

Improving the Clarity of IAASB Standards

Introduction

1. This Paper outlines a proposed approach to improve the clarity of IAASB Standards should the IAASB decide to adopt the concept of 'equal authority' within its Standards. It also provides recommendations on how the proposal could be implemented.

Background

2. Of the 21 respondents to the exposure draft (ED) Preface and Operations Policy No 1 – Bold Type Lettering, two regulators, three major Firms and one member body/national standard setter recommended that the IAASB establish that both bold type and ordinary type lettering have 'equal authority' and that amending change in the language used in Standards (i.e., use of the word "should") be considered.
3. At its May 2003 meeting, the IAASB discussed the issue of the authority of bold and ordinary type lettering in its Standards. Members debated the implications of 'equal authority', whether only basic principles (and not essential procedures) should be bold lettered, the use of "should" and present tense (which may be read as though it is mandatory), and implementation and transition issues. There was general consensus that clarity and understandability of IAASB Standards is essential and recognition that the suggestion by some of the respondents to the ED that the paragraphs should be given 'equal authority' needed careful consideration.
4. While no conclusion was reached, it was noted that a move to 'equal authority' would require amendment to the description of the status and distinction between bold and ordinary type lettering. It would also require consideration of whether the language used in the ordinary type lettering is sufficiently clear that potential misinterpretation of the requirements of an ISA is minimized. It was also suggested that the focus should be on the use of 'plain English' in describing the imperatives and guidance contained Standards such that they are clear, comprehensive and capable of consistent application.
5. In support of this process, Staff was asked to further explore the consequences of moving to 'equal authority' and to submit a proposal for ways in which the clarity of IAASB Standards could be improved.

Proposal Framework

6. The following represents Staff's proposed framework for enhancing the clarity and understandability of IAASB Standards, should the IAASB decide to move towards the concept of 'equal authority'. It comprises the objectives that need to be attained, the style in which IAASB Standards would be written, the statement of authority that would accompany IAASB Standards and an implementation plan.
7. The proposal aims to address the concern that some readers of IAASB Standards may be misinterpreting the intention of the IAASB as to how its Standards should be read. It seeks ways to clarify the IAASB's expectations of performance by auditors and to enhance the consistency in the application of IAASB Standards. Steps to improve the clarity of the language used in IAASB Standards may also help improve the consistency and accuracy of translation by member bodies.

Framework Objectives

8. **The objective of this proposal is to improve the clarity, and therefore effectiveness, of IAASB Standards by:**
- **Adopting the concept of ‘equal authority’ whereby the distinction between requirements and guidance is established solely by the language used rather than by the typeface convention.**
 - **Allowing more flexibility in the use of language within Standards in order to ensure that their imperatives are clear.**
 - **Maintaining an approach that focuses on principles, supported by guidance for their application, rather than prescriptive rules.**

Key Aspects of the Proposal

9. The key aspects of this proposal are summarized as follows:
- **The authority and purpose of the bold and ordinary type lettering is to be re-described to clarify the distinction between the two typefaces.**
 - **Equal authority is to be provided to both the bold type and the ordinary type lettering. Standards are to establish the obligation of the auditor, and to distinguish these from explanatory guidance, by the language and meaning of the words used in the text of a Standard.**
 - **The language used in IAASB Standards is to be improved and clarified. The use of the word “should” is to be used to identify imperatives to which the auditor is obligated to carry out. It may be used in either the bold type or the ordinary type sentences.**
 - **The status of appendices is to be clarified as being part of a Standard, having equal authority to the material that is included within the body of a Standard. The obligation imposed on the auditor, if any, or the explanatory nature of the guidance in an appendix will be communicated by the language used therein, in each case.**
 - **The review, re-issuance and approval of ISAs would need to be completed by the end of June 2004. Each revised ISA would bear an effective date of January 1, 2005.**
10. Details of the key aspects of this proposal are discussed below.

CLARIFYING BOLD AND ORDINARY TYPE LETTERING

11. **The bold type lettering convention is to be retained.**
12. Substantially all respondents to the ED Preface and Operations Policy No 1 expressed support for the continued use of the bold type lettering convention to highlight basic principles and essential procedures. Respondents found this convention facilitated an understanding of the key points of a Standard, increased its readability and understandability and supported the concept that IAASB standards are drafted focusing on principles rather than rules
13. **Bold type lettering is to be used solely as a stylistic convention to help the readability of Standards, and is not to be used to denote the only requirements to be followed by auditors.**

14. To enhance the clarity as to which procedures or actions are expected to be followed by an auditor, and to facilitate a move to 'equal authority', it is proposed that a statement be made that the bold type lettering does not indicate the only requirements to be followed by auditors.
15. **Bold type lettering is to be used to identify 'main principles'. 'Main principles' are to comprise what presently is referred to as 'basic principles and essential procedures' – a distinction between the two, however, will no longer be drawn.**
16. Proposed Operations Policy No 1 states: "basic principles have not been separated from the essential procedures in the text of IAASB Standards, and in some cases a black lettered sentence may be a mix of both. However, both are considered equally important and therefore separate consideration of them is unnecessary." The proposal logically extends this concept, but avoids the difficulty in attempting to explain (or reach consensus) as to the difference between a basic principle and an essential procedure.
17. This change is also proposed in order to enable 'equal authority' in that 'essential procedures' can no longer be defined as being exclusive to bold type sentences. This aspect of the proposal is consistent with the view that 'equal authority' requires consideration not only of the requirements identified in bold type lettering but also with the procedures described in the ordinary type lettering.
18. As an alternative, the phrase 'Basic principles and procedures' could be used, rather than the phrase 'main principles' as proposed. Staff however believes this alternative retains the potential for misinterpretation of the purpose and use of bold type lettering by possibly implying that they contain the only procedures or actions that are expected to be carried out. This alternative, therefore, has not been pursued.
19. **The entire text of a specific pronouncement (e.g., an ISA) is to be considered the Standard. The present description of the ordinary type sentences as being comprised of 'explanatory guidance and related material' will not be retained.**

EQUAL AUTHORITY

20. **Equal authority is to be provided to both the bold type and the ordinary type lettering. Standards are to establish the obligation of the auditor, and to distinguish them from the explanatory guidance, by the language and the meaning of the words used in the text of a Standard.**
21. This aspect of the proposal adopts the concept that text which has been through the same IAASB due process has 'equal authority' whether or not it is in bold type. It clarifies the responsibility of the auditor to consider all aspects of a Standard, not just the bold type sentences. This proposed change, conceptually, creates the greatest difficulty when revising IAASB Standards in that auditing standards are different from the accounting standards; accounting standards are aimed at providing output solution whereas auditing standards address modes of behavior (i.e., the application of procedures, which involve consideration of the circumstances and professional judgment). 'Equal authority' may therefore result in a move away from an approach that focuses on 'basic principles' to one that is more 'rules-based'. The proposal seeks to manage this potential consequence, which may be most pronounced in the audit of SMEs, through the language to be used in the ordinary type lettering, as explained below.

IMPROVING THE LANGUAGE USED IN IAASB STANDARDS

22. **The use of the word “should” is to be used to identify imperatives to which the auditor is obligated to carry out. It may be used in either the bold type or the ordinary type sentences.**
23. Some respondents to the ED suggested that the prohibition on the use of the word “should” in the ordinary type paragraphs be removed to better identify which procedures are considered necessary to be undertaken by auditors.
24. The aspect of the proposal results in a significant increase in the use of the word “should” through IAASB Standards and thereby potentially increasing the obligations of the auditor. This consequence may be particularly pronounced for those auditors that have developed alternative approaches to the achievement of the basic principles identified in the bold type sentences (i.e., those that have not fully incorporated the ordinary type lettering in their methodologies) and potentially on the work conducted by SMPs.
25. A further important, but less obvious, consequence of using the word ‘should’ throughout the Standards (and a concern, in general, when moving to ‘equal authority’) is the possibility that IAASB Standards (and the procedures included therein) are incorrectly interpreted as being comprehensive – a view that was not, and is not, intended to be conveyed.
26. Staff has also noted that the historical drafting style (as a result of the use of bold type lettering and the restriction on the use of the word ‘should’ therein) has caused some repetition of guidance in Standards between the bold type and the ordinary type paragraphs. Under the proposal, the wording contained in the Standards may require additional editorial change in order to enhance their clarity and conciseness.
27. This aspect of the proposal, in combination with a statement of ‘equal authority’ and the use of the concept of ‘main principles’ noted above, allows greater flexibility in determining which sentences or paragraphs should be bold lettered. It effectively eliminates the issue of the number of bold type sentences in a Standard, and permits the present number of bold type paragraphs to be retained, should this choice be preferred by the IAASB.
28. **If a procedure or action identified in an ordinary type sentence directly supports a main principle and is expected to be carried out in all circumstances (or whenever a stipulated condition(s) is met), the word “should” is to be used without any modifiers.**
29. **All other procedures or actions identified in ordinary type sentences are to be described in the simple present tense using appropriate modifiers such as ‘ordinarily’, ‘may’, ‘for example’, etc.** If the ordinary type sentence interprets or explains the main principle (and the action or procedure identified therein is not expected to be carried out in all circumstances), it is described using appropriate modifiers that denote the action as being conditional or optional, as the case may be.
30. Under the concept of ‘equal authority’, use of the simple present tense becomes increasingly problematic when attempting to ascertain those procedures that are expected

to be complied with. The proposal attempts to eliminate this potential ambiguity by more extensively using appropriate modifiers.¹

APPENDICES

31. **The status of appendices is to be clearly stated as being part of the Standard, having equal authority to the material that is included within the body of a Standard. The obligation imposed on the auditor, if any, or the explanatory nature of the guidance in an appendix will be ascertained by the meaning of the words used therein.**
32. Appendices are to be used where additional examples or other explanatory material in a Standard is desirable, but inclusion in the main text of a Standard reduces its overall readability.

Proposed Statement of Authority

33. The following is presently stated at the beginning of every ISA:

ISAs contain the basic principles and essential procedures (identified in bold type black lettering) together with related guidance in the form of explanatory and other material. The basic principles and essential procedures are to be interpreted in the context of the explanatory and other material that provides guidance for their application.

To understand and apply the basic principles and essential procedures together with the related guidance, it is necessary to consider the whole text of the ISA including explanatory and other material contained in the ISA, not just the text that is black lettered.

In exceptional circumstances, an auditor may judge it necessary to depart from an ISA in order to more effectively achieve the object of an audit. When such a situation arises, the auditor should be prepared to justify the departure.

34. Based on the proposal outlined above, it is proposed that the statement would be amended as follows:

ISAs contain paragraphs in bold type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles. The main principles are identified in bold type as a stylistic convention in order to enhance the readability and understandability of the Standard. The main principles are to be understood and applied in the context of the ISA in its entirety, including any appendices thereto.

In exceptional circumstances, an auditor may judge it necessary to depart from an ISA in order to more effectively achieve the object of an audit. When such a situation arises, the auditor should be prepared to justify the departure.

Does the IAASB agree with the key aspects of the proposal and the suggested Statement of Authority presented above?

¹ Despite the intention of this proposal, there remains a risk that the modifiers chosen in a particular situation may be interpreted differently by various users. Prescribing and restricting the options for modifiers used may help alleviate this problem, but may unduly restrict the flexibility needed in drafting Standards.

Application of Proposal

35. Staff has re-drafted two selected ISAs to illustrate the application of the proposals above. These re-drafted² ISAs are included in Appendix I and II.
36. This exercise highlights the impact of the above proposal, demonstrating the significant increase in the number of sentences which would now include ‘should’ and emphasizes the need to consider whether the correct modifiers have been selected to best describe the intended responsibilities of the auditor.

The IAASB is asked to carefully review the revised ISAs included in Appendices I and II and to evaluate whether they are an appropriate application of the proposal, in particular whether “should” is used in appropriate places in the ordinary type sentences? In light of these examples, does the IAASB agree with the approach taken?

Implementation and Transition Plan

RE-EXPOSURE

37. This proposal is intended only to improve the clarity of IAASB Standards. Application of the proposal is not intended to result in fundamental change to the essential points of a Standards nor significant editorial changes. Consequently, ISAs revised under this project, in most cases, may not require exposure for public comment.
38. Where however there are views that the procedures or actions in the revised ordinary type sentences may result in significant additional obligation on the auditor, exposure may be necessary. Exposure would solicit comments on the proposed changes only; comments would not be invited nor considered on other aspects of the Standard (that is, the ISAs are not being ‘re-opened’ in their entirety).
39. It may be argued that the introduction of any mandatory procedure that was not previously identified in bold type lettering is of significant interest to users and the public interest and that public input should be solicited. There are however obvious issues in the practicality of proposing to expose all ISAs in advance of June 2004, including the significant limitation on the due process that would arise.
40. The communication of the objectives and intention of the IAASB to clarify the language used in its Standards, the decision to adopt ‘equal authority’, and a description of the method in which this will be accomplished, should provide users of ISAs with sufficient information as to evaluate the impact of the proposals on auditors’ responsibilities. As an alternative to the above, the IAASB may wish simply to expose a proposed statement of intention. Staff however believes the actual application of the proposals would be of primary interest to users and readers of the Standards.

Does the IAASB agree that exposure is not a mandatory aspect of due process in this regard, and that decision thereof should be made on a case by case basis?

IAPSS

41. The authority attaching to IAPSSs in the proposed Preface describes IAPSSs as providing interpretive guidance and practical assistance to professional accountants in

² The re-drafted ISAs illustrate application of the tentative proposals by Staff only. Once the IAASB has had an opportunity to fully consider these proposals, a full-review of these ISAs would be undertaken by Staff and the identified reviewing team (described below).

implementing ISAs and to promote good practice. This description does not appear to conflict with the changes proposed above. The adoption of the concept of 'equal authority' in ISAs may however require the need to review the language used in IAPS and to further consider the status of IAPSs.

42. Given the IAASB timetable and the need to complete the revision of ISAs before June 2004, however, it is recommended that a review of IAPSs not be completed at this time. The implications to IAPS will need to be considered in more detail, and revision to IAPS, if any, is recommended to be conducted in 2005.

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43. If the IAASB agrees with the above proposal, it is proposed that the IAASB announce its intention to modify the authority of, and the drafting style used for, its Standards and the manner in which this will be accomplished by no later than September 1, 2003. It is recommended that the announcement include statements to the following effect:
- The IAASB has decided to undertake a re-codification project that aims to improve the clarity, and therefore effectiveness, of the ISAs by:
 - Adopting the concept of 'equal authority' whereby the distinction between requirements and guidance is established solely by the language used rather than by the typeface convention.
 - Allowing more flexibility in the use of language within ISAs in order to ensure that their imperatives are clear.
 - The re-codification process will consist of a review of all existing ISAs, or exposure drafts, issued before September 1, 2003. Exposure drafts issued after September 1, 2003 will incorporate the revised drafting principles.
 - Where considered necessary, re-codified ISAs will be exposed together by December 31, 2003 for public comment. The Invitation to Comment will solicit views pertaining to the application of the objectives of the re-codification only; comments on other aspects of the ISAs will not be sought at that time. The intention of the IAASB is to approve a set of re-codified ISAs by the end of June 2004. Each revised ISA would bear an effective date of January 1, 2005.
44. In implementing this proposal, it is proposed that the present set of ISAs be separated into three categories: (1) ISAs that have been issued within the past four years; (2) ISAs issued prior to 1999; and (3) ISAs which are presently under revision by Task Forces.
45. For those ISAs that have been issued within the past four years, members of the IAASB (where possible) and staff that had chaired or participated in the original Task Forces (subcommittees) would be asked to undertake the preliminary revision of the applicable ISA(s).
46. For those ISAs issued prior to 1999, it is proposed that a small team of IAASB members, supported by Staff resources, be assigned responsibility to undertake a full review of those ISAs following the proposed framework identified above by no later than the end of November 2003.
47. Task Forces responsible for current projects or exposure draft expected to be completed after adoption of these proposals (September 1, 2003) would reflect the proposed recommendations into their final exposure drafts or ISA(s), as applicable.
48. As reviews and re-drafts of ISAs are completed, small batches of completed ISAs would be submitted to the IAASB for approval. To avoid disruption to the present IAASB timetable, it is proposed that the approval process be conducted via ballot voting,

including the vote as to whether exposure is considered necessary. Where consensus is not reached on a particular revised ISA(s), the revised ISA(s) would be brought forward for deliberation at the October and December 2003 IAASB meetings.

49. Once approved, all re-codified ISAs requiring exposure would be issued by December 31, 2003 for a 90 day comment period, with final review by the IAASB scheduled for its June 2004 meeting. The finalization of the ISAs would need to be completed by the end of June 2004 to allow adequate time for adoption and methodological changes in practice to be completed before January 1, 2005. Each revised ISA would bear an effective date of January 1, 2005.

Does the IAASB agree with the proposed implementation plan?