

## **Explanatory Memorandum**

### **Background**

At the September 2002 meeting of the International Auditing and Assurance Standards Board (IAASB) it was agreed that IAPS 1005 should be revised to take account of International Standards on Auditing (ISAs) issued since March 1999.

In addition, the IAASB agreed that for revised and new ISAs issued subsequent to March 2003, whenever necessary, SMP considerations should be included in the body of those ISAs. For example, SMP considerations will be dealt with in the proposed Audit Risk Standards, which is currently being exposed for public comment. IAPS 1005 will be eliminated over time.

The IAASB did not consider the existing guidance on the application to small entity audits of ISAs issued before March 1999. Commentators are requested to comment on the application of ISAs issued since March 1999 to small entity audits (i.e. proposed changes highlighted by way of mark-up text), and not on the existing guidance.

### **Proposed Changes**

#### COMMENTARY ON THE APPLICATION OF INTERNATIONAL STANDARDS ON AUDITING

IAPS 1005 is not intended to be a “how to” guide for audits of small entities, nor is it intended to be a guide for small practitioners on how to carry out audits. Rather, it is intended to be used by practitioners who already know how to conduct an audit in accordance with ISAs, but who need guidance on how audits of the financial statements of small entities differ from audits of the financial statements of other entities. Accordingly, explanatory information and guidance that might be helpful but does not relate only to small entities is not included.

The following revised and new ISAs have been issued since March 1999:

- ISA 100, “Assurance Engagements”
- ISA 200, “Objective and General Principles Governing an Audit of Financial Statements”
- ISA 240, “The Auditor’s Responsibility to Consider Fraud and Error in an Audit of Financial Statements”
- ISA 260, “Communications of Audit Matters With Those Charged With Governance”
- ISA 505, “External Confirmations”
- ISA 545, “Auditing Fair Value Measurements and Disclosures”
- ISA 570, “Going Concern”
- ISA 700, “The Auditor’s Report on Financial Statements.”

ISA 100 deals with the principles of assurance engagements and their application to high level assurance engagements. These principles do not change when the subject matter of the engagement originates with a small entity. For these reasons, no change is proposed to IAPS 1005 in respect of ISA 100.

A change was made to paragraph 6 of ISA 600, requiring the auditor to exercise professional skepticism. IAPS 1005 does not discuss ISA 200 directly, but it does refer to professional

skepticism. However, the discussion in IAPS 1005 is in line with the thoughts expressed in the revised paragraph 6 of ISA 200, and no change is proposed.

ISA 505 replaced and expanded part B of ISA 501, “Audit Evidence – Additional Considerations.” IAPS 1005 has no paragraphs dealing with ISA 501. No points raised in ISA 505 should cause any problems with small entities, and there do not seem to be any particular difficulties in the use of confirmations that arise in audits of small entities. No change is proposed.

The only change made to ISA 700 was to require the auditor’s report to refer to the country of origin of the financial reporting framework. For financial statements of small entities this will usually be an easy matter to determine, and no change is proposed to the existing paragraphs in IAPS 1005 that deal with ISA 700.

THE PROVISION OF OTHER SERVICES TO SMALL ENTITY AUDIT CLIENTS AND COMMENTARY ON THE APPLICATION OF INTERNATIONAL STANDARDS ON AUDITING WHEN THE AUDITOR ALSO PREPARES THE ACCOUNTING RECORDS AND FINANCIAL STATEMENTS OF THE SMALL ENTITY

Section 8 of the IFAC *Code of Ethics for Professional Accountants* (the Code) was revised and issued in November 2001. Section 8 of the Code provides a framework that establishes principles that auditors should use to identify threats to independence, evaluate the significance of those threats, and, if the threats are other than clearly insignificant, identify and apply safeguards to eliminate the threats or reduce them to an acceptable level.

Although Section 8 of the Code is applicable to audit engagements when the auditor’s report is dated on or after December 31, 2004, earlier application is encouraged. As a result, the IAASB is of the opinion that it would be inappropriate not to change the above sections of the IAPS to reflect the above principles, and auditors rendering other services to small entity audit clients are encouraged to apply these principles as early as possible.

### **Specific Questions**

Commentators are requested to comment specifically on the completeness of the guidance on the application of ISAs issued since March 1999. I.e., with reference to the ISAs issued since March 1999, and the proposed changes, are there any other matters relating to application of those ISAs to small entity audits that should be covered?