IAASB International Auditing and Assurance Standards Board

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# IMPLEMENTATION OF THE CLARIFIED INTERNATIONAL STANDARDS ON AUDITING (ISAs)

ENHANCING AUDIT QUALITY






## IMPLEMENTATION OF THE CLARIFIED ISAs

**The International Auditing and Assurance Standards Board (IAASB)'s International Standards on Auditing (ISAs) are internationally-recognized standards that provide a global benchmark for audits of financial statements.**

- 126 jurisdictions around the world have adopted the ISAs or otherwise use them as the basis of their national standards.[i]
- There is significant acceptance of the ISAs for audits of financial statements of foreign issuers among the world's largest stock markets.
- The Financial Stability Board identifies the ISAs as one of 12 key international standards relevant to sound, stable and well-functioning financial systems.
- The International Organization of Securities Commissions (IOSCO),[ii] the Basel Committee on Banking Supervision, the World Federation of Exchanges, the World Bank and the United Nations Conference on Trade and Development have expressed their support for the ISAs.
- The 22 largest firms' audit methodologies align with the ISAs.[iii]

This platform of use of the ISAs around the world continues to strengthen as additional jurisdictions move to adopt the IAASB's recently clarified ISAs in recognition of the benefits of using a common set of high-quality global standards to their national financial reporting and auditing infrastructures.

ACHIEVING CLARITY


# INTRODUCTION

In March 2009 the IAASB completed its Clarity Project [iv] and released its full set of 36 clarified ISAs and the clarified International Standard on Quality Control (ISQC) 1.[v] The clarified ISAs became effective for audits of financial statements for periods beginning on or after December 15, 2009.

The Clarity Project involved a comprehensive review of all the ISAs and ISQC 1 to improve their clarity and, thereby, their consistent application. Approximately half of the clarified ISAs include substantive changes that aim to improve practice in a variety of respects (see the list of the clarified ISAs as revised and redrafted on page 7).[vi] The IAASB has committed to developing a process for gathering information to help it evaluate whether further changes need to be made to these clarified standards. This is being undertaken in two phases:

### Phase One—Pre-Implementation Monitoring [vii]

This phase of the project has involved obtaining pre-implementation information from a number of countries and firms about their experiences in introducing the clarified ISAs into their national standards or firm audit methodologies.

Phase One was not about monitoring which countries and firms have adopted the clarified ISAs. Rather, its objective was to obtain an understanding about the experiences to date for some of those countries and firms that are implementing the ISAs to help provide an early indication of whether:

- There are areas of difficulty regarding use of the ISAs;
- It is believed there is a need for additional guidance; or
- Other actions are needed to facilitate the successful implementation of the standards.

Information was obtained primarily from responses to survey questionnaires completed by eight larger auditing firms and by 11 countries that participate in the IAASB's National Auditing Standard Setters Liaison Group.[vii] The survey group was selected with a focus on those countries and firms that are adopting the clarified ISAs or using them for purposes of their national standards or firm methodologies, largely in line with the effective date of the ISAs.

### Phase Two—Post-Implementation Review

The second phase will be a post-implementation review of the ISAs, to be undertaken when the clarified ISAs have been in use for at least two years from their effective date.

# KEY FINDINGS – PHASE ONE

### Improvements to the Standards Resulting from the Clarity Project

- The clarity conventions applied in the format, structure and drafting of the ISAs are viewed as helpful improvements. Most adopters welcomed the changes and confirmed that the format does not present problems when incorporating the clarified ISAs in national auditing standards and firm audit methodologies.
- Many thought that the added rigor of the revised standards was appropriate and a helpful response to issues raised by the global financial crisis. However, there is some anxiety about the application of the ISAs to audits of smaller entities, notably whether they can be applied in a cost-effective manner.

In general there were no themes that suggest that at this stage implementation of any of the ISAs poses significant difficulties, with the exception of some concerns about one, relatively narrow, aspect of ISA 600 [ix] (see page 5).

### Preparing for ISA Implementation

- Those firms and countries surveyed were well-advanced in their implementation. Nearly all noted that preparing a robust implementation plan is a key factor in the successful implementation of the clarified ISAs.
- The following were noted as important elements in implementation planning:

**Countries:** Developing and communicating the national adoption and implementation strategy (including, where applicable, planning the timetable for changes to relevant legislation); Arrangements for translation of the ISAs (where applicable); and Developing training programs.

**Firms:** Developing updated audit methodologies and software; Developing training courses for firm personnel; and Communicating with audit committees about the impact of changes on audit performance.

In preparing for implementation some countries have found it helpful to confirm that in the first year of implementation the clarified ISAs do not apply to periods less than one year. The IAASB has provided clarification about its intentions in that regard—see IAASB's Frequently Asked Questions available at www.ifac.org/clarity-center/faqs-and-other-clarity-resources.

### Translation[x]

Some countries among those surveyed have translated or are in the process of translating the clarified ISAs. Among those countries some provided feedback about areas giving rise to translation challenges including, for example, use of complex language; long and difficult sentences; and use of words that have nuances that give rise to different interpretations in translation.

### Audits of Group Financial Statements (ISA 600)

- In relation to ISA 600, a number of firms raised issues relating to how to apply the requirements of ISA 600 to a significant component that is accounted for under the equity method under the applicable financial reporting framework.

- While the definition of a component has not changed from the previous ISA 600 to the clarified ISA 600, the nature and extent of the group auditor's involvement in a significant component has changed to reflect the "sole responsibility" concept—specifically, a level of involvement is needed as part of:

  (a) The group auditor's risk assessment to identify significant risks of material misstatement of the group financial statements. This requires the group auditor to have access to the component auditor and to documentation of the component auditor's conclusions on significant risks, and to component management (ISA 600.30).

  (b) The group auditor's evaluation of the appropriateness of the further audit procedures to be performed by the component auditor to respond to the significant risks of material misstatement of the group financial statements identified in a component, and in determining whether it is necessary for the group auditor to be involved in the further audit procedures (ISA 600.31).

This approach assumes that the group auditor has available access to the component auditor. A number of firms have indicated that in some instances, which are expected to be relatively rare, such access may not be available. In these circumstances ISA 600 suggests that the auditor's report may need to be modified, but in some jurisdictions the listing authority does not accept a modified audit report.

### Conformity of National Auditing Standards with the Clarified ISAs, and Modifications to the Clarified ISAs

- Most of the countries surveyed have developed their national auditing standards adopting the clarified ISAs, albeit in some cases with effective dates different to that of the ISAs.

- Some countries have adopted the clarified ISAs with only minimal modifications; some have made more extensive modifications. Modifications are mainly to add additional requirements either with regard to particular national laws, or because the national auditing standard setter believes that existing requirements in national auditing standards should be retained. In some cases the ISA requirements have been modified.

- While some countries provide a detailed trail of the modifications made to the clarified ISAs (often with reasons for the need for modifications) these can be complex and difficult to follow. It is likely to be difficult for readers to understand the extent to which national auditing standards differ from the clarified ISAs, and the implications of the differences.

- A number of countries have found the IAASB's Policy Position[xi] on modifications to the clarified ISAs helpful. However, few countries make reference to it when promulgating national auditing standards. Only a few countries have taken the step of making an unambiguous statement about the conformance of the national auditing standards with the ISAs.

- While a few countries use the (ISA) abbreviation within the name of their national auditing standards, most do not. The naming of national auditing standards appears to largely reflect the national regulatory structure of which the auditing standards are part, rather than the "degree of closeness" to the ISAs themselves. In some cases, the national standards made no reference to ISAs even though they had been issued without modification.

## RESPONSES TO KEY FINDINGS

### Audits of Group Financial Statements: Entities that Have Joint Ventures or Significant Influence but Not Control over Significant Component Investments

Group audit engagements that involve significant components that are joint ventures or investments for which the group has significant influence, but not control, may require additional planning considerations to obtain the necessary audit evidence and involvement by the group engagement team when a component auditor will be performing work on the financial information of that component. Situations in which it is anticipated that group auditors will not be able to have the necessary involvement are expected to be rare.

Where such situations do exist IAASB believes that early identification of potential difficulties in obtaining sufficient appropriate audit evidence and communication with the audit client will be a critical element of effective planning of group audit engagements to avoid unnecessary modifications to the group audit report.

There are differing views as to the extent to which this issue will create difficulty in practice and the IAASB has asked the Forum of Firms to provide information about the extent and nature of problems experienced on 2010 audits. Furthermore the Forum of Firms has agreed to alert its members to this concern and to encourage early discussion with client management or those charged with governance, as appropriate, to help avoid potential problems on a timely basis.[xii]

### Application of the Clarified ISAs to Smaller Audits

The clarified ISAs were developed with a view to being applied to audits of all sizes.[xiii] However, the IAASB notes that the effective implementation of the ISAs, on audits of entities of all sizes, is closely linked to the effectiveness of related training programs. Responsibility for the training of auditors lies with national accountancy bodies and audit firms. While the IAASB cannot mandate the nature and extent of training that auditors receive in the clarified standards, it does hope its implementation support initiatives (including the development of video modules for a number of the revised ISAs)[xiv] are helpful for education and training programs.

Professional bodies in countries that are adopting the ISAs are putting significant effort towards providing adoption and implementation support for small and medium practices (SMPs) on use of the ISAs for audits of small- and medium-sized entities (SMEs), including practice aids, guides, e-learning modules and educational events. However, it seems there is currently little sharing of this material on an international basis, and the IAASB considers there is likely to be benefit in sharing implementation support material on a regional or international basis to bolster effective application of the clarified ISAs on smaller audits.

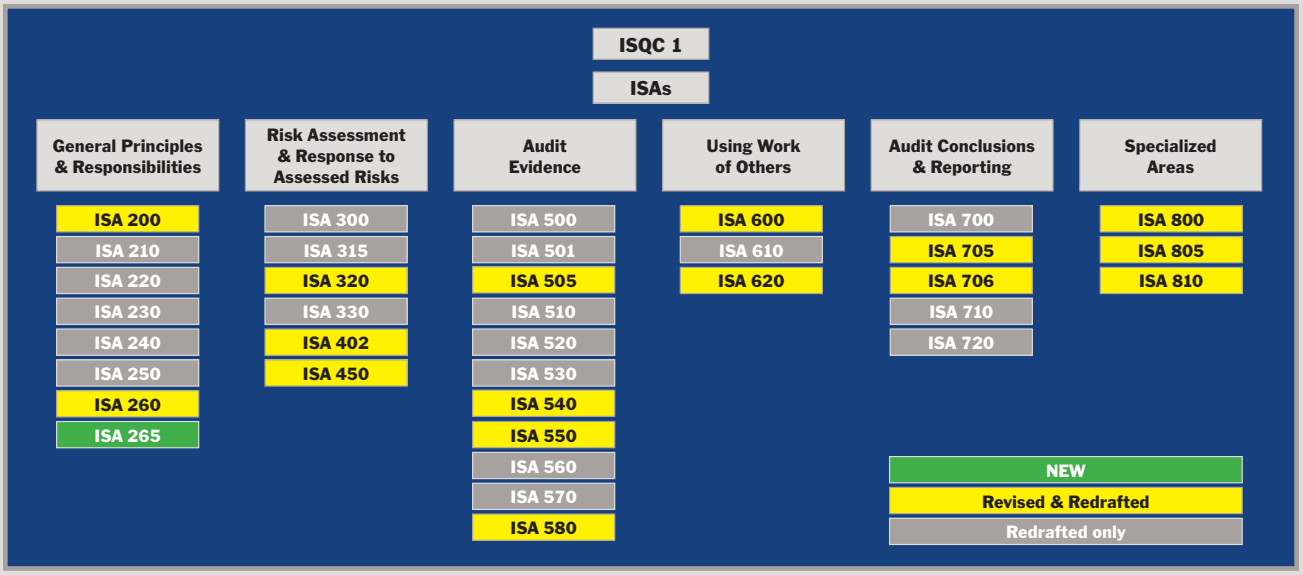
### IAASB Survey of SMPs

Some Phase One survey responses anticipated concerns about use of the clarified ISAs for smaller audits, including audits of micro-entities. The IAASB recognizes that it needs specific information on the extent and nature of any implementation difficulties on smaller audits, including information about areas that are perceived as having the greatest impact on being able to perform those audits cost-effectively. Accordingly the IAASB has initiated a survey for SMPs from a range of countries that have already implemented the clarified ISAs. Information about use of the ISAs for audits of smaller entities performed for financial periods in 2010 and 2011 (that is, two audit cycles) will be analyzed as part of Phase Two of the project.

### Auditor Reporting—Statement of Compliance with the ISAs in Auditors' Reports of Multinational Entities

For audits undertaken for multinational entities or entities that undertake cross-border transactions, IAASB believes there is likely to be benefit in the auditor stating compliance with the ISAs in the audit report, in addition to stating compliance with national auditing standards of the entity's home jurisdiction. Such a reference to compliance with the ISAs will serve as a clear signal to users of the audited financial statements that the audit performed complies with auditing standards that are internationally accepted and widely adopted.

## THE CLARIFIED ISAs AND ISQC 1: AREAS OF CHANGE




## PHASE TWO—POST-IMPLEMENTATION REVIEW

The IAASB is continuing discussions with stakeholders about how best to gather information about the way the clarified ISAs are being applied in practice. In addition to the SMP survey that is being undertaken (see above), the IAASB will design a process to obtain and evaluate information about implementation of the ISAs based on information to be collected in 2012. This will allow those firms and countries that have adopted the clarified ISAs in accordance with the effective date established by IAASB to provide information about the implementation of the clarified ISAs where they will have been applied over two successive audits.

## ABOUT THE IAASB

**The IAASB develops auditing and assurance standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance. The structures and processes that support the operations of the IAASB are facilitated by IFAC.**

## ENDNOTES

I. Information about countries that have adopted the ISAs is available from the IFAC Compliance Program, available at web.ifac.org/isa-adoption/chart.

II. IOSCO Statement on International Auditing Standards issued in June 2009 notes that IOSCO has endorsed the replacement of the previous ISAs with the new standards, noting the improvements that have resulted from clarifying the ISA requirements. IOSCO has recognized the important role the ISAs are able to play in facilitating cross-border securities offerings and listings in capital markets, and encourages securities regulators to accept audits performed and reported in accordance with the clarified ISAs for cross-border offerings and listings, as many securities regulators already do with respect to their capital markets. The statement is available at www.iosco.org/library/statements/pdf/statements-7.pdf.

III. The Forum of Firms promotes (among its other objectives) the consistent application of high quality audit practices worldwide, including the use of ISAs, and has expressed support for convergence of national audit standards with ISAs. Further information is available at press.ifac.org/news/2009/03/forum-of-firms-welcomes-completion-of-iaasb-clarity-project-encourages-firms-to-focus-on-implementation-issues.

IV. Full information about the Clarity Project can be found at www.ifac.org/IAASB/ProjectHistory.php?ProjID=0024.

V. ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

VI. Sixteen of the clarified ISAs incorporated revisions made to the previous ISAs. Information about the revised and redrafted ISAs is available at web.ifac.org/download/IAASB_Clarity_10-08.pdf.

VII. In June 2010, the project Task Force tabled a report on the findings from Phase One of the project. The report is available at www.ifac.org/IAASB/Meeting-FileDL.php?FID=5524.

VIII. See information available at www.ifac.org/IAASB/NationalAuditingStandardSetters.php.

IX. ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

X. See IFAC resources for translation of standards published by the International Federation of Accountants available at: www.ifac.org/Translations.

XI. Modifications to International Standards of the Auditing and Assurance Standards Board (IAASB)—A Guide for National Standard Setters the Adopt IAASB's International Standards but Find it Necessary to Make Limited Modifications, July 2006, is available at web.ifac.org/media/publications/d/modifications-to-internatio/modifications-to-internatio.pdf.

XII. See also the press release issued by the Forum of Firms on 7 October 2010 available at press.ifac.org/news/2010/10/forum-of-firms-focuses-on-practical-application-of-group-audit-standard.

XIII. An IAASB staff publication was issued in 2009 to explain how the ISAs can be applied to audits on a proportional basis. It is available at: web.ifac.org/publications/international-auditing-and-assurance-standards-board/practice-alerts-and-q-as.

XIV. Information about the ISA video modules developed to date by the IAASB is available at web.ifac.org/clarity-center/support-and-guidance#support-modules.



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