



Organización Internacional de Comisiones de Valores  
International Organisation of Securities Commissions  
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Organizaç o Internacional das Comiss es de Valore

September 14, 2007

Mr. James M. Sylph  
Executive Director, Professional Standards  
International Auditing and Assurance Standards Board  
International Federation of Accountants  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, NY 10017

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

**Re: Proposed Revised and Redrafted International Standard on Auditing ISA 200, *Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing***

Dear Mr. Sylph:

The International Organization of Securities Commissions (IOSCO) Standing Committee No. 1 on Multinational Disclosure and Accounting (SC 1) appreciates the opportunity to comment on the Exposure Draft of proposed redrafted an revised International Standard on Auditing ISA 200, *Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing*.

As an international organization of securities regulators representing the public interest, IOSCO SC 1 is committed to enhancing the integrity of international markets through promotion of high quality accounting, auditing, and professional standards.

Members of SC 1 seek to further IOSCO's mission through thoughtful consideration of accounting, auditing and disclosure concerns and pursuit of improved global financial reporting. As we review proposed auditing standards, our concerns focus on whether the standards are sufficient in scope and adequately cover all relevant aspects of the area of audit being addressed, whether the standards are clear and understandable, and whether the standards are written in such a way as to be enforceable. Our comments in this letter reflect those matters on which we have achieved a consensus among the members of SC 1; however, they are not intended to include all

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comments that might be provided by individual members on behalf of their respective jurisdictions.

### **Overall comments on ISA 200**

We consider ISA 200 a key ISA, a linchpin that covers the overall objective of the independent auditor and provides the basis and context for all the ISAs regarding the conduct of an audit. It is therefore important that it reflects what is legitimate and reasonable in terms of auditor accountability and the expectations of users of financial statements.

In this context, we appreciate the removal of the 'aim to achieve' in relation to objectives and the focus on reasonable assurance establishing a high, but not absolute, level of assurance. However, we have serious concerns about the following aspects of ISA 200:

- Statement of the overall objective of the independent auditor
- Premises on which an audit is conducted – Preparation of financial statements
- Need to consider the coverage of concepts in ISA 200 and how they relate to the overall objective of an audit and the audit risk model
- Exercise of professional judgement
- Inherent limitations of an audit
- Mandatory status of the objectives and relationship with the requirements

We provide more detail about our concerns in these areas, and other aspects, in the rest of the letter.

### **Statement of the overall objective of the Independent auditor**

The heading 'Overall Objective of the Independent Auditor' covers the objective of an audit (paragraph 4), the overall objective of the independent auditor (paragraph 5) and the actions to be undertaken if the overall objective cannot be achieved (paragraph 6). Our main concern is that the basic elements of an audit, being: (i) the auditor gathers sufficient and appropriate audit evidence, (ii) the auditor forms and expresses an opinion which adds credibility to the financial statements, and (iii) the opinion conveys reasonable (high, but not absolute) assurance to the users, are not expressed sufficiently clearly and robustly. In detail our concerns relate to:

- the rationale for having two different objectives;
- the interrelationship between the objective of the audit and the objective of the auditor;
- reasonable assurance;
- the coverage of the public interest perspective; and
- the tone of the objective.

#### *The rationale for having two different objectives*

While the objectives of all other ISAs address the auditor, ISA 200 also discusses the overall objective of an audit. The Exposure Draft does not explain why it is necessary to include the objective of an audit. We are not convinced of the benefit of the split of the objectives, and ask

the Board to reconsider the necessity of having two objectives. If the Board concludes that having two objectives is beneficial, the rationale should be provided so that we can understand and evaluate the Board's reasoning.

*The interrelationship between the objective of the audit and the objective of the auditor*

We note that the interrelationship between the objective of the audit and the objective of the auditor is mentioned in paragraph 6. In our view, this paragraph creates a circular argument, which increases confusion. If the Board decides to retain the two objectives, their interrelationship should be expressed more clearly and further explained.

*The coverage of the public interest perspective*

The current wording of the objectives does not include any reference to the ultimate role of the auditor: the expression of the auditor's opinion, which is intended to add credibility to the financial statements and conveys reasonable assurance to the users. We believe that it is necessary to include wording that acknowledges that the auditor provides his opinion for a public interest purpose.

*Reasonable assurance*

The Glossary of Terms explains that reasonable assurance is a high, but not absolute level of assurance. Given the importance of the level of assurance in the context of an audit, we believe that the objective should include the message that reasonable assurance is a high, but not absolute level of assurance.

*The tone of the objective*

Finally, we believe that the objective should address the auditor directly and clearly. Therefore we are of the opinion that it is better to write the objective in an active voice, as using the passive voice is inherently less clear.

**Coverage of the premises on which an audit is conducted – Preparation of financial statements**

In discussions in paragraphs 7 and 8, regarding preparation of the financial statements by management and the premises on which an audit is conducted, the tone of these paragraphs does not adequately describe the responsibilities of the auditor to seek out information in the audit and to figure out and tell management what information the auditor needs to conduct the audit. The statement that "The auditor is also entitled to expect that management and those charged with governance will make available to the auditor all the information the auditor requires for the purposes of the audit" sounds too much as if the auditor is just the recipient of information management provides. To be balanced, these paragraphs should also reflect that, while management is responsible for the financial statements, the auditor nevertheless has the responsibility to determine and obtain the information that is needed to conduct the audit. Paragraph 8 should also add the word "correct" to the statement in 8 (c) so that this would read "will provide complete and correct information to the auditor".

**Coverage of concepts in ISA 200 and how they relate to the overall objective of an audit and the audit risk model**

Much of the discussion on concepts is covered in the section of ISA 200, *An Audit of Financial Statements, and Related Concepts*. Paragraph 13, in particular, covers the concepts which provide the basis for a proper understanding of the overall objective of the auditor. We believe it would be

clearer to link the concepts together better, if this section included an exposition of the audit risk model. We are of the opinion that the audit risk model explains how the objective of the auditor relates to reasonable assurance and materiality and why absolute assurance cannot be obtained. In addition, the audit risk model also explains the extent of the inherent limitations. The concepts could be integrated into the exposition or covered separately as definitions as appropriate. Such a discussion could also assist in dealing with the 'audit expectation gap'.

Professional scepticism is noted as a concept in paragraph 13. It is discussed further in A 26, A 27 & A 42. However, not all these paragraphs convey the same message about this key concept. For example, A 26 states that the auditor should be alert to contradictory evidence (a key point, we would argue), while A 42 does not. We would suggest that the discussion about professional scepticism in the different paragraphs be aligned and located in one place within the ISA so that there is a consistent message.

We also note that A 27 states that 'an audit rarely involves the authentication of documents'. As per our previous comment letters (January 13, 2004 and February 27, 2006) we note our concerns regarding this statement. Though we do not expect an auditor to be a forensic auditor, auditing standards should require auditors always to be on the alert for possible indicators of misstatements or evidence that may not be reliable. Therefore, we propose to replace paragraph A 27 with: "Maintaining an attitude of professional scepticism is necessary to the critical assessment of audit evidence. While an audit performed in accordance with ISAs ordinarily does not involve specific measures to authenticate documents, nor is the auditor trained as or expected to be an expert in such authentication, an auditor always assesses the reliability of all information to be used as audit evidence, including controls over its preparation and maintenance where relevant. Unless the audit reveals audit evidence to the contrary, the auditor ordinarily accepts records and documents as genuine. This is because in the overall context of an audit the combination of audit procedures performed by the auditor is generally sufficient to corroborate that the audit evidence is reliable. However, the auditor should also determine whether further procedures are necessary to address the risk of fraudulent documents in other circumstances, for example, when a document is the sole supporting evidence for a material financial statement amount and is of a nature that is susceptible to fraud."

### **Exercise of professional judgement**

We fully support the exercise of professional judgement by the auditor as a key aspect in applying the ISAs. In our view, professional judgement is needed when making decisions in all phases of an audit, such as when deciding on audit procedures to meet the requirements, and when evaluating whether the outcomes of the audit procedures are sufficient to achieve the objectives.

As professional judgement is so key to many major decisions in the audit, it is therefore very important that professional judgement is appropriately described to ensure the delivery of a high quality audit. However, in the current draft of ISA 200, professional judgement is only mentioned briefly as a concept of an audit in paragraph 13 (d) and is described in paragraph A 25 as "a personal quality" rather than "a professional responsibility". As professional judgement is so fundamental in conducting high quality audits we are concerned that this description is not sufficiently robust. We therefore urge that professional judgment be discussed more thoroughly, including the need to have competent professional judgment, and emphasizing that the exercise of professional judgement is needed throughout the whole audit. This stronger concept professional judgment should be linked to and emphasized in the requirements.

We agree with the statements in the Explanatory Memorandum (page 8) that there is a need to ensure that 'professional judgement is not used as a justification for decisions for which no other explanation need be given', however we are of the opinion that the relevant paragraphs of ISA 200 do not sufficiently reflect the competence aspect of professional judgement. We believe there should be more focus in the application material on the need for professional judgement to be appropriately exercised and evidenced. The exercise of professional judgement should not just reflect an isolated individual judgement, but should also reflect, broadly, the professional judgement one would expect other competent auditors to make, having access to the same information in the same circumstances. As professional judgement is such a key aspect of audit work, it could also (and is likely to) be challenged, through the audit firm's internal review or externally by auditor oversight bodies.

### **Inherent Limitations of the audit**

Paragraph 13(f) deals with inherent limitations of an audit. We are not convinced that 'inherent limitations of an audit' is a concept underlying the audit. We believe that much of this discussion is really about what is often called 'the audit expectation gap' and is an issue of communication rather than a concept. We accept that there should be some discussion of this issue in ISA 200 (see our suggestion above re more coverage of the audit risk model as one way of dealing with this), but are concerned that the current discussion is so extensive and negative about what is possible with an audit (demonstrated by paragraphs A 28-A 40), that it may not set an appropriately high standard for what the auditor can achieve. We believe that some of this discussion is unnecessary and some may not be correct.

A 28 suggests there are three types of inherent limitation of an audit:

- the fundamental nature and characteristics of financial reporting and business processes;
- the nature of audit evidence and procedures; and
- the need for the audit to be conducted within a reasonable period of time and at a reasonable cost.

These types of limitations are further explained in the paragraphs A 29-A 40. Each of these types of inherent limitations is used to explain that an auditor cannot provide absolute assurance. As discussed above, we are of the opinion that it would be better to provide an explanation of the audit risk model, as this model does not only explain that absolute assurance is not possible within the context of an audit, but also explains the relations between audit risk and other important concepts, such as materiality.

A 29 covers the 'audit expectations gap', which we believe is appropriate. However, it is not an 'inherent limitation' of the audit, but a statement about what the audit is not. We also note that the second bullet point in this paragraph which covers that an auditor does not express an opinion on internal control, has been expanded to include in brackets, 'including the effectiveness of internal control.' We appreciate that this statement is correct for an audit conducted under ISAs, but would suggest that ISA 200 should also include some application material to highlight that in some jurisdictions, the auditor may also be providing a separate opinion on the effectiveness of internal control.

### **Mandatory status of the objectives and relationship with the requirements**

We believe that the discussion on the role of the ISAs in paragraphs 20 to 25 can be further clarified. Paragraph 20 states that "the auditor shall comply with all ISAs relevant to the audit and

describes what is meant by "relevant". This seems correct. But then paragraph 21 seems to address a different subject and states that the auditor "shall *consider* the entire text of an ISA to *understand* its requirements". (Italics ours). This seems to relegate an ISA to the status of providing background and context for the auditor's judgment - rather than providing the basis for the auditor's exercise of judgment. We believe the auditor is obligated to do more than just "consider" the entire text of the ISA.

We note that it could be interpreted from paragraph 24 of the draft standard that the auditor should exercise professional judgement in determining *whether* to meet the objectives stated in relevant ISAs. In our view, paragraph 24 should make it clear that, subject to the circumstances where an objective cannot be achieved, the objectives of individual ISAs must be met, as well as the overall objective of the auditor. This includes any objectives of individual ISAs that are not necessary to support the overall objective of the auditor. Professional judgement should be exercised in determining how the objectives of individual ISAs are met, not whether they need to be met.

In addition, we are concerned about the message conveyed by the sentence in paragraph 24 of the requirements that, 'the proper application of the requirements of the ISAs will ordinarily provide a sufficient basis for the auditor's achievement of the objectives'. The requirements included in each ISA are those that are 'expected to be applicable in virtually all engagements to which the Standard is relevant'<sup>1</sup>. Therefore it is likely, in many of the larger and complex audits, that application of the requirements on their own will not be sufficient to provide a sufficient basis for the auditor's achievement of the objectives. We therefore suggest that this element of the sentence in paragraph 24 should be deleted.

In paragraph 25, the statement is made that "if an objective in a relevant ISA cannot be achieved, the auditor shall *consider* (italics ours) whether this prevents the auditor from achieving the overall objective of the auditor" - we believe "determine" should be the word used, rather than "consider". Since non-achievement of an objective would be a very exceptional matter, we also suggest that an explicit statement be made in this ISA regarding the documentation of why an objective could not be achieved and how the auditor was able to determine that the overall objective of the auditor was still met.

Paragraph 29 could be more clearly worded - the statement that "the auditor shall apply the requirements in the context of the other material included in the ISA" seems ambiguous. Is what is meant here that "the auditor shall comply with the requirements in the context of the Application Material included in the ISA"? If so, this would be a clear and direct statement that leaves no room for doubt about what is meant.

Some clarification is also needed in paragraphs 11 and A 43. Paragraph 11 states that 'the ISAs are designed to support the auditor obtaining reasonable assurance'. A 43 states that, 'ISAs taken together, provide the standards for the auditor's work in fulfilling the objective of an audit.' It would be helpful if these paragraphs were aligned to convey the same message, that the ISAs, taken together, are designed to enable the auditor to achieve his overall objective.

Paragraph A58 deals with the relationship between individual ISA objectives and the overall objective of the auditor, where the relationship is indirect. Though we appreciate the concept behind the paragraph, we do not believe the examples provided are necessary or appropriate. For instance, stating that not meeting the objective of ISA 220 *Quality Assurance for an Audit of Financial Statements* does not necessarily lead to the conclusion that the overall objective is not

met, may convey the message that ISA 220 is not important and could be omitted. This ISA contains requirements on important subjects that contribute to the quality of audits, such as review within the audit team, consultation and engagement quality control review, and the language in paragraph A 58 appears to justify non-achievement of the objectives of this ISA. The last line of paragraph A58 hints at the risk that arises if the auditor fails to achieve the objective of an ISA which is indirectly linked to the overall objective and inappropriately issues an auditor's report. Given this risk, we are of the opinion that providing examples of objectives that the auditor could fail to achieve while nevertheless achieving the overall objective does not set the right tone for the ISAs.

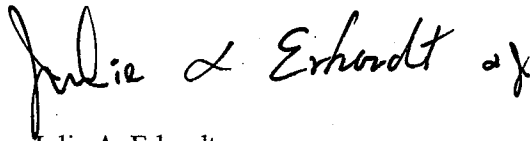
### **Other points**

Paragraph 23 – this paragraph states that the objective(s) of an individual ISA provides the context for the requirements of that specific ISA, and that the objectives of all individual ISAs support the overall objective of the auditor. This essential guidance is not as clear as that which is set out in A 53, which clearly states that the objectives of the individual ISA are the link between the overall objective and the requirements. We would suggest that A 53 replaces paragraph 23.

Paragraph 25 – rather than 'shall consider' it should be 'shall evaluate' as that is what the auditor would have to do.

We appreciate the Board's thoughtful consideration of the points raised in this letter. If you have any questions or need additional information about the comments that we have provided, please do not hesitate to contact me at 202-551-5300 or contact members of the SC 1 Auditing Subcommittee.

Sincerely,



Julie A. Erhardt  
Chair  
IOSCO Standing Committee No. 1

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<sup>1</sup> One of the criteria set by the IAASB determining the requirements of a Standard