gather from the standards themselves, and we note above our approval of the draft Staff Paper on disclosures which appears to do exactly that. Nevertheless, we encourage IAASB, in conjunction with those charged with its governance and oversight, to revisit its processes and range of pronouncements with a view to addressing this long-standing problem.
- 31.** While we concur with IAASB's conclusion that it would be most appropriate to devote a significant majority of its resources to progress certain ISA and ISQC-related topics on an accelerated basis in the period 2015–2016, we note in our major points above our concern with the suggestion that in future periods, IAASB will focus on fewer projects that it does now. The recent past demonstrates IAASB's capacity for flexibility which will be needed even more going forward. We urge IAASB and those charged with its governance and oversight to look at the nature and extent of its process requirements, and consider whether they can be made more efficient while maintaining the quality of its output in the public interest. We believe they can.



## Proposed Work Program for 2015–2016

Q 2 (a) What are respondents views on the approach taken to the development of the *Work Program for 2015–2016*, in particular the IAASB's decision to focus on fewer key projects towards the goal of their completion by 2017?

Q 2 (b) What are respondents views on the appropriateness of the topics chosen as the focus for the *Work Program for 2015–2016* (see paragraph 4 of the Work Program and Table A on pages 26–29) in light of the strategic objectives set out in the IAASB's *Strategy for 2015–2019*?

Q 2 (c) Is there any action(s) or project(s) that has not been included in the *Work Program for 2015–2016* that you believe the IAASB should address during that period. For example, should any of the topics in Appendix 1 (on pages 39–41) be prioritized sooner? If so, which initiative(s) identified in Table A (on pages 26–29) do you believe should be replaced by this action(s) or project(s). Please provide an explanation of your views.

Q 2 (d) Are there any alternative approaches for the IAASB to consider in order to enhance the IAASB's ability to address calls from stakeholders for IAASB efforts on a variety of important topics, in light of the constraints of available resources and the need for due process to be applied in the development or revision of standards?

32. We note in our major points above that we are not wholly convinced by IAASB's proposal to focus on fewer key projects and that we believe that this is not the only alternative. We suggest that IAASB and those charged with its governance and oversight should consider other approaches, such as changes to IAASB's process requirements and range of pronouncements, particularly the extent to which highly specialised detailed drafting work is conducted in full sessions of what is a very large board.
33. We note in our major points above the fact we agree with IAASB's proposed focus on professional scepticism, the audit of financial institutions and some aspects of quality control, subject to the addition of at least one more item to this list. This might involve bringing forward projects on the risk ISAs, on various aspects of ISQC 1 or on group audits, as outlined in paragraph 14 above, or considering projects on documentation or audit and assurance services provided to smaller entities, as outlined in paragraphs 16-21.

## The proportionate application of ISQC 1

34. We strongly support IAASB in giving priority to quality control. We noted in our response to the consultation to the *Audit Quality Framework* that we are keen to offer our active support to help IAASB with this. ICAEW has done a great deal already in helping develop best practice and improve audit quality through our publications, videos and webinars, for example, and it remains a high priority for us. We continue to host the long-running *Audit Quality Forum* which brings together a variety of stakeholders, and the more recent *Audit Futures* initiative that has commenced a number of projects designed to help audit evolve to better serve society.
35. We continue to advocate an in-depth review of ISQC 1 – some aspects of which are now included in the proposed work programme - and we are particularly pleased to see reference to the importance of internal culture and auditor competencies. We believe that the type of material currently in IAESB's draft revised IES 8 on auditor competencies would be better directed to audit firms through ISQC 1 application material. We also consider that more needs to be done to promote the value of ISQC 1 and its adoption across the globe.
36. In reviewing its quality control standards, IAASB should pay particular attention to non-audit assurance and non-assurance engagements. Any quality control regime should be proportional and appropriate and we are not convinced that this can be achieved by just one standard which applies to the full range of engagements. In particular, we are not convinced that all of the requirements of ISQC 1, such as those on monitoring, should apply to

engagements such as compilations. We suggested in our response to the consultation on the revised ISRS 4410 that IAASB might revise or amend ISQC 1 in the form of an ISQC 2 for non-audit services.

37. IAASB indicates that activities supporting the use of the *Audit Quality Framework* will continue throughout the period 2015 to 2019. Table A and paragraph 50 refer to support for its use and it would be helpful for IAASB to develop a more detailed plan for this.

### Professional scepticism

38. Professional scepticism is an important topic but not one that can be fixed through ISAs alone. Peppering ISAs with requirements for auditors to be sceptical is not of itself likely to make auditors any more sceptical than they are now. We suggest that IAASB considers the need to facilitate a high-level dialogue that takes account of other important factors that affect scepticism. These include the quality of staff recruited into the profession, the standing of the profession, the training provided by firms, the tone at the top of firms, behaviours that are encouraged, and social and cultural norms. Practical guidance with examples of how scepticism can be applied is much more likely to benefit practitioners than new requirements *per se*.
39. IAASB's *Audit Quality Framework* has many references to the need for professional scepticism and the various ways to help achieve the necessary mind-set. Once again, we are happy to engage with IAASB on what else might helpfully be provided on scepticism for use by audit firms. Our guidance materials, such as our videos on professional scepticism, have sought to emphasise key practical matters for auditors in this area.
40. While we support the need for work on the audit of financial institutions, we are concerned that IAASB should be clear about the limitations of ISAs in this context and that it should not raise expectations excessively. Banking crises are not caused, cured, or prevented by auditing standards, although we hope that auditors and the standards they use will improve as a result of the most recent crisis. We are also concerned that the scope of this project will be limited to banks, with a nod to similar issues within insurance companies. Financial institutions are a broad church and while banks may be the problem today, it may be pension fund providers - or indeed utility companies or other entities - tomorrow. We do not think that IAASB can easily deal with the wide range of audit issues facing financial institutions all at the same time. Banks, insurance companies and pension funds might be better served by industry-specific IAPNs which require less process than ISAs and are more flexible.
41. We are concerned by IAASB's stated intention to focus its post-implementation review efforts on its auditor reporting standards and the fact that monitoring of the clarified ISAs is to be dropped as a formal project. We note in our major point above our belief that IAASB should not neglect the maintenance of the corpus of ISAs on which its well-deserved good reputation is based.
42. We agree with IAASB's proposal to develop a process to monitor recently released new or revised assurance, review and related services standards, and in particular to understand implementation issues facing SMPs in relation to the revised review and compilation standards.
43. IAASB is proposing the revision of one or more of the standards on analytical procedures, experts, sampling, service organisations and audit evidence. We do not believe that the standard on analytical procedures is fundamentally flawed or that it requires revision. However, some guidance on its application would be helpful. We have never heard of an audit failure attributed to faulty sampling and while we are aware that some technical aspects of ISA 530 exercise some regulators, academics and a few practitioners, we really do not think that given all of the other calls on its time that IAASB should even be considering this issue. If firms are interpreting the requirements of the standard in a manner with which regulators disagree, it is

very unlikely that a change to the standard will do anything other than create further scope for disagreement which needs to be resolved between firms and regulators.

44. Similarly, we suspect that some of the perceived problems with ISA 500 on audit evidence are more to do with regulatory disagreement with the manner in which firms are interpreting the requirements, and with documentation requirements elsewhere, rather than with the standard itself. We acknowledge issues concerning the balance between professional scepticism and the need to obtain evidence to support the audit opinion, but we do not believe that ISA 500 is fundamentally flawed or no longer fit for purpose, and we suggest that IAASB deal with this particular tension in its work on professional scepticism.