

**Proposed Revised Amendments to the Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services
(Clean)**(Effective as of [Date])¹

[There are no proposed amendments to paragraphs 1 – 9 of the extant Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services (Preface). These paragraphs have therefore not been reproduced.]

NOTE: Further changes are being proposed by the ISA 800 Task Force; the amendments shown here and to extant ISA 200 take no account of such proposals.]

The Authority Attaching to International Standards Issued by the International Auditing and Assurance Standards Board

10. International Standards on Auditing (ISAs) are to be applied in the audit of historical financial information.
11. International Standards on Review Engagements (ISREs) are to be applied in the review of historical financial information.
12. International Standards on Assurance Engagements (ISAEs) are to be applied in assurance engagements dealing with subject matters other than historical financial information.
13. International Standards on Related Services (ISRSs) are to be applied to compilation engagements, engagements to apply agreed upon procedures to information and other related services engagements as specified by the IAASB.
14. ISAs, ISREs, ISAEs and ISRSs are collectively referred to as the IAASB's Engagement Standards.
15. International Standards on Quality Control (ISQCs) are to be applied for all services falling under the IAASB's Engagement Standards.

International Standards on Auditing²

16. ISAs are written in the context of an audit of financial statements³ by an independent auditor⁴. They also apply, adapted as necessary in the circumstances, to audits of other historical financial information.

¹ [Note: This date would be the date when the set of redrafted ISAs come into effect, assuming a single effective date for all redrafted ISAs.]

² The terms and concepts in this Preface are explained further in the ISAs.

³ Unless otherwise stated, "financial statements" mean financial statements comprising historical financial information.

⁴ Referred to hereafter as "the auditor."

17. 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. ISAs, taken together, provide the standards for the auditor's work in fulfilling this objective.
18. In conducting an audit, the overall objective of the auditor shall be to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to report in accordance with the auditor's findings and the requirements of the engagement. In all cases when this overall objective has not been or cannot be achieved, the ISAs require that the auditor modifies the auditor's report accordingly or withdraws from the engagement.
19. The auditor shall consider the entire text of each of the ISAs relevant to the audit. An ISA is relevant when the ISA is in force and the circumstances addressed by the ISA exist.
20. The ISAs deal with the general responsibilities of the auditor, as well as the auditor's further considerations relevant to the application of those responsibilities to specific topics. They contain objectives and requirements together with related guidance in the form of application and other explanatory material. They may also contain introductory material and definitions that provide context essential to a proper understanding of the ISAs.

ISA Objectives

21. Each ISA contains an objective or objectives, which provide the context in which the requirements of the ISA are set. The auditor shall aim to achieve these objectives, having regard to the interrelationships amongst the ISAs. For this purpose, the auditor shall use the objectives to judge whether, having complied with the requirements of the ISA, any further audit evidence is necessary in the context of the overall objective of the auditor. Where an individual objective has not been or cannot be achieved, the auditor shall consider whether the circumstances prevent the auditor from achieving the auditor's overall objective.

Requirements

22. The requirements of each ISA are contained in a separate section and expressed using the word "shall." The auditor shall understand and apply the requirements in the context of the other material included in the ISA.
23. The auditor shall comply with the requirements of an ISA in all cases where they are relevant in the circumstances of the audit. In exceptional circumstances, however, the auditor may judge it necessary to depart from a relevant requirement by performing alternative audit procedures to achieve the aim of that requirement. The need for the auditor to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective.
24. A requirement is not relevant only in the cases where: the ISA is not relevant; or the circumstances envisioned do not apply because the requirement is conditional and the condition does not exist. The auditor is not required to comply with a requirement that is not

relevant in the circumstances of the audit; this does not constitute a departure from the requirement.

Application and Other Explanatory Material

25. The application and other explanatory material contained in an ISA is an integral part of the ISA, as it provides further explanation of, and guidance for carrying out, the requirements of an ISA, along with background information on the matters addressed in the ISA. It may include examples of procedures, some of which the auditor may judge to be appropriate in the circumstances. Such guidance is, however, not intended to impose a requirement.
26. Appendices, which form part of the application and other explanatory material, are an integral part of an ISA. The purpose and intended use of an appendix are clearly explained in the body of the related ISA or within the title and introduction of the appendix itself.

Introductory Material and Definitions

27. Introductory material may include, as needed, such matters as explanation of: the purpose and scope of the ISA, including how the ISA relates to other ISAs; the subject matter of the ISA; specific expectations on the auditor and others; and the context in which the ISA is set.
28. An ISA may include, in a separate section under the heading ‘Definitions’, a description of the meanings attributed to certain terms for purposes of the ISAs. These are provided to assist in the consistent application and interpretation of the ISAs, and are not intended to override definitions that may be established for other purposes, whether in law, regulation or otherwise. Meanings of individual terms are provided only in those ISAs that deal principally with the subject matter to which the terms are most relevant. Unless otherwise indicated, those terms will carry the same meanings throughout the ISAs. The Glossary of Terms in the Handbook contains a complete listing of terms defined in the ISAs. It also includes description of other terms found in ISAs to assist in common and consistent interpretation and translation.

International Standards on Quality Control

29. ISQCs are written to apply to firms in respect of all their services falling within the scope of International Standards issued by the IAASB. Paragraphs 19-28 above apply also to the ISQCs, but are to be interpreted in the context of a firm rather than an individual professional accountant or engagement.

Other International Standards

30. The International Standards identified in paragraphs 11-13 contain basic principles and essential procedures (identified in bold type lettering and by the word “should”) together with related guidance in the form of explanatory and other material, including appendices. The basic principles and essential procedures are to be understood and applied in the context of the explanatory and other material that provides guidance for their application. It is therefore necessary to consider the entire text of a Standard to understand and apply the basic principles and essential procedures.

31. The basic principles and essential procedures of a Standard are to be applied in all cases where they are relevant in the circumstances of the engagement. In exceptional circumstances, however, a professional accountant may judge it necessary to depart from a relevant essential procedure in order to achieve the purpose of that procedure. When such a situation arises, the professional accountant is required to document how the alternative procedures performed achieves the purpose of the procedure, and, unless otherwise clear, the reasons for the departure. The need for the professional accountant to depart from a relevant essential procedure is expected to arise only where, in the specific circumstances of the engagement, that procedure would be ineffective.
32. Appendices, which form part of the application material, are an integral part of a Standard. The purpose and intended use of an appendix are clearly explained in the body of the related Standard or within the title and introduction of the appendix itself.

Professional Judgment

33. The nature of the International Standards requires the professional accountant to exercise professional judgment in applying them.

Applicability of the International Standards

34. The scope, effective date and any specific limitation of the applicability of a specific International Standard is made clear in the Standard. Unless otherwise stated in the International Standard, the professional accountant is permitted to apply an International Standard before the effective date specified therein.
35. International Standards are applicable to engagements in the public sector. When additional guidance is appropriate for the public sector, such guidance is included within the body of an International Standard, or by means of a Public Sector Perspective (PSP), where considered necessary, appearing at the end of the International Standard.

The Authority Attaching to Practice Statements Issued by the International Auditing and Assurance Standards Board

36. International Auditing Practice Statements (IAPSs) are issued to provide interpretive guidance and practical assistance to professional accountants in implementing ISAs and to promote good practice. International Review Engagement Practice Statements (IREPSs), International Assurance Engagement Practice Statements (IAEPSs) and International Related Services Practice Statements (IRSPSs) are issued to serve the same purpose for implementation of ISREs, ISAEs and ISRSs respectively.
37. Professional accountants should be aware of and consider Practice Statements applicable to the engagement. A professional accountant who does not consider and apply the guidance included in a relevant Practice Statement should be prepared to explain how:
 - the requirements in the ISAs; or
 - the basic principles and essential procedures in the IAASB's other Engagement Standard(s)

addressed by the Practice Statement have been complied with.

[Except for renumbering, there are no proposed amendments to paragraphs 22 – 29 of the extant Preface. These paragraphs have therefore not been reproduced.]

Exhibit IV**Proposed Draft Revised ISA 200 (Clean)****Overall Objective of the Independent Auditor, and General Concepts Relevant to an Audit of Financial Statements****Introduction****Scope of this ISA**

1. This International Standard on Auditing (ISA) establishes the independent auditor's overall responsibilities when conducting an audit in accordance with ISAs. .
- 2.⁵ ISAs are to be applied in the audit of historical financial information.⁶ They are written in the context of an audit of financial statements and require to be adapted, as necessary in the circumstances, to audits of other historical financial information.

Effective Date

3. This ISA is effective for audits of financial statements for periods beginning on or after [date].

Overall Objective of the Independent Auditor

4. In conducting an audit, the overall objective of the independent auditor⁷ is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to report in accordance with the auditor's findings and the requirements of the engagement.

General Concepts Relevant to an Audit of Financial Statements

5. The overall objective of the auditor can only be understood properly in light of the general concepts relevant to an audit. These include the following, which are described further in paragraphs A1-A36 of the application and other explanatory material of this ISA:
 - Independence
 - Reasonable assurance, including the inherent limitation of an audit
 - Professional judgment
 - Sufficiency and appropriateness of audit evidence
 - Materiality and audit risk

⁵ [Note: This paragraph does not contemplate changes being suggested by the ISA 800 Task Force, which will be subject to debate in September in connection with that project.]

⁶ Unless otherwise stated, "financial statements" mean financial statements comprising historical financial information.

⁷ Referred to hereafter and in the ISAs as "the auditor."

- Responsibility for the financial statements.

The Objective of an Audit and its Relationship to the Overall Objective of the Auditor

6. An audit of financial statements is an assurance engagement. The financial statements are prepared and presented by the management of the entity, with oversight from those charged with governance. The auditor is engaged for purposes of expressing an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. The objective of an audit, therefore, is to enable to auditor to express that opinion.
7. The overall objective of the auditor restates the objective of an audit in a way that can more readily be related to the auditor's work and the requirements of ISAs. Their equivalence may be explained as follows. If the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework, then they must be free from material misstatement. If the auditor's opinion is to be worthwhile, it must be supported by sufficient appropriate audit evidence, whereby the auditor obtains assurance about whether the financial statements are free from material misstatement; the level of assurance required by ISAs is that described as reasonable assurance. The opinion is expressed in a report from the auditor.
8. The objective of an audit cannot be fulfilled unless the auditor achieves the overall objective stated in paragraph 4. In all cases when the overall objective of the auditor has not been or cannot be achieved, the ISAs require that the auditor modifies the auditor's report accordingly or withdraws from the engagement.

Definitions

9. For purposes of the ISAs, the following terms have the meanings attributed below:
 - (a) Audit evidence – All of the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements, and other information.
 - (b) Audit risk – The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated.⁸
 - (c) Detection risk – The risk that the auditor's procedures will not detect a misstatement that exists that could be material, individually or when aggregated with other misstatements.
 - (d) Financial statements – A structured representation of the financial information, which ordinarily includes accompanying notes, derived from accounting records and intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting

⁸ This definition does not include the risk that the auditor might erroneously express an opinion that the financial statements are materially misstated.

framework. The term can refer to a complete set of financial statements, or a single financial statement⁹.

- (e) Misstatement – A difference, arising from fraud or error, between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. When the auditor expresses an opinion on whether the financial statements give a true and fair view or are presented fairly, in all material respects, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the auditor’s judgment, are necessary for the financial statements to give a true and fair view or present fairly, in all material respects.
- (f) Reasonable assurance – In the context of an audit of financial statements, a high, but not absolute, level of assurance about whether the financial statements subject to audit is free from material misstatement.
- (g) Risk of material misstatement – The risk that the financial statements are materially misstated. This risk consists of two components, described as follows at the assertion level:
 - Inherent risk – The susceptibility of an assertion to a misstatement that could be material, either individually or when aggregated with other misstatements, assuming that there are no related controls.
 - Control risk – The risk that a misstatement could occur in an assertion and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity’s internal control.

Requirements

Ethical Requirements Relating to an Audit of Financial Statements

10. The auditor shall comply with relevant ethical requirements, including those pertaining to independence, relating to audit engagements. (Ref: Para. A37-A38)

Professional Skepticism

11. The auditor shall plan and perform an audit with an attitude of professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated. (Ref: Para. A39-A40)

Conduct of an Audit in Accordance with ISAs

12. The ISAs are together designed to support the achievement of the auditor’s overall objective and accordingly, the auditor shall comply with all ISAs relevant to the audit. An ISA is

⁹ Examples of a single financial statement are listed in the Appendix of this ISA [not shown in this version].

relevant when the ISA is in force and the circumstances addressed by the ISA exist. The auditor shall consider the entire text of each such ISA. (Ref: Para. A41-A48)

13. In conducting an audit in accordance with ISAs, the auditor shall aim to achieve the objectives set out in the individual ISAs, having regard to the interrelationships amongst the ISAs. For this purpose, the auditor shall use the objectives to judge whether, having complied with the requirements of the ISA, any further audit evidence is necessary in the context of the overall objective of the auditor. Where an individual objective has not been or cannot be achieved, the auditor shall consider whether the circumstances prevent the auditor from achieving the auditor's overall objective. (Ref: Para. A49-A50)
14. In conducting an audit in accordance with ISAs, the auditor shall:
 - (a) Understand and apply the requirements (contained in a separate section in each ISA and expressed using the word "shall") in the context of the other material included in the ISA; and
 - (b) Comply with the requirements of an ISA in all cases where they are relevant in the circumstances of the audit, unless, in exceptional circumstances, the auditor judges it necessary to depart from a relevant requirement by performing alternative audit procedures to achieve the aim of that requirement. (Ref: Para. A51-A52)

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Application and Other Explanatory Material

General Concepts Relevant to an Audit of Financial Statements (Ref: Para. 5)

Independence

- A1. The independence of both the firm and the auditor from the entity whose financial statements are subject to audit allows the auditor to form an audit opinion without being affected by influences that might compromise the auditor's integrity, objectivity and professional judgment. To reinforce independence, the auditor is subject to ethical requirements relating to audits of financial statements.
- A2. The concept of independence refers both to the state of mind of the auditor and, because of the relevance of an audit of financial statements to a wide range of users in particular, independence in appearance. The concept does not mean to imply that an auditor ought to be free from all economic, financial and other relationships; this is impossible as every member of society has relationships with others. Rather, it is the significance of the economic, financial and other relationships, considered in light of what a reasonable and informed third party having knowledge of all relevant information would reasonably conclude to be unacceptable.

Reasonable Assurance

- A3. The auditor's overall objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance relates to the whole audit process, and is a high level of assurance. An

auditor cannot, however, obtain absolute assurance. This is because there are inherent limitations in an audit that affect the auditor's ability to detect material misstatements, whether due to fraud or error. Because of these limitations (described below), an audit is not a guarantee that the financial statements are free from material misstatement due to fraud or error. Consequently, some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with ISAs.¹⁰

- A4. The concept of reasonable assurance therefore acknowledges the concept of audit risk, and may be regarded as its mathematical complement. Reasonable assurance is obtained when the auditor has reduced audit risk to an acceptably low level. Audit risk is reduced by obtaining appropriate audit evidence; that audit evidence is sufficient when audit risk has been reduced to an acceptably low level.

Inherent Limitations of an Audit

- A5. There are several factors that give rise to the inherent limitations of an audit. The following describes the principal such factors:
- A6. Foremost, there is an expectation that the auditor will form an opinion on the financial statements within a reasonable period of time and at a reasonable cost. Underlying this expectation is the understanding that the auditor is not expected to address all information that may exist or to pursue every matter exhaustively on the assumption that information is in error or fraudulent until proved otherwise.
- A7. One of the most important consequences of this expectation is that an audit requires the use of testing by using sampling approaches and other means of selecting items for testing. While it is well recognised that sampling may give the sampler a high degree of confidence in the results of the sample, nevertheless it is inevitable that there is a risk that the sample results may lead to an invalid conclusion.
- A8. Similarly, an audit rarely involves the authentication of documents, nor is the auditor trained as or expected to be an expert in such authentication. Accordingly, unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine. However, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement (i.e., fraud) that involves, for example, falsified documentation which may cause the auditor to believe that audit evidence is valid when it is not. Because of these risks, ISA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" contains specific requirements designed to assist the auditor in reducing them..
- A9. In addition, the evidence available to the auditor includes information about the entity's internal control. ISAs provide the conditions under which the auditor is required to, or may

¹⁰ That is, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not, in and of itself, indicate a failure to conduct an audit in accordance with ISAs. Whether the auditor has performed an audit in accordance with ISAs is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor's report based on an evaluation of that evidence.

choose to, test the operating effectiveness of controls in determining the extent of substantive procedures to be performed. However, internal control, no matter how well designed and operated, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives, because of the limitations inherent in internal control. These include, for example, the possibility of human errors or mistakes and that controls may be circumvented by collusion or inappropriate management override. Neither the entity nor the auditor can overcome fully such inherent limitations.

- A10. Because of the above, and because of the nature of audit evidence and evidence gathering procedures, it is necessary for the auditor to form an opinion based on audit evidence that is persuasive rather than conclusive. However, while it is not possible to obtain conclusive evidence, it must be sufficient and appropriate to reduce audit risk to an acceptably low level.
- A11. Further, the work undertaken by the auditor to form an audit opinion is permeated by professional judgment, in particular regarding decisions about materiality and audit risk, the nature, timing and extent of audit procedures used to gather audit evidence, and the drawing of conclusions based on the audit evidence gathered. Judgment is also required by management in applying, and by the auditor in reviewing the application of, the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. Though professional judgment is an essential feature of auditing, it nevertheless contributes to the inherent limitations of an audit.
- A12. An audit is also necessarily limited by its objective, which is an expression of an opinion on the financial statements. For example, an audit opinion does not assure the future viability of the entity or the efficiency or effectiveness with which management has conducted the affairs of the entity.

Professional Judgment

- A13. Professional judgment is essential to the proper conduct of an audit. The value of professional judgment is a function of both its importance and its quality, and each of these depends on the other. Professional judgment may be described in auditing as the application of relevant knowledge and experience, with an attitude of professional skepticism and within the context provided by auditing, accounting and ethical standards, in reaching decisions.
- A14. The importance of the proper exercise of professional judgment lies in the fact that no rule of general application can be phrased to suit all circumstances or combination of circumstances that may arise, nor is there any substitute for the exercise of professional judgment in the determination of what constitutes the appropriate action in a particular case.

Sufficiency and Appropriateness of Audit Evidence

- A15. Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits and a firm's quality control procedures for client acceptance and continuance. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. Most of the auditor's work in forming the audit opinion consists of obtaining and evaluating audit evidence.

- A16. Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the risk of misstatement (the higher the risk, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality.
- A17. Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for, or detecting misstatements in, the financial statements. The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.
- A18. The sufficiency and appropriateness of audit evidence are interrelated. Whether sufficient appropriate audit evidence has been obtained during the evidence gathering process to enable the auditor to draw reasonable conclusions on which to base the audit opinion is a matter for the auditor to determine using professional judgment.

Materiality and Audit Risk

- A19. Material misstatements in the financial statements can arise from fraud or error. The auditor is concerned with material misstatements, and is not responsible for the detection of misstatements that are not material to the financial statements taken as a whole. In general, misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial information. The concept of materiality is used both in planning and performing the audit, and in evaluating the effect of identified misstatements on the financial information and the related auditor's report. Materiality and audit risk are related.
- A20. Audit risk is a function of the risk of material misstatement and detection risk, the assessment of which is a judgment rather than a precise measurement of risk. The risk of material misstatement may exist at two levels: at the overall financial statement level, and in relation to classes of transactions, account balances, and disclosures and the related assertions.
- A21. Risk of material misstatement at the overall financial statement level refers to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions.
- A22. Risk of material misstatement at the class of transactions, account balance, and disclosure level need to be considered because such consideration directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level necessary to obtain sufficient appropriate audit evidence and thereby enable the auditor to express an opinion on the financial statements taken as a whole at an acceptably low level of audit risk. Auditors use various approaches to accomplish that objective.¹¹

¹¹ The auditor may make use of a model that expresses the general relationship of the components of audit risk in mathematical terms to arrive at an appropriate level of detection risk. Some auditors find such a model to be useful

- A23. The risk of material misstatement at the assertion level consists of two components: inherent risk; and control risk. Inherent risk and control risk are the entity's risks; they exist independently of the audit of the financial statements.
- A24. Inherent risk is higher for some assertions and related classes of transactions, account balances, and disclosures than for others. For example, it may be higher for complex calculations or for accounts consisting of amounts derived from accounting estimates that are subject to significant measurement uncertainty. External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement. In addition to those circumstances that are peculiar to a specific assertion, factors in the entity and its environment that relate to several or all of the classes of transactions, account balances, or disclosures may influence the inherent risk related to a specific assertion. These latter factors include, for example, a lack of sufficient working capital to continue operations or a declining industry characterized by a large number of business failures.
- A25. Control risk is a function of the effectiveness of the design and operation of internal control in achieving the entity's objectives relevant to preparation of the entity's financial statements. Some control risk will always exist because of the inherent limitations of internal control.
- A26. The ISAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risk of material misstatement." However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risk of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.
- A27. Detection risk relates to the nature, timing, and extent of the auditor's procedures that are determined by the auditor to reduce audit risk to an acceptably low level. It is therefore a function of the effectiveness of an audit procedure and of its application by the auditor. For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessment of the risk of material misstatement at the assertion level. The greater the risk of material misstatement the auditor believes exists, the less the detection risk that can be accepted. Conversely, the less risk of material misstatement the auditor believes exist, the greater the detection risk that can be accepted.
- A28. Detection risk cannot be reduced to zero because of the inherent limitation of an audit and other factors. Such other factors include the possibility that an auditor might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results. These other factors ordinarily can be addressed through adequate planning,

when planning audit procedures to achieve a desired audit risk though the use of such a model does not eliminate the judgment inherent in the audit process.

proper assignment of personnel to the engagement team, the application of professional skepticism, and supervision and review of the audit work performed.

- A29. The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting a material misstatement resulting from error because fraud may involve sophisticated and carefully organized schemes to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor, with such concealment made even more difficult to detect when accompanied by collusion. Further, the risk of not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because management is frequently in a position to manipulate accounting records, present fraudulent financial information or override control procedures designed to prevent similar frauds by other employees.

Responsibility for the Financial Statements

- A30.¹² ISAs do not impose responsibilities on management and those charged with governance, and do not override laws and regulations that govern their responsibilities. However, underlying the concept of an independent audit is that the financial statements subject to audit are those of the entity, with the auditor engaged for purposes of forming and expressing an opinion on them. Accordingly, the ISAs are written on the basis that the responsibility for the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework, including activities necessary for that purpose, as described further below, is that of the management of the entity, with oversight from those charged with governance.¹³ Where such responsibilities are not established by law or regulation, or not accepted by management and those charged with governance absent such law or regulation, the auditor may be unable to conduct an audit in accordance with ISAs. The audit of the financial statements does not relieve management and those charged with governance of their responsibilities.
- A31. In accordance with the above, management, with oversight from those charged with governance, is responsible for establishing a control environment and for designing, implementing and maintaining controls sufficient to enable them to prepare the entity's financial statements and manage risks that may give rise to material misstatements, whether due to fraud or error, in those financial statements. Such controls reduce but do not eliminate the risks of misstatement. Those charged with governance of the entity are responsible for ensuring, through oversight of management, that the entity designs, implements and maintains internal control over the reliability of financial reporting.

[Note: Paragraphs A32-A36 are held as placeholder for extant paragraphs ISA 200.34-51 and material relating to management's responsibilities for preparing and presenting the financial statements in accordance with the applicable financial reporting framework. That material is

¹² [Note: The ISA 580 Task Force is considering wording that may be relevant to this paragraph, as it considers the issue of the nature and scope of management representations.]

¹³ The terms "management" and "those charged with governance" are described in ISA 260, "Communications with Those Charged with Governance."

under consideration by the IAASB ISA 800 Task Force, the revision of which is scheduled for discussion by the IAASB in September.]

Ethical Requirements Relating to an Audit of Financial Statements (Ref: Para. 10)

- A37. As discussed in ISA 220, “Quality Control for Audits of Historical Financial Information,” ethical requirements relating to audits of financial statements ordinarily comprise Parts A and B of the International Federation of Accountants’ Code of Ethics for Professional Accountants (IFAC Code) together with national requirements that are more restrictive.
- A38. ISA 220 identifies the fundamental principles of professional ethics established by Parts A and B of the IFAC Code and sets out the engagement partner’s responsibilities with respect to ethical requirements. ISA 220 recognizes that the engagement team is entitled to rely on a firm’s systems in meeting its responsibilities with respect to quality control procedures applicable to the individual audit engagement, unless information provided by the firm or other parties suggests otherwise. Accordingly, International Standard on Quality Control (ISQC) 1, “Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements,” requires the firm to establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements.

Professional Skepticism (Ref: Para. 11)

- A39 Professional skepticism is a concept relating to the accumulation and assessment of the audit evidence. An attitude of professional skepticism involves the critical assessment, with a questioning mind, of the validity of audit evidence obtained, recognizing that circumstances may exist that cause the financial statements to be materially misstated, and being alert to audit evidence that contradicts or brings into question the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. Maintaining an attitude of professional skepticism throughout the audit is necessary if the auditor is, for example, to reduce the risk of overlooking unusual circumstances, of over generalizing when drawing conclusions from audit observations, and of using faulty assumptions in determining the nature, timing and extent of the audit procedures and evaluating the results thereof.
- A40. A belief that management and those charged with governance are honest and have integrity does not relieve the auditor from maintaining an attitude of professional skepticism or allow the auditor to be satisfied with less-than-persuasive audit evidence.

Conduct of an Audit in Accordance with ISAs

Nature of ISAs (Ref: Para. 12)

- A41. ISAs, taken together, provide the standards for the auditor’s work in fulfilling the objective of an audit. The ISAs deal with the general responsibilities of the auditor, as well as the auditor’s further considerations relevant to the application of those responsibilities to specific topics. The nature of the ISAs requires the auditor to exercise professional judgment in applying them.

A42. ISAs contain objectives and requirements together with related guidance in the form of application and other explanatory material, and may contain introductory material and definitions that provide context essential to a proper understanding of the ISA:

- The objective or objectives in each ISA provide the context in which the requirements of the ISA are set. These objectives support the overall objective of the auditor set out in paragraph 4 of this ISA.
- The requirements (contained in a separate section in each ISA and expressed using the word “shall”) are designed to assist the auditor in meeting the objectives specified in the ISA and thereby, the overall objective of the auditor.
- The application and other explanatory material is an integral part of the ISA, as it provides further explanation of, and guidance for carrying out, the requirements of an ISA, along with background information on the matters addressed in the ISA. It may include examples of procedures, some of which the auditor may judge to be appropriate in the circumstances. Such guidance is, however, not intended to impose a requirement.

Appendices, which form part of the application and other explanatory material, are an integral part of an ISA. The purpose and intended use of an appendix are clearly explained in the body of the related ISA or within the title and introduction of the appendix itself.

- Introductory material may include, as needed, such matters as explanation of: the purpose and scope of the ISA, including how the ISA relates to other ISAs; the subject matter of the ISA; specific expectations on the auditor and others; and the context in which the ISA is set.
- An ISA may include, in a separate section under the heading ‘Definitions’, a description of the meanings attributed to certain terms for purposes of the ISAs. These are provided to assist in the consistent application and interpretation of the ISAs, and are not intended to override definitions that may be established for other purposes, whether in law, regulation or otherwise. Meanings of individual terms are provided only in those ISAs that deal principally with the subject matter to which the terms are most relevant. Unless otherwise indicated, those terms will carry the same meanings throughout the ISAs. The Glossary of Terms in the Handbook contains a complete listing of terms defined in the ISAs. It also includes description of other terms found in ISAs to assist in common and consistent interpretation and translation.

A43. The scope, effective date and any specific limitation of the applicability of a specific ISA is made clear in the ISA. Unless otherwise stated in the ISA, the auditor is permitted to apply an ISA before the effective date specified therein.

A44. In performing an audit, auditors may be required to comply with other professional, legal or regulatory requirements in addition to the ISAs. The ISAs do not override laws and regulations that govern an audit of financial statements. In the event that those laws and regulations differ from the ISAs, an audit conducted only in accordance with laws and regulations will not automatically comply with ISAs.

- A45. The auditor may also conduct the audit in accordance with both ISAs and auditing standards of a specific jurisdiction or country. When the auditor conducts the audit in accordance with ISAs and auditing standards of a specific jurisdiction or country, in addition to complying with each of the ISAs relevant to the audit, it may be necessary for the auditor to perform additional audit procedures in order to comply with the relevant standards of that jurisdiction or country.

Considerations Specific to Audits in the Public Sector

- A46. ISAs are applicable to engagements in the public sector. When additional guidance is appropriate for the public sector, such guidance is included within the body of an ISA.
- A47. Irrespective of whether an audit is being conducted in the private or public sector, the basic principles of auditing remain the same. What may differ for audits carried out in the public sector is the audit objective and scope. These factors are often attributable to differences in the audit mandate and legal requirements or the form of reporting (for example, public sector entities may be required to prepare additional financial reports).
- A48. Specific requirements of any other relevant regulations, ordinances or ministerial directives may affect the audit mandate and may include special auditing requirements, including the need to have regard to issues of national security. Audit mandates may be more specific than those in the private sector, and often encompass a wider range of objectives and a broader scope than is ordinarily applicable in the private sector. The mandates and requirements may also affect, for example, the extent of the auditor's discretion in establishing materiality, in reporting fraud and error, and in the form of the auditor's report. However, these differences would not constitute a difference in the overall objective of the auditor.

Objectives (Ref: Para. 13)

- A49. The objectives in individual ISAs provide a link between the requirements and the overall objective of the auditor, having regard to the need for the auditor to obtain reasonable assurance through gathering sufficient appropriate audit evidence.
- A50. The auditor's judgment about whether an objective has been achieved and the need to obtain further audit evidence in the context of the auditor's overall objective is made having regard to the fact that some ISAs deal with the general responsibilities of the auditor, while others address the auditor's further considerations relevant to the application of those responsibilities to specific topics. The ISAs are therefore interrelated, and the auditor bears this in mind in making the necessary judgments.

Compliance with Relevant Requirements (Ref: Para. 14(b))

- A51. The auditor is required to comply with the requirements of an ISA in all cases where they are relevant in the circumstances of the audit. In exceptional circumstances, however, the auditor may judge it necessary to depart from a relevant requirement to achieve the aim of that requirement. The need for the auditor to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective. In such circumstances, the auditor needs to perform alternative audit procedures that achieve the aim

of that requirement. ISA 230, “Audit Documentation” establishes documentation requirements in those circumstances where the auditor departs from a requirement.

A52. A requirement is not relevant only in the cases where:

- The ISA is not relevant (e.g., in a continuing engagement, nothing in ISA 510, “Initial Engagements—Opening Balances,” is relevant); or
- The circumstances envisioned do not apply because the requirement is conditional and the condition does not exist (e.g., the requirement to modify the auditor’s report where there is a limitation of scope).

The auditor is not required to apply a requirement that is not relevant in the circumstances of the audit; this does not constitute a departure from the requirement.