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Agenda Item

7

Committee: IAASB

Meeting Location: Toronto

Meeting Date: April 19-23, 2004

Audit Documentation

Objectives of Agenda Item

To review and discuss a first read of the proposed exposure draft of revised ISA 230, "Audit Documentation" and the proposed exposure draft of new International Standard on Review Engagements (ISRE) XX, "Documentation for Reviews of Historical Financial Information."

Background

The IAASB discussed an issues paper on audit documentation at its February 2004 meeting and provided input and direction to the Task Force. Since then, a representative from INTOSAI, Kelly Ånerud, joined the Task Force. In addition, IAASB member, Rogerio Gollo, joined the Task Force after the retirement of previous Task Force member Suresh Kana from the Board in December 2003.

Activities Since Last IAASB Discussions

The Task Force held a meeting and a conference call in March 2004 to discuss the feedback provided by the Board in February as well as comment letters provided by INTOSAI and IFAC's SMP Task Force on the issues paper. These comment letters, including the Task Force's responses to the issues raised, are attached as Agenda Items 7-D and 7-E respectively.

Main Issues

1. SCOPE

At the February meeting, the Board had agreed that, for the time being, it would not be appropriate for the scope of the Standard to be broadened to cover the entire Assurance Framework since the Board had not yet issued any assurance Standards dealing with specific subject matters. However, the Board believed that if the principles in ISA 230 were pitched at an appropriately high level, then the scope could be expanded to cover both audits and reviews of historical financial information, since there were similarities in the purposes of documentation for both types of engagement. Accordingly, the Task Force took the mandate from the Board to consider an expanded scope and evaluated two alternatives:

- a) Have ISA 230 cover both audits and reviews of historical financial information in one single document; or
- b) Have ISA 230 deal with audits only, and have a separate ISRE dealing with documentation for review engagements.

If alternative (a) were to be pursued, the Standard would have to be positioned at a level higher than ISAs in the IAASB's hierarchy of pronouncements to cater for both audit and review engagements. This would effectively result in the setting of a precedent for the IAASB's future revisions projects. For example, a broadening of the scope in a revision to ISA 520, "Analytical Procedures," to cover both audits and reviews inside one Standard could result in the withdrawal of ISA 520 and the creation of a new Standard positioned one level higher in the hierarchy. The end result of running through the revisions process in that way would be to divide ISAs into two separate hierarchies. From the perspective of structure, the Task Force believes that this would reduce clarity.

In addition, the Task Force took note of the fact that the Clarity Task Force is currently evaluating how best to restructure ISAs and IAPs to bring about greater clarity. Without prejudging the outcome of the Clarity Task Force's deliberations, the Task Force concluded that the complexity of that project would increase if there were to be a new level of fieldwork Standard that dealt with both audits and reviews in a single pronouncement.

For this reason, the Task Force proposes a new ISRE addressing documentation for review engagements separately. Because the basic principles, essential procedures and guidance in ISA 230 are substantially similar for review engagements, the Task Force took the approach of stating in the proposed new ISRE that these basic principles, essential procedures and guidance are applicable in all material respects to review engagements, and providing guidance on an exception basis. As a result of taking this approach, the Task Force proposes a conforming change to ISRE 2400, "Engagements to review Financial Statements," to delete paragraph 17 on documentation. This change is illustrated in Agenda Item 7-C.

2. EXTENT OF AUDIT DOCUMENTATION

The Task Force believes that documentation serves not only to assist members of the audit team with supervision responsibilities to review the work performed but also to enable experienced auditors to conduct quality control inspections as required by ISQC 1 or other requirements. In debating what would be an appropriate standard with regard to the extent of documentation necessary to satisfy the purposes in both of the above situations, the Task Force felt that a minimum threshold of documentation should be set in the case of experienced auditors conducting inspections because, in many cases, such inspections do not reach down to the same level of review detail as would be necessary in the case of members of the audit team responsible for supervision during the audit. Accordingly, the Task Force proposes to set a minimum threshold for the auditor to document significant conclusions reached on the audit for the purposes of experienced auditors conducting inspections, separately from having the requirement for the auditor to prepare sufficient documentation for members of the audit team with supervision responsibilities to review during the audit.

3. SIGNIFICANT MATTERS

Although the Board had cautioned against attempting to produce a complete list of items that could be considered significant in an audit, there was general consensus at the February meeting that some explanatory description was useful to guide the auditor. The Task Force also concluded that a definition was not workable because of the diversity of circumstances or situations that could give rise to significant matters. Accordingly, the Task Force agreed to provide some guidance in paragraph 14 in terms of generic examples.

4. RE-PERFORMANCE

The Board had agreed during the discussion of the issues paper in February that mandating a documentation standard to enable full re-performance of the audit was an unworkable proposition. However, there was general agreement that the auditor should document the identifying characteristics of the specific items tested since this would fulfill a number of key purposes for documentation, for example, to enable the engagement team members who performed the work to be accountable for their work, and to enable members of the engagement team with supervision responsibilities to review and understand that work. In addition, the documentation of such information plays an important role in providing the auditor with an audit trail to follow should there be exceptions or unusual items that need to be further investigated. Accordingly, there is a new black letter imperative (see paragraph 17) that requires the auditor to document the identifying characteristics of the specific items tested.

5. SUBSEQUENT CHANGES TO DOCUMENTATION AFTER THE DATE OF THE AUDITOR'S REPORT

A variety of views were expressed during the Board discussion in February regarding how the auditor should deal with subsequent changes to documentation after the auditor's report had been signed, i.e. after the date of completion of the audit. The Task Force had noted that it was important to balance the practical needs of the auditor to make necessary "housekeeping" changes to audit documentation after the sign-off date against the risk of the auditor making inappropriate changes to documentation after the event and that could be viewed as "file doctoring."

The Board agreed with the principle that housekeeping-type changes could be made to documentation after sign-off provided that such changes were intended to document contemporaneous evidence, i.e. evidence obtained before the auditor's report was signed and dated. Consequently, this principle is now embodied in paragraph 21.

With regard to information that comes to the auditor's attention after sign-off of the auditor's report, such as a late third party confirmation, the Task Force debated the various scenarios that could occur in practice, and noted that the key consideration in the determination of whether the auditor retained such information was whether the information turned into evidence. The Task Force believes that this would happen if, on the basis of professional judgment, the auditor decided to evaluate, or perform other audit procedures on, that new information.

If the auditor determined that it was not necessary to examine the new information, that information would not need to be retained. However, if the auditor judged it necessary to examine the new information, what the auditor would need to document would depend on whether the new piece of evidence affected the previously signed auditor's report:

- a) If the new evidence did not affect the auditor's report, the auditor could either retain it with the audit documentation or separately, but should appropriately document a conclusion that it did not affect the auditor's report.
- b) If the auditor believed that the new evidence might have caused the auditor to modify the auditor's report if known at the date the report was signed, such evidence should be retained, and the auditor should follow the requirements and guidance in ISA 560, "Subsequent Events" dealing with evidence received after the date of the auditor's report.

Paragraph 25 in the first-read draft provides the guidance to address the above cases.

6. RETENTION OF DOCUMENTATION

At the February meeting, a majority of the Board asked the Task Force to incorporate grey letter guidance in the Standard specifying a minimum period for which audit documentation should be retained, mainly to support the quality control monitoring process and to cater for jurisdictions that do not presently have regulatory or legal requirements for retention. While acknowledging that any specific period would, by nature, be arbitrary, the Task Force chose 7 years from the date the financial information is issued as being an appropriate period for retention, unless local law or regulation prescribes a longer period. This was on the basis that such a period appeared to be a common retention period in many of the world's major economies and incorporated in national law or regulation, which often addressed not just audit documentation for the audit firms but also other types of documentation for the audited entities themselves such as bookkeeping records, tax data, etc. In addition, given the current external environment where auditors' work is subject to closer scrutiny by regulators and other stakeholders at large, the Task Force felt it was preferable to have a longer period rather than a shorter one.

7. CONFIDENTIALITY

In their comment letter on the issues paper, INTOSAI noted that one of the other fundamental differences between private sector audits and public sector audits is the public sector's focus on transparency and accountability. INTOSAI noted that there is an ongoing need in the public sector to balance confidentiality with the need for transparency and accountability, and that it might be typical for some of the audit documentation in a public sector audit to be a matter of public record. INTOSAI accordingly suggested that guidance on such an issue be incorporated into the revised ISA in the section dealing with confidentiality.

The Task Force acknowledged that, in a public sector setting, there may be particular needs for audit documentation to be publicly disclosed for the reasons given above. However, the Task Force felt that the disclosure of audit documentation on a public forum could be seen as a breach of the professional duty of confidentiality, and hence was more of an ethics issue than an audit issue.

8. REBUTTABLE PRESUMPTION

During the discussion of the issues paper at the February meeting, the IAASB debated the issue of the rebuttable presumption that work that is not documented by the auditor was not performed. This was a requirement that the U.S. PCAOB had introduced in their exposure draft on audit documentation in November 2003. Although the IAASB had tentatively agreed that ISA 230 should not introduce a similar requirement, the IAASB directed the Task Force to analyze the pros and cons of having such a rebuttable presumption and to report back.

The Task Force conducted a review of the comment letters that were submitted to the PCAOB in respect of its November 2003 exposure draft. A summary of the arguments for and against this principle is attached as Agenda Item 7-F. After reviewing these comments and debating the issue further, the Task Force concluded that the arguments against introducing this principle as part of the revised ISA 230 were more convincing. Accordingly, the Task Force recommends that the IAASB not adopt the principle of rebuttable presumption in the revised ISA.

Material Presented

Agenda Paper 7-A (Pages 469 – 478)	Proposed exposure draft of revised ISA 230, “Audit Documentation”
Agenda Paper 7-B (Pages 479 – 480)	Proposed exposure draft of new ISRE XX, “Documentation for Reviews of Historical Financial Information”
Agenda Paper 7-C (Pages 481 – 486)	Conforming change to ISRE 2400, “Engagements to review Financial Statements”
Agenda Paper 7-D (Pages 487 – 490)	Comment letter from INTOSAI on the issues paper, with Task Force response
Agenda Paper 7-E (Pages 491 – 498)	Comment letter from SMP Task Force on the issues paper, with Task Force response
Agenda Paper 7-F (Pages 499 – 502)	Arguments for and against the rebuttable presumption that work that is not documented has not been performed

Action Requested

IAASB is asked to review the first-read drafts of the proposed revised ISA 230 and new ISRE XX and to provide comments to the Task Force to consider in preparing the final drafts for the Board to approve for issue as exposure drafts.

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