

Basis for Conclusions: Clarity

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

ISA 240 (Redrafted), The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

ISA 300 (Redrafted), Planning an Audit of Financial Statements

ISA 315 (Redrafted), Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment

ISA 330 (Redrafted), The Auditor's Responses to Assessed Risks

Prepared by the Staff of the International Auditing and Assurance Standards Board



**International Federation
of Accountants**

BASIS FOR CONCLUSIONS: CLARITY

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

ISA 240 (Redrafted), “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements”

ISA 300 (Redrafted), “Planning an Audit of Financial Statements”

ISA 315 (Redrafted), “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment”

ISA 330 (Redrafted), “The Auditor’s Responses to Assessed Risks”

This Basis for Conclusions has been prepared by staff of the International Auditing and Assurance Standards Board (IAASB). It does not form part of the approved amended Preface or the redrafted International Standards on Auditing (ISAs) 240, 300, 315, and 330.

Background

1. In September 2004, the IAASB issued the Exposure Draft (ED), Proposed Policy Statement, “Clarifying Professional Requirements in International Standards Issued by the IAASB,” and the Consultation Paper, “Improving the Clarity and Structure of IAASB Standards and Related Considerations for Practice Statements.”
2. Based on the responses received, the IAASB developed a proposal to improve the clarity of its Standards, designed to meet the needs of the widest range of stakeholders and users of the Standards. This was presented to an invited forum of interested parties to determine whether there was broad acceptance of the proposal, whether it was of sufficient benefit to be taken forward, and what further refinements may be needed.
3. On the basis of these consultations, the IAASB determined the conventions to be used in drafting future ISAs and other International Standards, including the obligations of auditors who follow those Standards, and the IAASB’s intended approach for implementing the new conventions. The IAASB was confident that the revised proposals would receive sufficiently wide acceptance, and concluded that further consultation would be most effective if the final proposals were accompanied by a number of draft ISAs to which they had been applied.
4. In October 2005, the IAASB therefore issued for exposure:
 - Proposed amendments to the Preface (ED-Preface), explaining the conventions to be used by the IAASB in drafting future ISAs and other International Standards, including the obligations of auditors who follow those Standards; and
 - Four ISA EDs (ED-ISAs), redrafted in accordance with the new conventions.
5. The IAASB received forty-six comment letters from a variety of respondents, including regulators, IFAC member bodies, and firms. Input was also received from the IFAC Small and Medium Practices and Developing Nations Committees. The IAASB revised

the ED-Preface and four ED-ISAs as a result of these comments, and released them in final form in December 2006.

6. Section I summarizes the more significant issues raised by respondents on matters applicable generally to the ED-Preface and the four ED-ISAs, and how the IAASB addressed them. The issues summarized below are:
 - Objectives: their completeness, form and the related obligation on auditors (paragraphs 8-38).
 - Requirements: their extent and detail (paragraphs 39-48).
 - Structure and drafting: the separation of requirements and application material, the inclusion of introductory and definitions sections and essential explanatory material, and guidance for audits of smaller entities (paragraphs 49-60).
7. Section II summarizes additional issues raised by respondents specifically in relation to each of the ED-Preface (paragraphs 61-68) and ED-ISAs (paragraphs 69-113), and how the IAASB addressed them.

Section I

Objectives

8. The explanatory memorandum accompanying the October 2005 Clarity EDs explained that the IAASB would specify, in a separate section at the beginning of each ISA¹, the objective of the auditor in relation to the subject matter of the ISA. Paragraph 19 of the ED-Preface required the auditor² to achieve those objectives when the ISA is relevant in the circumstances. Proposed objectives were specified in each of the four ED-ISAs, and views were sought from respondents on whether they were appropriate.
9. The overall message from responses was one of strong support for objectives-based standards. The idea of an objective in each ISA, with a corresponding obligation, received majority approval, and strong support by respondents in the regulatory community. The principal issues raised concerned the following:
 - The overall approach to determining the objectives, and the general form that they should take; and
 - The appropriateness of the proposed obligation on auditors to achieve the objectives.

The following paragraphs discuss these points, but the general support for the overall approach should be borne in mind in reading them.

¹ For convenience, this document refers to 'ISAs', 'auditor' and 'audit', rather than 'International Standards,' 'professional accountant' and 'engagement,' respectively, as used in the ED-Preface.

² See footnote 1.

Overall Approach

10. Several respondents were of the view that the determination of objectives on a case-by-case basis, as individual ISAs are redrafted, would create the potential for inconsistency or a set of objectives that may be incomplete in some areas, and limit the ability of the IAASB to evaluate whether these risks have been avoided. It was recommended that the objectives be developed taking a top-down approach, and reviewed in totality, at an early stage.
11. Further, a few respondents opposed having an objective specified in each and every individual ISA, particularly when taken together with the unconditional obligation on the auditor to achieve each of those objectives. It was argued that this approach fails to recognize that ISAs are an integrated body of standards, and the fundamentally different natures of some ISAs. The IAASB was therefore asked to reconsider its approach, and to consider whether it would be appropriate to establish a few, much higher-level objectives that serve as the foundation for the body of ISAs and which relate directly to the objective of an audit.
12. The IAASB accepted the need to create and consider draft objectives for all of the ISAs to obtain a total picture of the possible objectives and their interrelationships. It therefore undertook that exercise. This entailed considering the content of the extant ISAs and the International Framework for Assurance Engagements, and the collective experience and knowledge of members of the IAASB. Informal input was also obtained from representatives of the IAASB Consultative Advisory Group and national auditing standards-setters.
13. This exercise has helped the IAASB identify where there might be inconsistencies, and to eliminate them in the draft objectives. To the extent that there may be gaps in the objectives – and no significant gaps have been identified – it would have indicated matters that require additional ISAs, or substantive revision to existing ISAs. The IAASB accepts that the objectives should not be constrained by existing requirements, but does not believe that drafting objectives that go ‘over and above’ what is stated in the requirements, as suggested by a few respondents, should drive how the objectives are formulated for the purposes of a project primarily directed at clarifying current requirements. Intentionally creating a gap between the objectives and requirements is not a valid objective of the clarity project. However, if any such matters are identified during the course of the project, they will be considered under the IAASB’s future work program. That being the case, the IAASB saw no merit in holding a separate consultation on the complete set of objectives, but will welcome comments on individual future exposure drafts of ‘clarified’ ISAs, including whether the objectives are complete.
14. Based on the above exercise and taking account of the views expressed by respondents, the IAASB concluded the following. First, a single overall objective of the auditor, derived from the objective of an audit and supported by objectives in individual ISAs, should be specified. This reflects the need for there to be a coherent link between the objective of an audit and the ISA objectives and requirements for the auditor. The IAASB believes this can most effectively be done by restating the objective of an audit in a way that can more readily be related to the auditor’s work and the requirements of ISAs.

15. Second, an objective should, as originally proposed, be specified in each ISA. Although the IAASB accepted that the overall objective of the auditor is paramount, it is of the view that it is insufficient by itself to result in appropriate and consistent performance by auditors. It believes therefore that it is necessary and appropriate to create a specific objective for each ISA that is supported by its requirements.
16. The IAASB considers that including an objective in each ISA provides the necessary focus for the ISA and for the judgments to be made by the auditor. Further, this approach is more easily understood when compared to alternatives, and is consistent with the general expectation amongst many respondents that an objective for each ISA be specified. The IAASB noted that many respondents viewed the specification of an objective in each ISA as a key strength of the clarity proposals, providing a beacon (as one respondent called it) to which the auditor is aiming in following the requirements of an ISA, in particular in understanding the outcome to which the requirements are directed. In addition, the objectives provide a basis for the IAASB in considering what requirements should be specified.
17. Although the IAASB saw some merit in the alternative of specifying objectives for some, but not all, ISAs, it was concerned that this might send an incorrect message that ISAs without an objective were somehow less important than those that do contain an objective. This in turn could be seen as a weakening of the revised set of ISAs. The IAASB, on balance, concluded that this would be unhelpful, and that it is desirable to avoid such distinctions appearing to arise between different ISAs.

Form of Objectives

18. Proposed objectives were stated at the beginning of each of the four ED-ISAs. Many respondents considered them to be appropriate. However, the majority were of view that they took the form of a summary of the requirements rather than true objectives, and focused too much on process rather than the expected outcomes.
19. The IAASB accepted the view that objectives should reflect the outcome that the ISA is directing the auditor to achieve, and that objectives that are procedural in form may diminish the benefits of specifying objectives and blur the distinction between them and the requirements. However, the IAASB also considered that setting objectives at too high a level may make them ineffective. Accordingly, the IAASB is of the view that the objectives need to be specific enough to assist the auditor in: determining what is to be accomplished; understanding how the objectives and requirements relate; deciding what more, if anything, needs to be done; and evaluating whether they have been met.
20. The IAASB therefore agreed that the general form of objectives should take the following form: “The objective(s) of the auditor is to [achieve outcome] [through some means (if necessary or helpful to specify the means in the objective)].” That is, the objective is always the end, but it may sometimes be necessary to state the means to make the objective more effective. The IAASB revised the objectives of the ED-ISAs accordingly, with a view to having them feature prominently the outcomes expected of the auditor in relation to each ISA.

Obligation Attaching to Objectives

21. Paragraph 19 of the ED-Preface stated that the auditor must achieve the objective stated at the beginning of each ISA that is relevant in the circumstances of the audit. It explained that the auditor achieves the objective by complying with the requirements of the ISA, and by performing other procedures that, in the auditor's professional judgment, are necessary in the circumstances.
22. Although objectives and the related obligation were seen as key strengths of the approach being taken by the IAASB, several respondents were concerned about the absolute nature of the obligation, noting that the proposed wording does not allow for the inherent limitations of an audit, or for the fact that achievement of the objectives may not always be possible. Further, some respondents argued that if auditors were required to conclude separately whether each objective has been met, there is a risk that the auditor may not properly focus on the broader achievement of the objective of the audit.
23. The IAASB noted these concerns, but agreed that a solution must also reflect the general approval of the respondents for the notion that each ISA should have an objective, and that the auditor should have a significant obligation in relation to the objectives. The IAASB concluded the following:
 - The overall objective of the auditor should be to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to report on the financial statements in accordance with the auditor's findings. In all cases when this overall objective has not been or cannot be achieved, the auditor modifies the auditor's opinion accordingly or withdraws from the engagement in accordance with the ISAs. (Paragraph 12 of the Preface.)
 - Each ISA should contain an objective. (Paragraph 15 of the Preface.)
 - The auditor should be required to aim to achieve the objectives specified in the ISAs, having regard to the interrelationships amongst the ISAs. For this purpose, the auditor uses the objectives to judge whether, having complied with the requirements of the ISAs, sufficient appropriate audit evidence has been obtained in the context of the overall objective of the auditor. Where an individual objective has not been or cannot be achieved, the auditor considers whether this prevents the auditor from achieving the auditor's overall objective. (Paragraph 15 of the Preface.)
 - The differing nature and interrelationship of the ISAs should be acknowledged in the Preface. (Paragraphs 14 and 15 of the Preface.)
24. The IAASB is of the view that the above improves and refines appropriately the obligation relating to the objectives in response to the issues raised by respondents, while retaining the strength of the original proposal.
25. The obligation in relation to the objectives has been improved in several respects. First, it distinguishes the overall objective of the auditor from other objectives and places a specific obligation on the auditor to achieve that overall objective. This provides a

primary focus on the end result, rather than the individual components, of the audit process.

26. Second, the reference to reasonable assurance in the auditor's overall objective acknowledges the inherent limitations of an audit. This specifies appropriately the overall objective, and the context in which the objectives in individual ISAs are to be considered, and does not suggest an absolute and unachievable obligation. The obligation is therefore realistic.
27. Third, it acknowledges that there are consequences when the auditor's overall objective has not been or cannot be achieved. Specifically, as required by the ISAs, the auditor modifies the auditor's opinion or withdraws from the engagement.
28. Regarding the obligation with respect to objectives specified in individual ISAs, the proposed wording that stated that the auditor "achieves" these objectives has been replaced by the phrase "aims to achieve". As with the overall objective, this acknowledges the inherent nature of an objective – that is, the achievement of an objective cannot be mandated, only the attempt to achieve it and the consequences of failure. An alternative that mandated the achievement of each objective would require the objective itself to be redrafted to include the consequences of failure. The IAASB believes that doing so would detract from the clarity of the individual objectives.
29. The obligation relating to the objectives specified in individual ISAs also recognizes the context of the overall objective and the relationship amongst the individual objectives. This is important because the audit process is dynamic, and the ISAs are interrelated and not intended to be applied in isolation of one another. Further, it avoids superimposing the structure of the ISAs into the audit process.
30. Finally, the proposed wording that stated that the auditor achieves an objective by complying with the requirements of the ISA, and "by performing other procedures that, in the auditor's professional judgment, are necessary in the circumstances" has been replaced by the statement that "the auditor uses the objectives to judge whether, having complied with the requirements of the ISAs, sufficient appropriate audit evidence has been obtained in the context of the overall objective of the auditor." The purpose of this change was to focus the auditor on the desired outcome of obtaining sufficient appropriate audit evidence rather than on the means of achieving it.
31. The IAASB believes that the essence of the original proposal has been retained, refined by consideration of the responses to it. First, each ISA has an objective, and the auditor has an obligation in relation to those objectives. This was a cornerstone of the clarity proposal of the IAASB and supported by the majority of respondents.
32. Second, the obligation is a realistic one that recognizes that an objective may in some cases not be achieved, but the obligation specifies that the consequence of the failure to achieve an individual objective may be that the auditor cannot achieve the auditor's overall objective. It requires the auditor specifically to consider this possibility.
33. Third, objectives are used for the same purpose as that originally proposed – to determine whether, having complied with the requirements of the ISA, more needs to be done in the

circumstances to obtain sufficient appropriate audit evidence in the context of the overall objective of the auditor.

34. Further explanation of the obligation may be helpful to auditors, but the Preface is not the appropriate document for such material. The IAASB will consider the development of appropriate application and other explanatory material in ISA 200 when the IAASB revises it to incorporate relevant provisions of the Preface.

Documentation

35. The ED-Preface did not specify a documentation requirement in connection with the obligation attaching to objectives. Some respondents asked for greater certainty about whether there is a related documentation requirement and if so, the nature of that requirement. They noted the disadvantages of overburdening auditors with documentation that does not serve to enhance audit quality. A few respondents, particularly those from the regulatory community, found it important for there to be a link between objectives and documentation.
36. The IAASB is aware that there is substantial concern among auditors about the extent of documentation, and the need for an appropriate balance of effort between carrying out the audit and documenting it. New documentation requirements must be judged by the contribution that they make to the quality of the audit. The IAASB is of the view that audit documentation in connection with objectives can add value to the audit process only if it focuses the auditor on the consideration of how significant professional judgment was applied in important areas of the audit. Absent this context, the IAASB considers that a specific requirement for documentation about conclusions in relation to objectives may lead to ‘boilerplate’ that contributes little to the quality of the audit. Accordingly, the IAASB agreed in principle that ISA 230 (Revised), “Audit Documentation” should be amended to:
- Expand the extant requirement for the auditor to document significant matters arising from the audit to make it clear that this includes documentation of the significant professional judgments made in reaching conclusions on these matters.
 - Expand the related application material to highlight why such documentation is important, and the circumstances in which it would be appropriate to prepare audit documentation relating to the use of professional judgment, where the matters and judgments are significant.
 - Clarify that audit documentation that meets the requirements of ISA 230, together with the specific documentation requirements of other relevant ISAs, provides evidence of the auditor’s basis for a conclusion about the achievement of the overall objective of the auditor.
37. The IAASB believes that these changes, taken together, should serve to enhance the auditor’s judgment on significant matters and thereby the quality of the audit, while also providing documentation that may assist audit oversight authorities and others when reviewing audit files. It also believes that these amendments should not be subject to concern about over-documentation, as the documentation suggested focuses on those

areas where significant judgment is applied and ought to feature in good audit files (as in many cases it already will).

38. The IAASB agreed that these changes should be provided through amendment of ISA 230, rather than as part of the Preface. This is consistent with the recommendation of some respondents that it is inappropriate to include documentation requirements in the Preface. (ISA 230, revised for these matters, has been issued as an exposure draft in Clarity form, in December 2006.)

Requirements

Application of Guidelines for Specifying Requirements

39. A significant part of the IAASB's Clarity project is to review the material in the current ISAs that uses the present tense (generally regarded as guidance), and to consider whether that material in fact includes matters that should be stated as requirements. The explanatory memorandum accompanying the October 2005 Clarity EDs explained that the IAASB would determine the requirements of a Standard as follows:

- “The requirement is necessary to achieve the objective stated in the Standard;
- The requirement is expected to be applicable in virtually all engagements to which the Standard is relevant; and
- The objective stated in the Standard is unlikely to have been met by the requirements of other Standards.

In determining the requirements of a Standard, the IAASB will consider whether the requirements are proportionate to the importance of the subject matter of the Standard in relation to the overall objective of the engagement.”

40. Nearly all respondents supported these general guidelines. Several respondents, however, were not convinced that the guidelines had in all cases been applied consistently, particularly in the small-and medium-sized entity (SME) context. Although in many cases these respondents cited only a few new requirements that they thought did not appear to meet the guidelines, the IAASB was asked to re-examine its application of the guidelines have been met. In addition, some respondents observed that there is no evidence that either element of the proportionality test referred to in the explanatory memorandum had, in fact, been applied, although respondents often accepted it as an important aspect of the criteria for requirements.
41. The IAASB attributed much of the concern (in particular, whether the requirements were in fact ‘applicable in virtually all engagements’) to the fact that the wording of some requirements was not drafted to make clear their wide relevance. Accordingly, the IAASB agreed to amend the requirements of the redrafted ISAs, where applicable, to:
 - Convey adequately that they applied to both large and small entities.
 - Identify clearly any conditionality attaching to a requirement, thereby making clear any limits to their relevance and applicability.

42. Further, the IAASB considered carefully whether those new requirements that specify in detail the types of matters that should be considered by the auditor in undertaking an action or procedure or in making a judgment remain appropriate.
43. The IAASB acknowledged that considering whether the requirements are ‘proportionate’ presented some challenge in defining how proportionality is to be judged, and how the ‘test’ is to be applied. It agreed, however, that the intended result would have been achieved if:
- Each of the proposed new requirements appears necessary, and their absence may adversely affect the quality or consistency of audits having regard to the international context.
 - The requirements appropriately focus on the actions to be taken and on the question of whether a matter has been considered and appropriately addressed.
 - Each ISA, having regard to the requirements as a whole, is such as to result in the application of judgment and thoughtful consideration in light of the varying circumstances of the audit, and is unlikely to encourage a focus solely on compliance.

Based on the above, the IAASB is satisfied that the end result is appropriate.

44. A very few respondents were of the view that there remained a small amount of material in the application material that should be considered requirements, although within this group there were also suggestions that were directed towards the need to reduce the requirements. Overall, the IAASB is satisfied that it has not missed substantive requirements in its process of reviewing sentences containing the present tense.

Requirements Expressed Using “Shall Consider”

45. Paragraph 20 of ED-Preface stated: “If a Standard provides that a procedure or action is one that the professional accountant “shall consider,” the consideration of the procedure or action is required, while carrying out the procedure or action is not.” The phrase “shall consider” appeared extensively in the ED-ISAs, and the equivalent “should consider” or “considers” in extant ISAs. Several respondents raised concern over the use and intended meaning of this phrase, and noted that in some cases it is used in a way other than that described in the ED-Preface. It was also observed that, in some cases, requirements using “shall consider” are ambiguous, in that it is difficult to understand the context of the consideration when the requirement is not explicit about what is to be considered. Further, it was noted that it was unclear whether there is a related documentation obligation.
46. The IAASB accepted these points, and reviewed each use of “shall consider” in the ED-ISAs to determine whether in fact it is the clearest way of expressing the desired action. Although it concluded that the phrase should be avoided whenever requirements can be written in another way to explain exactly what the auditor is expected to do, the IAASB did not accept that the use of “shall consider” should be eliminated altogether. The IAASB believes that “shall consider” does reflect a reasonable action, particularly when the auditor is expected to review a matter and evaluate whether it is applicable in the circumstances in order to make a judgment or decide on a course of action. In some

cases, an alternative phrase that communicates the same intent in as clear and unambiguous manner is not possible. The IAASB is satisfied that the changes made to the ISAs improve their clarity, and that those requirements that retain the use of “shall consider” are appropriate.

47. The IAASB also concluded that, taking account of the improvement made to the ISAs, there is no need for an explanation of this kind included in paragraph 20 of the ED-Preface. Accordingly, paragraph 20 was removed.
48. The IAASB accepted the need for further guidance on documentation where the auditor is required to consider some matters. It agreed that this matter should be addressed as part of clarification of ISA 230.

Structure and Drafting

Separation of Requirements and Application Material

49. Each of the four ED-ISAs presented the requirements of the ISA in a section separate from the related application material. The explanatory memorandum accompanying the ED-ISAs explained that the IAASB believes that such separation appropriately distinguishes requirements from the application material, thereby maintaining clarity between what is required and what is guidance. It noted that a minority of the IAASB believed it would be an advantage to repeat the requirements at relevant points within the application material to enable the auditor to read the requirements and related application material together. The IAASB sought views of respondents on the relationship between the requirements and the application material.
50. A substantial majority of respondents expressed support for the separation of requirements and application material. It was observed that repetition of the requirements in the application material may confuse matters again regarding what is a requirement and what is application material, and that it is unnecessary in light of the obligation stated in paragraph 18 of ED-Preface (paragraph 14 of the final Preface) for auditors to consider the entire ISA. A minority of respondents expressed concern over the separation. The nature and balance of views and arguments raised for and against the separation were consistent with those considered by the IAASB in October 2005 and, accordingly, the IAASB concluded that no change is warranted.

Introductory Material

51. ED-ISA 240 was the only redrafted ISA of the four exposed in October 2005 to contain a separate ‘introductory section’ that served to explain the context in which the requirements of the ISA are set. Several respondents were of the view that the IAASB should establish a consistent practice regarding use of introductory sections across all ISAs.
52. The IAASB concluded that, unless absolutely necessary, introductory material should be kept to a minimum, as had been the case in ED-ISAs 300, 315, and 330. The IAASB believes that doing so will help to highlight the inclusion of such material in those ISAs where it is deemed necessary to elaborate on the scope or context of the particular ISA. For this purpose, the IAASB is satisfied that there is no further material in the extant and

redrafted ISAs 300, 315 and 330 that further defines their scope and warrants placement as part of the introductions of the ISA.

53. The IAASB concluded, however, that it is necessary to retain in redrafted ISA 240 certain material setting out the context of the auditor's responsibilities relating to fraud, as it is essential to a proper understanding of that ISA.

Essential Explanatory Material within 'Requirements' Sections

54. The explanatory memorandum accompanying the ED-ISAs explained that the Requirements section of redrafted ISAs may contain essential explanatory material where necessary to make that section understandable by an experienced auditor. Several of the ED-ISAs contain such essential explanatory material. Respondents found that this created a degree of unnecessary ambiguity; many mistook such material as requirements, or were of the view that much of it should be treated as application material. Several respondents also observed inconsistencies between the ED-ISAs in terms of the extent to which such material is included, and observed that the intent and status of the material are unclear.
55. The IAASB concluded that unless it is absolutely essential to include such material to define the scope of a requirement, the Requirements section of ISAs should contain only requirements. Accordingly, much of such material in the ED-ISAs was repositioned as application and other explanatory material, as recommended by respondents.

Definitions

56. Three of the four ED-ISAs contained a separate section including definitions of certain terms used in the respective ISAs. Respondents recommended that either all definitions be included in the Glossary of Terms (Glossary) and the Definitions section within the ISAs be eliminated, or if there is to be a Definitions section, to ensure it is complete.
57. The original intent of the use of a Definitions section was to:
- Highlight those new key terms being introduced by the ISA, which should be helpful to readers and translators.
 - Define certain terms without disturbing the flow of the requirements.
 - Embed definitions within the ISAs, given that the status of the adoption of the Glossary may be unclear in some jurisdictions.
58. The IAASB concluded that these aims remain valid, and therefore the use of a Definitions section in ISAs should be retained. It also agreed that there may be explanations of terms that are not strictly definitions, and therefore not included in the Definitions sections, but which may usefully be included in the Glossary.

Application Material

59. Some respondents urged the IAASB to reconsider the application material in the ED-ISAs pertaining to SMEs. It was noted that such material described the characteristics of SMEs that may differ from other entities, but often did not spell out the consequences for the application of the requirements, or the relevant considerations or types of procedures that may be appropriate in such circumstances. In some cases, the guidance was considered to repeat other points made. In light of the increase in the number of

requirements as a result of redrafting, respondents also sought additional guidance on the nature and extent of documentation to assist in clarifying expectations and in managing the potential documentation burden.

60. In reviewing each of the four redrafted ISAs, the IAASB has endeavored to improve the material discussing SME considerations. In particular, the ISAs are now more specific about how a requirement, including documentation requirements, might be applied in the audit of an SME.

Section II

ED-Preface

The following summarizes additional issues raised by respondents specifically in relation to the ED-Preface, and how the IAASB addressed them.

Applicability of the New Conventions

61. The ED-Preface presupposed that the new conventions would apply to all International Standards issued/effective after a certain date (to be specified). Some respondents observed that, as the focus so far had been principally on the ISAs, it may be inappropriate to extend the conventions to the other International Standards (such as those on Assurance Engagements) without further consultation.
62. The IAASB accepted this, and accordingly it has made the new conventions applicable only to the ISAs for the time being³. Therefore, the existing description of the authority and conventions of the Standards contained in the Preface remains applicable to the other existing Engagement Standards until the IAASB has further considered whether the new conventions can be applied thereto without amendment. However, the proposal that departures from existing basic principles and essential procedures should be documented has been retained, which the IAASB believes responds to the public interest and is appropriate for what should be a rare occurrence.

‘Relevant in the Circumstance’ (Paragraphs 13, 17-18 & 25 of the amended Preface)

63. Paragraphs 17, 19 and 21 of ED-Preface used the phrase ‘relevant in the circumstance’ or ‘relevant’ in connection with the description of the auditor’s responsibilities to apply ‘relevant’ requirements, or to document departures from such requirements. Several respondents found its use unclear, and questioned whether the IAASB intended the phrase to refer to a particular ISA, the objective stated in an ISA, or the requirements of an ISA, or all three. Some respondents took the view that relevance needs to be applied at the ISA or objective level only; others believed that it needs to be applied at the requirement level to allow for some judgment in determining whether to apply a requirement, particularly in the SME context.

³ The IAASB anticipates that ISQC 1, “Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements” will require clarification at the same time as ISA 220, “Quality Control for Audits of Historical Financial Information” is redrafted. Accordingly, to avoid uncertainty in the Preface the IAASB agreed that the Preface should specify that the authority of ISQCs will be set out in the introduction to the ISQCs (paragraph 23 of the Preface).

64. The IAASB believes that the question of relevance applies at both the ISA-level and at the level of the individual requirements therein. The Preface was therefore revised to eliminate any ambiguity in this regard and to introduce additional guidance explaining what may make something relevant or not; this included making clear that the notion of departure does not apply to requirements that are not relevant.

Documentation of Departures (Paragraph 21 of ED-Preface)

65. Paragraph 21 of ED-Preface required that, where in exceptional circumstances the auditor judges it necessary to depart from a requirement in order to achieve the purpose of that requirement, the auditor document how the alternative procedure(s) performed achieves the purpose of the requirement, and, unless otherwise clear, the reasons for the departure. A few respondents questioned whether it is necessary and appropriate to include a documentation requirement in the Preface, particularly when it is covered by ISA 230.
66. The IAASB accepted this point and, accordingly, removed from the Preface the proposed requirement to document a departure from ISAs. The IAASB agreed, however, to retain the requirement in the Preface in relation to the other International Standards issued by the IAASB. This was done because the Preface is the only document at present that sets out this obligation for other International Standards (i.e., ISA 230 deals only with audits of historical financial information).
67. One respondent expressed the view that the restriction on departure to where a procedure would be ineffective in the circumstance restricts the auditor in applying professional judgment and does not permit improvement in methodology. This point was debated by the IAASB in finalizing the ED-Preface. The IAASB remains of the view that whether a procedure is as effective or more effective than that specified in an ISA is highly subjective, and such a test may encourage departures from requirements in more instances than intended. The IAASB concluded that no new or persuasive arguments have been raised that would require the IAASB to reconsider its position.

Status of Other Material in Redrafted ISAs (Paragraphs 14 & 21-22 of the amended Preface)

68. Several respondents noted that although the Preface makes clear the status of objectives, requirements and application and other explanatory material, it does not do so for the 'introductory' and 'definitions' sections that some redrafted ISAs have. The IAASB accepted this point and, accordingly, introduced additional guidance to make clear the status of such material.

ED-ISA 315

The following summarizes additional issues raised by respondents specifically in relation to the ED-ISA 315, and how the IAASB addressed them.

Controls Relevant to the Audit (Paragraphs 12 & 20 and related application and other explanatory material of redrafted ISA 315)

69. Paragraphs 13, 14 and 17(d) and the related application material of ED-ISA 315 explained the auditor's responsibilities to obtain an understanding of internal control,

controls and control activities relevant to the audit. Several respondents indicated that practice varies in terms of applying the related requirements and guidance of extant ISA 315, and that there is difficulty in interpreting the intent of the ISA and in determining whether a control, or control activity, is relevant. Respondents urged the IAASB to consider whether ED-ISA 315 sufficiently explained “controls relevant to the audit” and the considerations appropriate when the auditor is making the necessary judgment.

70. The IAASB accepted these points, with some IAASB members confirming that such concerns do exist in practice. The IAASB agreed therefore to improve the consistency of the wording of redrafted ISA 315 with respect to references to *internal control*, *controls* and *control activities*, as appropriate. Further, the IAASB introduced new guidance to assist in the determination of whether a control is relevant, including guidance explaining that the auditor’s considerations include the significance of the identified risk to which the control relates, and whether the auditor thinks it is likely to be appropriate to rely on the control in determining the extent of substantive testing. The IAASB was of the view that these changes clarify an existing ambiguity and are therefore within the scope of the clarity project.

Components of Internal Control

Elements of the Control Environment (Paragraph 14 and related application and other explanatory material of redrafted ISA 315)

71. Paragraph 17(a) of ED-ISA 315 expanded the previous requirement to understand the control environment by requiring the auditor to obtain an understanding *inter alia* of specific elements thereof. Several respondents expressed concern, in general, over the detailed nature of the requirement, noting that it is too prescriptive and contains matters unlikely to be relevant in the context of the audit of an SME.
72. The IAASB accepted that moving this guidance material to a requirement detracted from the necessary focus on the understanding of the effect of the control environment, rather than on its elements. Accordingly, the IAASB concluded that this material should be repositioned as part of the application material of redrafted ISA 315.

The Entity’s Risk Assessment Process (Paragraphs 15-17 and related application and other explanatory material of redrafted ISA 315)

73. Paragraph 17(b) of ED-ISA 315 expanded on the requirement in extant ISA 315 for the auditor to obtain an understanding of the entity’s risk assessment process by specifying the components of the entity’s risk assessment process, and the actions required when the auditor judges that the process may not be adequate in the circumstances. Some respondents were of the view that the requirement did not meet the general guidelines specified by the IAASB for determining requirements, and that such detail belongs more appropriately as part of application material.
74. The IAASB attributed much of the concern by respondents to the fact that the wording used in ED-ISA 315 implied a formal process, and contained language that resulted in the requirement not being readily understood in the context of an audit of an SME. The IAASB concluded that the considerations are relevant to all audits of entities, but that the

applicability of requirement would be clearer if it gave specific consideration to the circumstance where an entity does not have a formal process.

Information Systems Relevant to Financial Reporting (Paragraph 18 and related application and other explanatory material of redrafted ISA 315)

75. Several respondents commented on the descriptive nature of the requirement in paragraph 17(c) of ED-ISA 315 pertaining to the information systems relevant to financial reporting, and recommended reconsideration of whether such detail is necessary, and whether each element is applicable in virtually all audit engagements. The IAASB noted that this requirement exists in extant ISA 315, established for the purposes of ensuring that relevant elements have been considered at an appropriate level of understanding. The IAASB therefore concluded that the requirement cannot be amended without potentially weakening the ISA.
76. Most respondents opposed the new requirement in paragraph 17(c)(i) of ED-ISA 315 for the auditor to understand the information system relevant to financial reporting by tracing transactions through the information system. This was previously guidance material. The IAASB accepted the view of respondents that the requirement unnecessarily specifies a certain auditing technique and that the ISA should not be prescriptive as to the manner in which the required understanding should be obtained. Accordingly, the IAASB concluded that this procedure should be repositioned as part of the application material of redrafted ISA 315.

Identifying and Assessing Risks of Material Misstatement and Significant Risks (Paragraphs 25 & 27 and related application and other explanatory material of redrafted ISA 315)

77. Paragraph 19 of ED-ISA 315 specified, as part of the requirements, the previous guidance about the principal activities of the auditor for purposes of identifying and assessing risks of material misstatement at the financial statement and assertion levels. Paragraph 22 established a new requirement, from material previously drafted as guidance, for the auditor to consider certain matters in determining whether, in the auditor's judgment, a risk is a significant risk. Several respondents were of the view that these matters address the application of the related requirements and would more appropriately be presented as application material.
78. The IAASB reconfirmed its view that the actions and considerations identified in paragraphs 19 and 22 of ED-ISA 315 represent requirements. The IAASB believes that they are essential to the proper and consistent exercise of professional judgment when making the required risk assessments, a matter fundamental to the objective stated in the ISA.
79. In addition to the above, the IAASB also concluded that grey-lettered material in extant ISA 200 pertaining to the auditor's assessment of risks of material misstatement at the financial statement and assertion levels, and material in extant ISA 500, "Audit Evidence" pertaining to the use of assertions, should be moved to paragraphs A98-A99 and A102, and A103-A105, respectively, of redrafted ISA 315. The IAASB considers this appropriate in light of the fact that redrafted ISA 315 contains the primary requirement

for the assessment of risks at the financial statement and assertion levels and the use of assertions in respect of the auditor's risk assessment, yet (absent the changes) provides limited or no guidance thereon.

Communication with Those Charged with Governance and Material Weakness in Internal Control (Paragraphs 31-32 and related application and other explanatory material of redrafted ISA 315)

80. Paragraph 26 of ED-ISA 315 required the auditor to make those charged with governance and management, at an appropriate level of responsibility, aware of material weaknesses in the design or implementation of internal control which have come to the auditor's attention. Some respondents noted that the requirements of an ISA should directly serve towards fulfilling the objective stated in the ISA, but in the case of this requirement the linkage appears unclear.
81. The IAASB accepted this point, and concluded that the link would be clearer, and the ISA improved by explicitly directing the auditor to consider whether, on the basis of the work performed, the auditor has identified a material weakness. The communication requirement is a consequence of this evaluation.
82. The IAASB also concluded that the existing definition of material weakness is unhelpful, as recognized by the current project to revise it, and therefore removed it from the list of defined terms until an improved definition is determined, with the expectation that an amended definition will be in place by the time the ISA becomes effective.

Other Matters Addressed in the Application Material of ED-ISA 315

83. A few respondents suggested that certain matters in the present tense in extant ISA 315 represent items that should be specified as requirements, including:
 - Understanding how transactions originate within business processes, and how the entity's business processes and information system ensure compliance with laws and regulations (paragraph A77 of ED-ISA 315).
 - Matters that may affect the auditor's understanding of the entity's selection and application of accounting policies (paragraph A24 of ED-ISA 315).
 - Specific risk assessment procedures in addition to inquiry to obtain audit evidence about the design and implementation of relevant controls (paragraph A62 of ED-ISA 315).
84. The IAASB reconsidered these but concluded that these represent matters guiding the application of the related requirements, rather than requirements in and of themselves.

ED-ISA 240

The following summarizes additional issues raised by respondents specifically in relation to the ED-ISA 240, and how the IAASB addressed them.

Fraud in the Context of an Audit of Financial Statements (Paragraphs 2-6 and related application and other explanatory material of redrafted ISA 240)

85. In addition to comments about the consistent use of introductory sections across the four redrafted ISAs (see paragraphs 51-53 of this document), respondents expressed various views regarding the balance between the material presented in the introduction and related application and other explanatory material sections of ED-ISA 240. Respondents made various suggestions for rebalancing the material, and encouraged the IAASB to ensure that the discussion of the responsibilities of the auditor and management and those charged with governance is presented in a balanced fashion.
86. The IAASB reviewed the material presented in the introductory and related application and other explanatory material sections of ISA 240. It concluded that these sections should contain only material essential to a proper understanding of the auditor's responsibilities under the redrafted ISA. For this purpose, the IAASB also agreed to:
 - Retain only material specific to fraud and the related inherent limitations of an audit; material of more general relevance will be placed in ISA 200.
 - Emphasize in the introduction the responsibility of the auditor for maintaining an attitude of professional skepticism, having regard to the characteristics of fraud.
 - Restructure the application and other explanatory material dealing with the characteristics of fraud to give greater emphasis to the fraudulent financial reporting element of fraud.
 - Introduce headings in the introductory section of the redrafted ISA to clarify further the nature and extent of the material included therein.

The Presumption of Risks of Fraud in Revenue Recognition (Paragraph 26 and related application and other explanatory material of redrafted ISA 240)

87. Paragraph 20 of ED-ISA 240 specified as a new requirement (formerly guidance) that the auditor shall presume that there are risks of fraud in revenue recognition, identify which types of revenues, revenue transactions or assertions may give risk to such risks, and treat those assessed risks of material misstatement due to fraud related to revenue recognition as significant risks. Several respondents questioned whether the proposed requirements would apply in virtually all circumstances, suggesting that fraud in revenue recognition is unlikely to be a risk prevalent in smaller entities. Respondents questioned also whether it is appropriate to single out revenue recognition when there may be other areas where specific attention is needed.
88. The IAASB believes that the new requirement reflected the intent of extant ISA 240. This was apparent both in the wording of the guidance in extant ISA 240 and the fact that it required the auditor to document cases where the auditor concluded that the presumption did not apply. Further, the IAASB concluded that fraud in revenue (either overstatement

or understatement) may exist in entities of all sizes, and that revenue is an area highly susceptible to fraud which requires specific attention by the auditor. Accordingly, the requirement was retained. However, in light of respondents' comments, the IAASB agreed to:

- Improve the wording of the requirement to integrate it better within the process of identifying and assessing the risks of material misstatement and significant risks.
- Introduce additional guidance explaining further the context in which the requirement is set, and emphasizing the fact that the presumption is rebuttable where it is not applicable in the circumstances of the engagement.

Risks of Management Override of Controls (Paragraphs 32-33 and related application and other explanatory material of redrafted ISA 240)

89. Paragraph 26 of ED-ISA 240 specified as a new requirement (formerly guidance) that the auditor shall consider whether, in order to respond to the risks of management override of controls, the auditor needs to perform procedures in addition to those specifically referred to in paragraph 25 of ED-ISA 240. Several respondents noted that this requirement is unnecessary in light of the obligation in paragraph 19 of the ED-Preface for the auditor to perform other procedures as necessary in the circumstances to achieve the objective stated in the ISA. On the other hand, at least one respondent noted the importance of the robustness of the requirements relating to management override of controls, in light of the ever-present risk of such override.
90. The IAASB considers that it is important to the consistent application of redrafted ISA 240 to make clear that there may be specific additional risks of management override of controls that are not covered as part of the procedures performed to meet the requirements in paragraph 25 of ED-ISA 240. Accordingly, the IAASB has retained the proposed requirement (paragraph 33 of redrafted ISA 240). However, it concluded that the clarity of the requirement would be improved by stating that the specified procedures are performed irrespective of the auditor's assessment of the risks of management override of controls, and by explaining that the auditor is required to determine whether additional audit procedures are needed in order to respond to the identified risks of management override of controls.
91. The IAASB also considered that more proactive language for the requirement in paragraph 25(c) of ED-ISA 240 (paragraph 32(c) of redrafted ISA 240) would enhance the clarity of the ISA. It did not believe, however, that incorporation in that requirement of examples of transactions that are outside the normal course of business or that may constitute an unusual transaction, as suggested by one respondent, would be appropriate, in light of the potential of inadvertently defining too narrowly such transactions. Nor did it believe this to be necessary since the auditor has an obligation to consider the application and other explanatory material relating to the requirements of the ISAs.

Professional Skepticism (Paragraphs 13-14 and related application and other explanatory material of redrafted ISA 240)

92. A few respondents, variously, suggested that it may be appropriate to specify as requirements the following application and other explanatory material pertaining to professional skepticism:
- The description of professional skepticism (paragraph A13 of ED-ISA 240);
 - The direct confirmation with a third party or using the work of an expert to assess a document’s authenticity where the auditor has doubts about the reliability of a document (paragraph A14 of ED-ISA 240); and
 - The corroboration of responses to inquiries of management (paragraph A22 of ED-ISA 240).
93. The IAASB is of the view that such matters are clearly in the nature of application and other explanatory material, and that it would be inappropriate to specify as requirements the specific procedures that might be performed arising generally from the auditor’s maintenance of an attitude of professional skepticism. The IAASB concluded, however, that the proper application of professional skepticism does require the auditor to be alert to matters that may affect the reliability of audit evidence obtained. Accordingly, the IAASB revised redrafted ISA 240 to require the auditor to investigate inconsistencies where responses to inquiries of management or those charged with governance are inconsistent (paragraph 14 of redrafted ISA 240).
94. Related to the issue of professional skepticism, one respondent urged the IAASB to reconsider whether the threshold for acceptance by the auditor of documents as evidence (i.e., “unless the auditor has reason to believe to the contrary....the auditor may accept records and documents as genuine”) is adequate. The IAASB deliberated this substantive issue in finalizing extant ISA 240, and did not consider it appropriate to re-examine its position at this time; it is not a matter of the clarity or understandability of the present responsibilities of the auditor or the existence of a gap in content that requires correction or the development of additional guidance. The point raised has been recorded on file for consideration as and when redrafted ISA 240 is revised in the future. The IAASB also observed that the new requirement in redrafted ISA 240 (paragraph 15 of ED-ISA 240; paragraph 13 of redrafted ISA 240) appropriately requires the auditor to take investigative action when conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the auditor.

Other Matters Addressed in the Application Material of ED-ISA 240

95. The IAASB was also asked to review the bulleted examples in the appendices of ED-ISA 240 to identify matters that warrant inclusion in the Requirements section. The IAASB did not identify any such matters.

ED-ISA 330

The following summarizes additional issues raised by respondents specifically in relation to the ED-ISA 330, and how the IAASB addressed them.

Reliance on Internal Controls (Paragraph 7(a)(ii) & 8(a) and related application and other explanatory material of redrafted ISA 330)

96. Paragraph 8 (a) of ED-ISA 330 required the auditor to design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls when the auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively. One respondent urged the IAASB to clarify this requirement, as many practitioners are misinterpreting the phrase "...includes an expectation that the controls are operating effectively" to mean that the auditor is obliged to adopt an audit approach that uses tests of the operating effectiveness of those controls, even though it may be more efficient to perform a substantive audit.
97. The IAASB noted that the intent of extant ISA 330 is to require the auditor to test the operating effectiveness of controls only when the auditor is adopting an approach in which the auditor intends to rely on the effective operations of controls in determining the nature, timing and extent of substantive procedures. It accepted that there may be potential ambiguity arising from the fact that the requirements of extant ISA 330 do not explicitly state this. Accordingly, the IAASB revised paragraphs 7(a)(ii) and 8(a) of redrafted ISA 330 to clarify this point.

Extent of Test of Controls (Paragraph 9 and related application and other explanatory material of redrafted ISA 330)

98. Paragraph 15 of ED-ISA 330 specified as a requirement (formerly guidance) that the auditor shall increase the extent of tests of controls the more the auditor relies on their operating effectiveness in the assessment of risk. Some respondents noted that this requirement is not only flawed in its focus on extent only, but also unnecessary in light of the requirement in paragraph 8 of ED-ISA 330 for the auditor to design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls when the specified conditions exist.
99. The IAASB accepted the argument that the appropriate action when intending to increase reliance on a control is not always to increase the extent of testing. It concluded that the auditor should seek more persuasive audit evidence, which can result from modifying the nature, timing or extent of procedures, rather than extent only. The IAASB therefore amended the requirement to require the auditor, in designing and performing tests of controls, to obtain more persuasive audit evidence as the auditor places greater reliance on the effectiveness of a control. The IAASB also concluded that the requirement should be retained, as it clarifies and amplifies appropriately the general requirement for the auditor to design and perform tests of controls, thereby assisting the consistency with which the redrafted ISA is applied.

Communication with Those Charged with Governance and Material Weaknesses in Internal Controls (Paragraphs 18-19 of redrafted ISA 330)

100. A respondent noted that although ED-ISA 315 required the auditor to communicate a material weakness in the *design or implementation* of internal control with those charged with governance, there was no corresponding requirement in ED-ISA 330 regarding a material weakness in *operating effectiveness*. It was recommended that one be added to redrafted ISA 330.
101. The IAASB accepted this recommendation and, accordingly, revised redrafted ISA 330 to require to the auditor to:
- Evaluate whether, on the basis of the audit work performed, the auditor has identified a material weakness in the operating effectiveness of controls (paragraph 18 of redrafted ISA 330); and
 - To communicate material weaknesses in internal control identified during the audit on a timely basis to management at an appropriate level of responsibility and with those charged with governance (unless all of those charged with governance are involved in managing the entity) (paragraph 19 of redrafted ISA 330).
102. The IAASB is of the view that this change is consistent with the intent of extant ISA 330, and aligns the redrafted ISA more closely with that of redrafted ISA 315, thereby reducing or removing any potential ambiguity that may have existed.

Substantive Analytical Procedures (Paragraph 23 of ED-ISA 330)

103. Paragraph 23 of ED-ISA 330 specified new requirements, based on material previously provided as guidance, about matters that the auditor considers when planning to perform substantive analytical procedures with respect to the period between the interim date and the period end. Several respondents opposed setting those matters as part of a requirement, noting that they are ancillary, rather than fundamental, to the objective of the redrafted ISA, and are clearly in the nature of guidance as to how and when to perform analytical procedures.
104. The IAASB accepted these points, having regard to the general need to revisit the consistency with which the IAASB had applied its guidelines for determining requirements. The IAASB concluded that the proposed requirement was at a level of detail that is inconsistent with the other requirements of the redrafted ISA. Nor did it consider the requirement as essential to the achievement of the objective of the ISA. Accordingly, the material was repositioned as application and other explanatory material in support of the requirement in paragraph 23 of redrafted ISA 330.

Audit Evidence from Prior Period Substantive Procedures (Paragraph 24 and related application and other explanatory material of redrafted ISA 330)

105. Paragraph 24 of ED-ISA 330 specified a new requirement, based on material previously provided as guidance, for the auditor to use audit evidence obtained in previous audits as substantive audit evidence in the current period only if the audit evidence and the related subject matter have not fundamentally changed; if the auditor planned to use such evidence, the auditor was required to perform audit procedures during the current period

to establish its continuing relevance. In reviewing the requirements of the proposed ISA against the general guidelines, the IAASB concluded that treatment as a requirement does not appear necessary in light of the rarity of such circumstances. Accordingly, the proposed requirement was removed and reinstated as guidance (paragraph A50 of redrafted ISA 330).

Adequacy of Presentation and Disclosure (Paragraph 25 of redrafted ISA 330)

106. Paragraph 25 of ED-ISA 330 required the auditor to perform audit procedures to evaluate whether the overall presentation of the financial statements, including the related disclosures, are in accordance with the applicable financial reporting framework. A few respondents questioned the need for this requirement in light of the proposed objective, and whether it is redundant because of ISA 700 (Revised), “The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements.”
107. The IAASB believes that the requirement follows from the revised objective of ISA 330. The evaluation of the presentation and disclosure relates to the assessed risk of material misstatement at the assertion level regarding the form, arrangement, and content of the financial statements and their appended notes, which is an essential activity as part of obtaining sufficient appropriate audit evidence.
108. The IAASB accepted the principle of the point being made by respondents, in that the requirement does relate, in part, to the auditor’s formation of an opinion. Accordingly, the IAASB reconsidered whether this requirement, and those within other ISAs that relate to forming an opinion, should be moved to a separate ISA dealing solely with forming an opinion. It discussed the proposed content and some preliminary drafting but concluded that the clarity and coherence of the ISAs are best preserved by retaining such requirements in the ISAs as they are at present.

ED-ISA 300

The following summarizes additional issues raised by respondents specifically in relation to the ED-ISA 300, and how the IAASB addressed them.

Clarity of the Wording of Certain Requirements

109. Respondents noted variously that some of the wording of the requirements of ED-ISA 300 is ambiguous. In response the IAASB redrafted the wording of the requirements to improve their clarity and specificity in terms of what precisely is expected of the auditor. For example, the IAASB replaced the phrases ‘important factors’ and ‘ascertain resources’ used in paragraph 7 of ED-ISA 300 with more specific wording (paragraph 7 of redrafted ISA 300).

Communication with Management (Paragraph A4 of redrafted ISA 300)

110. ED-ISA 300 excluded guidance contained in paragraph 27 of extant ISA 300 pertaining to communication with those charged with governance and management. This was done on the presumption that it would be dealt with in revised ISA 260, “Communication with Those Charged with Governance.” The IAASB subsequently concluded that that guidance is not appropriate for inclusion in ISA 260, as it relates to discussions with

management about matters of planning to facilitate the conduct and management of the audit (for example, to coordinate some of the planned audit procedures with the work of the entity's personnel). Accordingly, the IAASB reinstated this material in redrafted ISA 300, edited appropriately.

Acceptance of, and Withdrawal from, an Engagement (Paragraph A5 of ED-ISA 300)

111. Paragraph 5 of ED-ISA 300 required the auditor to perform certain preliminary engagement activities, as required by ISA 220, “Quality Control for Audits of Historical Financial Information” and ISA 210, “Terms of Audit Engagements.” Paragraph A5 of ED-ISA 300 explained, in the context of an audit of an entity in the public sector, that the auditor’s mandate may create an obligation to accept, and an inability to withdraw from, an engagement and therefore the preliminary engagement activities set out in paragraph 5 of ED-ISA 300 would not be applicable. The IAASB believes that this consideration exists, in some cases, in the private sector as well, and so the public sector consideration was deleted. It also decided that the points would be better positioned in ISAs 220 and 210 respectively.

Other Matters Addressed in the Application Material of ED-ISA 300

112. One respondent suggested that it may be appropriate to specify requirements:
- For the auditor’s documentation of the overall audit strategy to record the key decisions considered necessary to properly plan the audit and to communicate significant matters to the engagement team (derived from paragraph A13 of ED-ISA 300).
 - For the auditor’s documentation of the audit plan to demonstrate the planned nature, timing and extent of risk assessment procedures, and further audit procedures at the assertion level for each material class of transaction, account balance, and disclosure in response to the assessed risks (derived from paragraph A14 of ED-ISA 300).

The IAASB was also asked to review the bulleted examples in the Appendix of ED-ISA 300 to identify matters that warrant inclusion in the Requirements section.

113. The IAASB concluded that these items represent, in substance, matters guiding the application of the related requirements, rather than requirements in and of themselves. The IAASB did not identify any matters in the examples in the Appendix that warrant inclusion in the requirements section.



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