



Organización Internacional de Comisiones de Valores  
International Organisation of Securities Commissions  
Organisation internationale des commissions de valeurs  
Organizaçào Internacional das Comissões de Valore

February 27, 2006

Mr. James Sylph  
Technical Director  
International Auditing and Assurance Standards Board  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, NY 10017

Email [Edcomments@ifac.org](mailto:Edcomments@ifac.org)

Re: IAASB Exposure Draft on Improving the Clarity of IAASB Standards

Dear Mr. Sylph:

IOSCO's Standing Committee No. 1 on Multinational Disclosure and Accounting appreciates the opportunity to comment on the IAASB's October 2005 Exposure Draft of proposed changes to the International Standards on Auditing (ISAs) 240, 300, 315, and 330 and the Preface to ISAs, relating to the project to improve clarity of IAASB Standards.

As an international organization of securities regulators representing the public interest, IOSCO Standing Committee No. 1 (SC 1) is committed to enhancing the integrity of international markets through promotion of high quality accounting, auditing, and professional standards. Our comments in this letter reflect those matters on which we have achieved a consensus among the members of SC 1 and are not intended to include all comments that might be provided by individual members on behalf of their respective jurisdictions.

#### **We welcome the introduction of objectives into standards**

We strongly support the introduction of objectives into the international auditing standards. We seek high quality standards that will serve the public interest by guiding auditor practice and providing accountability for audit performance. We believe that standards that have clear and well-formulated objectives will contribute to auditor performance and accountability, provided that it is also made clear to auditors that achievement of the objectives for all the ISAs is *mandatory*.

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We also strongly support the concept that auditors must achieve the objective stated at the beginning of each standard and that in achieving the objective the professional accountant may need to perform procedures other than those set out in the standard. This is a message that needs to be stressed in each standard as well as in the Preface.

IOSCO has been seeking an improvement in the clarity of ISAs for many years, beginning with our concerns that the earlier introduction of bold type and present tense to indicate requirements in the ISAs was an ambiguous approach that detracted from the quality of the standards. We were very pleased to see the IAASB begin a project to address this in 2003. We have monitored the progress of this project from the initial proposals to replace bold type and the present tense with specific language that would indicate mandatory and conditional requirements, which we welcomed, to the project's expansion in 2005 to encompass a restructuring of the entire body of ISAs, and most recently, the issuance of the first Exposure Draft (ED) of redrafted ISAs.

The expansion of the Clarity project to redraft ISAs into separate sections for Objectives, Requirements, and Application Material has received mixed reactions among our members. While all our members are in favor of specifying clear objectives and clear requirements in standards, member reactions are less uniformly supportive of a three-part approach for standards.

Some of our members welcome the IAASB's proposal to redraft ISAs into separate sections for Objectives, Requirements, and Application Material, believing that this approach could make the standards easier to read and understand. However, other members are concerned that separating requirements from related explanatory material that elaborates upon them could make standards less understandable and also harder to enforce. Because of these mixed opinions, we will reserve our judgment as to whether the three-section approach in the restructured ISAs will in fact improve clarity and understandability until we can judge its use in practice by auditors and by those who must enforce auditing standards.

In the attachments to this letter, we respond to the questions presented in the ED and provide additional comments on the way in which the redrafting of the ISAs is being executed and on the clarity and quality of the standards being produced. We have not responded to all questions in the ED, but rather to those questions for which the members of SC 1 have experience to offer and consensus views. Our additional comments on a number of substantive points in the redrafted ISAs are provided to assist the Board as it further considers these ISAs and do not constitute a full assessment on our part of those standards.

We would like to emphasize in this letter some overarching comments relating to the IAASB's approach for the new standards, as follows:

**The objectives for all the ISAs need to be identified and evaluated at an early stage in this project.**

"Objectives" play an extremely critical role in the new form of ISAs, both in driving the definition of stated requirements and in providing the foundation for auditor judgment. We have concerns regarding the completeness and interrelationships of the objectives, and concerns in the way that individual objectives are stated in these first four redrafted ISAs.

On the completeness and interrelationships of objectives, we believe that the IAASB needs to do additional work on the identification and formulation of objectives among the various ISAs. We believe it is essential for the staff and Board to identify the objectives implicit in the current existing body of ISAs – which should reflect the objectives for an audit in total – and then look to see whether the identified objectives do form a coherent whole. Only in this way will it be possible to assess with confidence whether the objectives for an individual ISA are adequate.

Without a review of all the objectives for all the ISAs it is difficult to ascertain whether the individual objective provided in a particular ISA is sufficient to lay out (all) the relevant outcome (s) to be achieved in that subject area. For example, if an objective that one might think should be appropriate for a particular ISA is not present, how is one to know whether this is a deficiency in that ISA, or a matter of how the ISAs are organized because the necessary objective appears in another ISA? It is important to understand how the individual ISAs, and their objectives, relate to one another.

We recognize that on page 9 of the Explanatory Memorandum, under the heading “Consistency of the Body of ISAs as a Whole,” it is stated that “the Board will consider whether the content (in particular the objectives and requirements) of the redrafted ISAs is consistent, complete, and free of overlap” before the ISAs are finalized. We presume that the Board is referring to the entire body of ISAs to be redrafted, or at least the body covered in the 2005-2007 work program. We think this overall consideration is extremely important and we think the consideration to identify and evaluate the objectives of all ISAs should be part of the Board’s deliberations at an early stage in the Clarity project. We also believe that particular attention needs to be paid to ISA 200, as this ISA provides the context for considering and using individual standards on particular aspects of an audit. We believe it would be helpful to accelerate the timing to combine reconsideration and redrafting of ISA 200 with the Board’s evaluation of the objectives for the entire body of ISAs.

We understand that an effort to identify and analyze all objectives now and accelerate work on ISA 200 would delay the beginning of work on additional specific standards; however, we believe that this investment of time could facilitate and greatly speed up the remaining restructuring process and could help to produce better standards.

As we were considering these issues of objectives and the interrelationships of ISAs, some of our members found it helpful to sketch out and discuss illustrative diagrams of how it appears that the ISAs and their objectives relate to one another. We think it would be useful for the Board to consider whether some type of illustration of the interrelationships between ISAs could be useful as an aid to understanding. As information for the Board’s consideration, we have included two charts that were used in our discussions but are not necessarily suggesting that the Board would use either of these diagrams. We discuss this further in our answer to Question 2.

**The objectives in individual ISAs need to be stated more clearly and explicitly.**

Some of the objectives in the redrafted ISAs as now written do not clearly and sufficiently communicate the objective of an auditor’s work in terms of the outcomes to be achieved. We believe these objectives will not be sufficient to guide the auditor’s judgment of work needed and will not establish accountability for performance. For example, the objective laid out for

ISA 300 does not seem to reflect an outcome, but instead a procedure or process, and so it is unclear how this proposed objective could satisfy the Board's criteria.

The Board's idea to identify objectives for an ISA and then to drive the requirements and guidance from that objective is a key potential strength for ISAs. It is direct and it is clear to say as noted in paragraph 19 of the Preface, 'the professional accountant must achieve the objective stated at the beginning of each Standard'. However, we would like to see some additional explanation of what is intended by the remainder of that sentence "... that is relevant in the circumstances of the engagement". Is this intended to refer to the objective or the standard as being relevant? Does "relevant" mean in every audit where the subject or condition is present and therefore "existence" makes it relevant? Or could other factors or criteria enter into a determination of "relevance".

**There is a need to emphasize more strongly that it is mandatory for the auditor to achieve all objectives in the ISAs.**

This could be done by including the word "must" in the individual statements of objectives, or by stipulating more prominently in ISAs that the objective(s) for each ISA must be achieved.

We recognize that paragraph 19 in the Preface addresses this issue, and that page 6 in the Explanatory Memorandum states that "a similar description to that proposed as an amendment for the Preface will be included also in ISA 200 when it is revised." However, the status and future placement of the Preface is unclear to us and we are not confident that the statement in paragraph 19 will be widely noticed by auditors looking at ISAs. Some of our members are also unsure whether a companion addition to ISA 200 will be sufficient. We believe that the obligation of auditors to achieve the objectives of each ISA must be made abundantly clear in the body of ISAs, and we urge the IAASB to explore how best to provide the needed emphasis.

**Consistency in presenting the requirements in ISAs.**

Part of the value of the IAASB's stated three-part approach and the criteria it establishes for requirements in a standard arises from its potential usefulness in guiding the development of individual ISAs. As we reviewed the four redrafted ISAs, our observation is that they do not appear to have been developed consistently.

Some ISAs have minimal explanation with one requirement, yet in a succeeding requirement present additional information that does not appear to meet the IAASB's stated criterion of being "essential explanatory material necessary to make the section understandable by an experienced professional accountant" – for example, compare paragraph 23 to paragraph 25 in the redrafted ISA 240.

In another case, an ISA presents information in the Application Material Section that we believe is of the same nature and importance as related but incomplete explanatory content that appears in the Requirements section. For example, in ISA 240, paragraph 25 states that "the auditor shall design and perform audit procedures to respond to the risk of management override of controls" and then in subparagraphs (a) through (c) the ISA provides additional descriptions of required procedures. When one reads paragraph 25 (a) through (c), and then

reads the associated Application Material section paragraph A44, some of the material in A44 seems essential to having a proper understanding of the requirements of paragraph 25. Taking paragraph 25 (c) as another example, we think that some mention in 25 (c) of the types of specific conditions described in the five bullets under paragraph A48 would explain what is meant by "outside the normal course of business or otherwise unusual."

Paragraphs A13, A14, and A22 of ISA 240 were also noted by some of our members as having content that should appear in the Requirements section. Please see our fuller discussion of some consistency or completeness issues in individual ISAs in the Attachment to this letter.

We believe the Board should reexamine how the division of ISA content between "Requirements" and "Application Material" has been carried out under its guiding principle and criteria, utilizing additional staff resources if needed to check for logic and consistency.

### **Content or substance of a requirement**

We notice in the redrafted ISAs frequent instances where the term "shall consider" is used and are concerned that inappropriate application of this term could weaken the auditing standards. Sometimes this term is used when a more specific action-oriented or decision-oriented term such as "determine", "evaluate" or "assess" would be appropriate. At other times, it appears that "shall consider" is used with more than one meaning in different parts of the ISAs, for example, when different actions and conditions are presented in a Requirements section and the auditor must decide whether they are needed or applicable in the audit. We are concerned that the ISAs fail to make clear that a "shall consider" statement appearing in a requirement is an audit procedure that involves a specific judgment choice, the outcome of which should be documented in some way in the audit work papers. It should be clear what has been done as a result of the auditor's choice or judgment.

Terms like determine, assess and evaluate imply the performance of specific procedures and actions and are more useful in guiding auditor performance. In other circumstances, the auditor is required to "think about something" and to conclude whether or not it is necessary to do something. We think consideration should always be given to use of more concrete decision or action words before settling on the term "shall consider".

We recognize that paragraph 20 of the proposed Preface states that "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." But what is missing from paragraph 20 is content regarding what is involved in "consideration" and how the assessments, evaluations, judgments and resulting actions of the auditor should be documented. We provide further comments on this subject in the attachment to this letter in our response to Question 10.

### **Explanatory material in Requirements versus Application Material sections.**

We note that certain ISAs have very short and minimally-stated requirements, while others have more explanation mixed in with the requirements – for example, compare the stated requirements in ISA 315 to ISA 330 and ISA 240.

Some of our members have noted that portions of what is now in the Application Material sections appear to constitute required actions that would need to occur in all audits and should therefore, under the Board's principles for redrafting, be brought forward to requirements. Examples mentioned include additional coverage of actions to address the need for professional skepticism in ISA 240 and other specific content in the application material in this standard. At the same time, members recognize the concern that too much detail in a Requirements section could create a procedural focus that might detract from a focus on the overall objective of the ISA, and understand that this is a factor favoring keeping the requirements minimally stated, in outline form as much as possible.

As it needs to be clear that meeting the objective in an ISA could necessitate auditor work *beyond* what is stated in listed requirements, all of our members agree that we do not want lists of requirements that are too lengthy, but at the same time we want all the actions and procedures that would need to occur in all audits to be present. This would be in accordance with the Board's stated criteria for requirements.

In determining the optimum level of explanation to accompany requirements in ISAs, as well as the stated requirements themselves, we ask that the Board evaluate whether any of the actions that are presently described only in the Application Material *would* need to occur in all audits. If so, we request that these be brought forward to Requirements and stated concisely. We also ask that consideration be given to providing greater emphasis on the Application Material as being important guidance that describes best practices and matters that must be addressed fully by the auditor.

#### **Consistency of Format and Content in Redrafted ISAs.**

We note an inconsistency in the content of the introduction in the four ISAs exposed for comment. We suggest that the Board confirm whether introductions should only present scope and date of application as described in the Explanatory Memorandum, or should also present some background commentary as was done with one of the four ISAs. We do not believe it will improve clarity to have the Introductions in some ISAs elaborate about one or more aspects of the subject of the particular ISA, as is done in the proposed ISA 240, but not do this in other ISAs. We think the format of ISAs should be consistent from ISA to ISA.

An additional concern that we have about Paragraphs 3 through 9 in the redrafted ISA 240 is that the text seems principally designed to lower expectations about what others might think an auditor should do or that an audit can accomplish. We do not think this is helpful guidance for auditors or the right tone to set in an auditing standard on fraud.

We also note that, as described in the Proposed Preface, a definitions section could be included in some ISAs but not in other ISAs. We believe that all the needed definitions for terms, words, and phrases used in ISAs should be in one place for ease of reference and consistency. Therefore we do not support having a definition section in individual ISAs. The appropriate place for definitions is the Glossary. It should be updated whenever necessary, so that it can serve as an authoritative data dictionary for ISAs. Having a single source for all definitions assists users of the ISAs and can prevent problems that may arise when words are defined differently within what is a single body of ISAs. We noticed in the redrafted ISAs some instances where a definition presented in the ISA did not exactly match a related

definition that is in the current glossary - for example, the definitions of fraud, tests of controls, internal control, and significant risk.

As one other general comment on the redrafting of ISAs, we noted a number of instances where an ISA contained some very long sentences. Overly long sentences are difficult to understand for both native English speakers and those for whom English is a second language. We would therefore encourage the Board to have an editing process to identify and eliminate very long sentences.

**Gaps in ISA content that are identified in the process of redrafting ISAs should be corrected as part of the revision of the ISA, whenever possible.**

We recognize that this comment is not a minor point in terms of the Board's project strategy. However, as we have reviewed the redrafted ISAs and considered the work involved on the part of the Board and others, we have concluded that this strategy should be reexamined. We believe that as an individual standard is being redrafted, it is highly desirable that gaps in guidance that are discovered should be corrected, and new guidance developed and proposed, as part of the standard's revision process.

We understand that the Board's originally stated intent in redrafting ISAs under the clarity project was merely to redraft the content in a previous standard and not add new provisions into a standard. However, the redrafting of standards is a major revision program that has gone beyond clarifying the requirements originally presented in bold type and present tense, and we can see that this project will require work over a considerable period of time. For the IAASB to continue to follow a plan that says that a standard that needs "improvement" as well as "redrafting" would only receive redrafting in the current project will virtually guarantee that any deficiencies discovered in ISAs are relegated to a growing cumulative list of problems and go uncorrected for a substantial amount of time. We also note that the Board has elected to remove content that it believes is repetitive and unnecessary. We think the Board should also add content that it discovers to be missing.

Once a standard has been opened up for review and redrafting by virtue of the clarity project, and exposed for public comment, we believe it would be better to carry out the job of revising the standard once for both substantive improvements and clarity changes.

As examples of important content that we believe to be missing in a standard, paragraphs 7 and 15 of ISA 240 cause us concern. These statements set a very low bar for the auditor's work with regard to the acceptance of documents as evidence. When the previous ISA 240 was exposed for comment during its development, IOSCO SC 1 made a comment that we thought was very useful and reasonable request from regulators. Our comment concerned the need for the auditor to do more than simply assume authenticity *when a document is the sole supporting evidence for a material financial statement amount and is of a nature that is susceptible to fraud*. We were disappointed that this comment was not addressed and picked up in the final revision of the standard at that time. The language in this most recently redrafted version of ISA 240 now states that "Unless the auditor has reason to believe to the contrary.... the auditor may accept records and documents as genuine."

We believe that there should be some coverage in ISA 240 of such basic and desirable actions as "examining a document for appearance of alterations, or for a lack of signatures that would

be expected to be present” and also “evaluating the significance of this document in supporting the financial statement assertions, such as when the document is the sole support for a material financial statement item”. Such basic actions were the substance of our earlier comment on this standard and we urge the Board to make these additions to ISA 240.

**Priorities and timetable.**

Now that we have seen the first four redrafted standards and have had an opportunity to consider many issues raised by the proposed new approach to ISAs, our members are concerned about the suggested project plan and the currently listed priorities. We believe it is highly important to identify and evaluate the adequacy of the objectives of all of the present ISAs before proceeding much further in the redrafting efforts, and we also believe that standards improvement work should be incorporated into the clarity redrafting project work. We discuss this further in our response to Question 9 in the attachment.

This concludes our general comments on the Clarity ED and the work on this project so far. As stated earlier, our comments in response to questions in the ED and a number of additional comments regarding particular ISAs are contained in the Attachments to this letter.

Questions regarding any of the comments in this letter may be directed to me or to Susan Koski-Grafer on 202-551-5300.

Yours truly,



Scott A. Taub  
Chairman  
IOSCO Standing Committee No. 1



## ATTACHMENT 1

### **Responses to questions in the Exposure Draft**

*The responses to each of these individual questions in the Exposure Draft should be read in combination with the statements made in our accompanying letter of general comments.*

***Q1. In the light of the separation of requirements and application material, as presented in the four ISA Exposure Drafts, do you believe there is a need to repeat the requirements at relevant points within the application material to enhance context and reference, as discussed on page 10?***

We do not object to some repetition of requirements or reference to requirements in the Application Material section when the Board believes that this would increase understanding of the matters being discussed; however, we caution that undue repetition should be avoided, as this could increase the focus on specific requirements and lessen the focus on the objectives in an ISA.

As we discussed this issue, we came to the conclusion that *reference to requirements* that are being further explained and discussed in the Application Materials section, as opposed to *repetition of requirements* may be useful and should be done whenever the Board thinks this would be helpful. Certainly there should be no prohibition or constraint against making mention of requirements that are being explained and discussed. For example, in paragraph A45 from the redrafted ISA 330, we note the repeat of the requirements from paragraph 19. We support this as a good example of how the Application Material can both refer back to a requirement and elaborate on it, providing additional clarity to the readers of the standard.

***Q2. Are the objectives to be achieved by the auditor, stated at the beginning of the proposed ISAs, appropriate?***

Following our comments earlier in this letter, we believe that the objectives as stated in the redrafted ISAs are not appropriate yet. Our main concerns are:

- The activity-based character of some of the proposed objectives;
- Lack of coherence between the objectives;
- Wording of the objectives.

We believe that further work is needed to present objectives clearly as outcomes and results to be achieved, and would suggest some rewording of most of the objectives. Some of our specific concerns are described below, and further comments appear in Attachment 2 of this letter.

In ISA 315 (Revised) the objective sets the target for the auditor only “to obtain an understanding” (sufficient to carry out other stated actions). We believe it would be more effective if the objective of the auditor were focused more to the outcome to be achieved, e.g., “the development of an assessment of all relevant risks of material misstatement at both the

level of the financial statements and the assertions for classes of transactions, account balances and disclosures” - as opposed to “obtain an understanding of.”

We think that obtaining an understanding of an entity should be a requirement in order to make an effective risk assessment rather than be stated as the objective. Therefore we would omit this part of the objective, and transfer this text to the requirements section. Some members also suggest that the statement ‘whether due to fraud or error’ in this objective is unnecessary, because this is already part of the general objective for an audit.

We suggest skipping the first part of the objective, namely “In relation to this ISA” because we believe that the whole set of objectives for individual ISAs should be derived from the overall goal of an audit. The part of the objective we propose to skip stresses the opposite, namely the objective in relation to the specific ISA, not to the whole audit. Furthermore it makes the objective longer, which does not contribute to clarity.

On the other hand, we believe it is useful to have two distinct levels of risk assessment - namely, the assessment on the level of the financial statements and on the level of assertions. We think that this gives more clarification of the objectives.

We would like to raise for the Board’s consideration the overall objective of an audit of financial statements as stated in ISA 200 – Objective and General Principles Governing an Audit of Financial Statements. Today ISA 200 states that “The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.” We believe it would be appropriate to provide greater emphasis within a statement of the objectives of an audit to reflect objectives from the perspective of the persons who desire and use financial statements in the capital markets – investors and lenders. We believe it is important to describe the objectives of the audit from the public interest and users’ standpoint as well as from the standpoint of the auditor’s work and process. We would therefore propose that a statement of the general objectives of an audit of financial statements should also include such statements as “The objective of an audit of financial statements is:

- a) The detection of any material misstatements, whether due to fraud or error, in the financial statements;
- b) The determination of whether the financial statements are in accordance with the applicable financial reporting framework in all material respects;
- c) The development and issuance of an appropriate auditor’s report.”

Our discussions of these objectives included reflection on the concepts of “absolute assurance” versus “a high level of assurance” and “reasonable assurance” along with the fact that achievement of objectives should be mandatory. In our view, these concepts of assurance should refer to *the way in which the mandatory objectives are pursued by the auditor*. By this we mean that an objective itself should describe the desired end state – the outcome – to be achieved and not be qualified in any way. However, a standard could recognize that the auditor would be working to obtain a high level of assurance, not absolute assurance, that the objective is attained. In this way, we can reconcile the mandatory achievement of objectives with the reality that absolute assurance cannot be guaranteed.

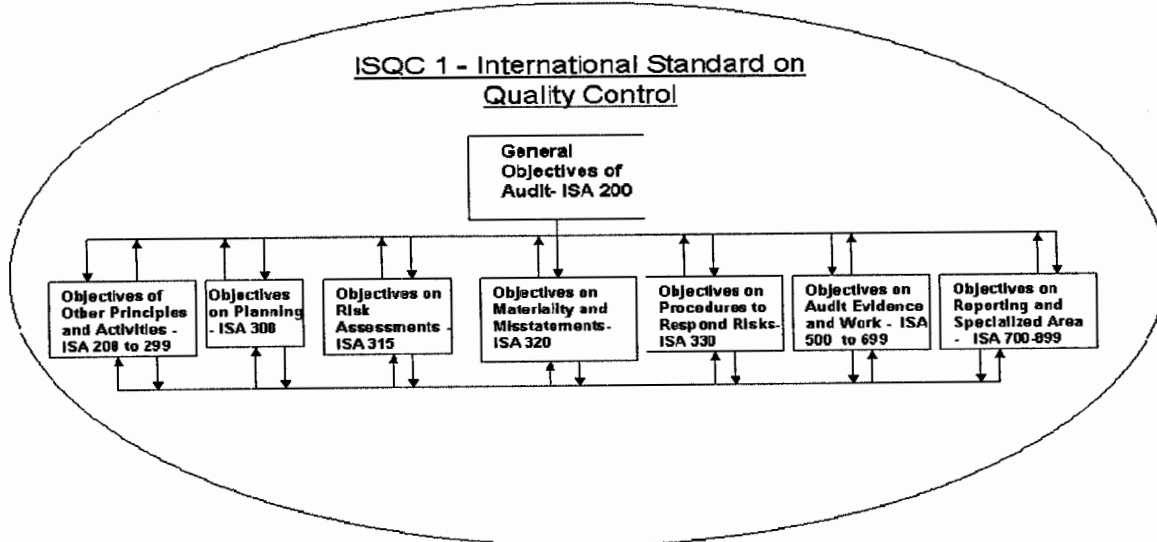
As we worked with objectives, some of our members found it helpful to try to diagram the relationships between the ISAs and their objectives and also ISQC 1. We share two that we used in our discussions and encourage the Board to consider if some type of illustration of relationships – not necessarily what we used – would be helpful in the standards.

Schema of Objectives

Illustration 1



Illustration 2



***Q3. Have the guidelines identified by the IAASB for determining whether a requirement should be specified, as set out on page 6, been applied appropriately and consistently, such that the resulting requirements are at a level that promotes consistency in performance and the use of professional judgment by auditors?***

In our view the application of the guidelines for determining whether a requirement should be specified, can be improved. We believe this could promote consistency in performance and the use of professional judgment by auditors, and also improve the enforceability of the ISAs. The main improvements can be met by a better distinction between requirements and application material and by rewriting the requirements.

We suggest that the requirements be restated. We have three suggestions to improve the requirements. First: to accentuate the relationship between objectives and requirements. Second: to distinguish activities from behavioral aspects (such as professional skepticism). Third: to include documentation requirements for the decisions made, the activities performed and the conclusions drawn.

One example of a missing requirement to document an audit adequately is paragraph 27 in ISA 315, which does not require the auditor to document the communication with management and those charged with governance regarding material weaknesses, if any, in the design or implementation of internal control. While the most recent draft of the proposed ISA 260 contains a statement that the auditor “may” do this, ISA 315 does not mention this nor provide a cross reference.

***Q4. Has the application material been edited in a way that makes it clearer?***

Although much of the application material contributes to a clarification of the work of an auditor in specific situations, we have made comments earlier regarding the presence of some material in the Application Material sections that all or some members believe should be in requirements, and vice versa. Our members recognize that bringing forward too much application material into the requirements could provide a level of specificity which may not enhance the overall quality of the audit, and we request that the Board review application material to ensure that any actions and procedures that would be needed in all audits do get brought forward into requirements.

As some examples that we have identified, we cite paragraphs A13 and A14 in ISA 300. We believe that, in virtually all audits, it should be a requirement that the documentation include the matters set forth in these application material paragraphs: A13: The auditor’s documentation of the overall audit strategy records the key decisions considered necessary to properly plan the audit and to communicate significant matters to the engagement team. A14: The auditor’s documentation of the audit plan is sufficient 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.

Also, we ask that the Board evaluate the bulleted examples in the Appendix for ISA 240 and ISA 300 to identify matters that warrant inclusion in the Requirements section.

***Q5. Has an appropriate balance been achieved between eliminating duplicative material and retaining some repetition in the proposed ISAs to help users understand a particular ISA or how the ISAs interrelate?***

We would not be able to answer this question without performing a detailed review on the total set of ISAs, including both old and new ISAs, as well as an analysis on an ISA by ISA analysis.

***Q6. Do you support the way in which special considerations in the audits of SMEs and public sector entities have been presented in the application material?***

SC 1 has no comments to offer in this area.

***Q7. Do respondents from developing nations foresee difficulties arising from the changes in the proposed ISAs in their environment?***

SC 1 has no comments to offer in this area.

***Q8. Do you foresee any potential translation issues?***

SC 1 has no comments to offer in this area.

***Q9. Do you agree with the proposed implementation approach, including priorities and timetable, as discussed on pages 8 and 9 and as set out in Appendix 1?***

Now that we have seen the first four redrafted standards and have had an opportunity to consider many issues raised by the proposed new approach to ISAs, our members feel the proposed implementation timetable appears very optimistic. At the same time, there are a number of ISAs that we would welcome work on sooner rather than later, especially ISAs listed in Category IV on the timetable, those planned to be addressed in the period 2008 - 2011.

Our concern about the suggested project plan and the currently listed priorities is increased for two reasons: (1) because we believe it is highly important to identify and evaluate adequacy of the objectives of all of the present ISAs before proceeding much further in the redrafting efforts, and (2) because we believe that standards improvement work should be incorporated into the clarity redrafting project work. Please see our comments on this at the beginning of our letter on this ED.

The following ISAs in Table IV of the Board's timetable were noted by our members as being ones that it would be desirable to begin work on sooner if possible: ISA 250, Consideration of Laws and Regulations in an Audit of Financial Statements, ISA 402, Audit Considerations Relating to Entities Using Service Organizations, ISA 505, External Confirmations, ISA 545, Auditing Fair Value Measurements and Disclosures, and ISA 720 Other Information in Documents Containing Audited Financial Statements.

***Q10. Do you have any comments on the necessary changes to the Preface to reflect the new drafting conventions?***

We have many comments on the Preface, as noted earlier in our letter. In particular, we put forth the following:

- Paragraphs 17 and 21 and everywhere else the phrase “relevant in the circumstances of the engagement” appears: We believe this phrase is unclear and that there is a need for additional explanation, at least to include discussion of the factors or types of circumstances that would make something relevant versus not relevant. Furthermore, it should be clarified whether “relevant” refers to requirements within a standard or to the standard itself. Departure from objectives should not be allowed. In the case of a departure from a requirement, the departure should be documented. This is a matter in which the auditor must make a judgment, but that use of judgment should be informed by the intended issues and factors to be evaluated and taken into account.
- Paragraphs 17 and 21 and anywhere else the phrase “unless otherwise clear” appears. We believe this phrase is unclear and unneeded. The way that something could be otherwise clear would be because some action was taken and documented, and therefore it should be stated without qualification that departures should always be documented.
- Paragraphs 18 and 22 –We request that the Board find a way to be more positive regarding the usefulness of the content of the Application Material section and about the degree to which an auditor should review and be guided by application material. Perhaps the sentences describing the application material section in a standard might be revised to read “The application material in a standard is intended to provide useful guidance and best practice for carrying out the requirements of a standard, along with background information on the subjects addressed in the ISA” – or some other statement that would more fully describe the type of content found in the Application Material and its value to auditors as guidance on a best way, in most circumstances, to implement the requirements. This would help to foster use of the Application Material by auditors.
- Paragraph 20 – We have already expressed our concern about the use of the phrase “shall consider” earlier in this letter. Use of this phrase should be reduced and the meaning should be clarified. It often can be replaced with a more specific and descriptive word for the activity involved, even when it involves a mental judgment. The meaning of this phrase when it is used, and the documentation expected for this type of activity should be further explained. It may be helpful to add a statement providing more guidance about “consideration”, such as something like “Consideration involves thoughtful review of the information, conditions, issues and/or action alternatives that exist and an evaluation of their value and applicability in the situation presented to the auditor”. As a final comment about “shall consider” – we believe it to be true that under the ISAs an auditor can never depart from a requirement that is a “shall consider”. If this is not true, it is unclear how an auditor could justify and document such a departure. We believe it would be helpful to explicitly address this in the standards or the Preface or both.

## ATTACHMENT 2

### **ADDITIONAL COMMENTS ON INDIVIDUAL REDRAFTED ISAS**

*The following comments represent additional observations that were noted in the course of reviewing the four redrafted ISAs in the Exposure Draft for clarity purposes. These comments do not constitute an exhaustive assessment of the standards involved.*

#### **ISA 240 “The Auditor’s Responsibility to Consider Fraud in an Audit of Financial Statements.”**

- Paragraph 18 – In the first sentence, we think it would be more appropriate to say “The auditor shall evaluate whether the information obtained from the risk assessment procedures and related activities performed indicates that one or more fraud risk factors are present. (Rather than the auditor “shall consider”).
- Paragraphs 23 through 26 – The requirements in these paragraphs seem very general in light of the ever-present risk of management override of controls. We request that the IAASB evaluate whether there is a need to bring forth some of the guidance in the related application material paragraphs, especially A44 and A48. For example, in the lead sentence of paragraph 25 (c), which is describing a critical auditor requirement, the sentence reads (The auditor shall) (c) *Obtain an understanding of the business rationale of significant transactions of which the auditor becomes aware that are outside the normal course of business or otherwise appear to be unusual given the auditor’s understanding of the entity and its environment and other information obtained during the audit.* (Italics ours).

We encourage the IAASB to consider more proactive language for this requirement and whether the requirement can be clarified by incorporation of some key information from paragraph A48. One suggestion would be to say something like: “The auditor shall assess whether there are indicators of transactions that are outside the normal course of business or otherwise unusual, such as transactions where the form appears overly complex or of questionable substance or that do not appear to have been approved or communicated in the usual manner or are otherwise questionable.

#### **ISA 300 “Planning an Audit of Financial Statements”.**

- Paragraph 10 sets forth a requirement related to supervision and review. This requirement is presented under an italicized heading similar to (but separate from) the

section above on audit strategy and plan. Paragraph 11 sets forth the documentation requirements, but makes no reference to the matters in paragraph 10. Therefore, it is unclear to us whether the requirements related to supervision and review in paragraph 10 are subject to a documentation requirement.

**ISA 315 “Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement”.**

Examples of requirements that do not meet the IAASB’s guidelines and/or do not promote audit quality and use of professional judgment are:

- Paragraph 5: ‘The purpose of performing risk assessment procedures is to provide a satisfactory basis, supported by audit evidence, for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion.’ In this case, paragraph 5 does not impose any obligation on the auditor and therefore it should not be included in the requirements.
- Paragraph 8: “The auditor shall consider information obtained from the auditor’s client acceptance or continuance process or from experience gained on other engagements performed for the entity that may be helpful in identifying risks of material misstatement.” We think that the requirement to “consider” information is imprecise and unclear as to what should be involved, and should thus be avoided. Would a better word here be “evaluate”? Both the understandability and the enforceability of the ISAs can be improved by avoiding the use of “shall consider” whenever possible.
- Paragraph 11: “The discussion assists members of the engagement team to gain a better understanding of the potential for material misstatement of the financial statements in the specific areas assigned to them, and to understand how the results of the audit procedures that they perform may affect other aspects of the audit including the decisions about the nature, timing, and extent of further audit procedures”. This paragraph does not impose any requirement on the auditor; it is merely an explanation of the position and importance of discussion in the engagement team during an audit. The requirement can be adequately understood without the explanation. Therefore, under the IAASB’s stated criteria for explanation to accompany requirements, this paragraph should be entered in the application material-section.
- Paragraph 6 – This requirement seems extremely brief and light as to what is actually required. Subparts (a), (b) and (c) should be supplemented with at least a few points of consideration and/or some statements of the principles involved. Such content is now covered only in the application materials section.
- There appears to be an inconsistency between the requirements in paragraphs 12(b) and 12(c) that could be eliminated by incorporating paragraph A24 from the



application material into the requirements. Paragraph 12(b) includes four bullets containing aspects of the nature of the entity the auditor is required to understand. However, a similar bulleted list does not exist for 12(c) and rather appears in the application material. We believe it should be a requirement for the auditor to understand the items in the four bullets in A24 regarding the entity's selection and application of accounting policies.

- Paragraph 8 – The use of “shall consider” here seems particularly inappropriate, in that the requirement is describing information that the auditor should “evaluate”, not just “think about”.
- Paragraph A3 – This does not seem to be a very useful paragraph. The last sentence seems negative and irrelevant as guidance for the auditor – since nothing in the standard has suggested or implied that an auditor should (or could) develop an understanding of the entity that is equal to that of management, we ask the Board “what is the purpose of putting this statement in the standard?”
- Requirement 12(e) discusses pressures on management to achieve certain performance measures. Therefore, we believe a cross-reference to ISA 240, *The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements*, either in the requirement itself or in the applicable application material (A32 – A37), would be appropriate.
- In paragraph A77 under Compliance with laws and regulations: We believe that obtaining an understanding of an entity's process and systems for ensuring compliance with laws and regulations should be included within the requirements section rather than the application material (A77).
- Paragraphs 81 to 89 of original ISA 315 contained a great deal of useful information, including requirements, relating to the entity's procedures for capturing information relevant to financial reporting. It does not appear that the substance of these requirements has been fully carried over into the redrafted ISA 315 – or if it has, the text in the redrafted ISA, especially the length of some requirements, makes this unclear. Paragraph 17(c) has been cited by some of our members as not describing the notions in a way that will achieve consistent performance. For example, paragraph 88 of the original ISA required that an auditor's understanding include how transactions originated within the entity's business processes. A similar requirement was not carried over to the redrafted ISA under the premise that it was illustrative of information already in 17 (c)(i).
- Some members have noted deletions from the original ISA of examples that they believe were useful guidance and should be included in a section of application material. They are as follows:
  - Original ISA paragraph 49 – discussion of operational controls that may be relevant to financial reporting;
  - Original ISA paragraph 72 – examples of use of codes of conduct;

- Original ISA paragraph 52 contained specific examples of safeguards that were not carried over into paragraph 58 of the redrafted ISA;
- Original ISA paragraph 118 – examples of situations when substantive tests alone are not effective;
- Original ISA paragraph 123 – deletion of examples of documentation evidencing risk assessment procedures.

**ISA 330 “The Auditor’s Procedures in Response to Assessed Risks”.**

- The objectives in ISA 330 do not appear to be stated in terms of one or more “outcomes”. Instead, they seem to be more like a summary list of requirements. It is difficult to see how these descriptions of procedures could provide a basis for the auditor’s judgment of “have I done enough (to achieve the objective)?” Because the objectives are procedural, doing the procedure described de facto achieves the objective.
- In the requirements paragraph 7 (b), some members have noted that the last sentence raises a point of importance by stating “The nature of the audit procedures is, however, of utmost importance in responding to the assessed risks” but then does not develop this point in the requirement. These members urge that the point be developed with some mention that an auditor shall evaluate whether to add an audit procedure of a different nature than the one already planned or used, in response to an assessment of higher risks. Also, in the discussion of this matter in paragraphs A7-9 and A16, A9 provides examples of how procedures might vary where the risk is lower but does not provide examples of how procedures might vary when the risk is higher.