

Discussion Paper

Improving the Clarity of IAASB Standards

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Improving the Clarity of IAASB Standards

I. Purpose

The purpose of this Discussion Paper is to explain why the project to improve the clarity of IAASB standards is being undertaken and to present the objectives and key aspects of a comprehensive proposal to do so.

II. Background

The objective of the International Auditing and Assurance Standards Board (IAASB) is “*to serve the public interest by setting high quality auditing and assurance standards and by facilitating the convergence of international and national standards, thereby enhancing the quality and uniformity of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.*” Though the term ‘high quality’ is not defined, this objective can be understood as meaning that the IAASB is to issue standards that *inter alia* are:

- (a) understandable by those who perform the relevant engagements;
- (b) clear and capable of consistent application;
- (c) recognised by the various regulators around the world;
- (d) accepted by the profession at the international and national levels; and
- (e) applicable and applied in practice by all auditors for all audits, regardless of the size and structure of their firm, or of the entities audited.

The early international auditing and assurance standards were generally fairly brief documents, typically comprising between 4-15 pages each, with a relatively limited number of basic principles and essential procedures that imposed obligations on the auditor, supplemented by explanatory material where considered necessary. Over time, however, standards have included more specific essential procedures and more detailed guidance on how to apply the basic principles and essential procedures in differing circumstances. This trend is the result of demand from practitioners and regulators, who both wish to increase the quality and consistency of auditor performance globally, and of the increasing complexity of business.

More recently, though, some respondents to exposure drafts issued by the IAASB, while recognizing the drivers behind such a trend, invited the IAASB to consider how best this trend could be managed to avoid perceived difficulties with unwieldy and complex standards.

In 2003, in light of such suggestions, and to a large part in response to encouragement by the International Organization of Securities Commissions (IOSCO), certain national standard setters and others to the IAASB to clarify certain aspects of its standards¹, the IAASB undertook a review of the drafting conventions used in its standards. The objective of the review was to identify ways to improve the clarity, and thereby the consistent application, of International Standards issued by the IAASB. The proposal arising from that review included recommendations on the use of language, the treatment of sentences describing audit procedures or actions in the present tense and the use of the bold type lettering convention. In addition, the proposal responded to concern that there may, in some quarters, be the perception that the auditor need only consider sentences presented in bold type lettering and that guidance in grey type

¹ Based on responses to the IAASB’s November 2002 Exposure Draft, *Proposed Terms of Reference, Preface and Operations Policy No 1 – Bold Type Lettering*.

lettering could be overlooked. It was therefore proposed that the whole text of a standard should carry ‘equal authority.’

The IAASB recognised the need to clarify the drafting conventions used in its standards, but raised a number of concerns about the proposal. One concern was that a new drafting convention might result in an unreasonable increase in the number of detailed professional requirements and, consequently, a move away from a focus on basic principles and essential procedures and the application of professional judgement. Further work on the consequences of the application of the proposal to existing standards was therefore required. The IAASB was also concerned, however, that the proposal sought to deal only with one aspect of the problem. It concluded, therefore, that consideration should also be given to the issues of the length and complexity of the standards and the way in which they are structured.

Accordingly, in 2004 the IAASB Clarity of Standards Task Force considered some further proposals for improvements to standards, including elements arising from a review commissioned by the UK Auditing Practices Board from the British Standards Institute of UK auditing standards. In doing so, it consulted representatives of national auditing standard setters about how the clarity of the standards could be improved, and solicited preliminary views from some regulators.

The following Discussion Paper highlights aspects of IAASB’s standards that have been identified for possible improvement and, based on these, presents a proposal to improve their clarity.

III. Aspects of IAASB Standards Identified for Consideration

THE DISTINCTION BETWEEN PROFESSIONAL REQUIREMENTS OR OBLIGATIONS AND EXPLANATORY MATERIAL

International auditing standards that are clear and capable of consistent application should contain no ambiguity about the professional obligations to be fulfilled by the auditor.

In considering whether IAASB’s standards achieve this benchmark, it has become apparent that there is some confusion in the minds of some readers over the authority of the grey type lettering that contains explanatory and other material as compared with that presented in bold type. In particular, some constituents have questioned the expected level of compliance by auditors with material presented in the present tense, noting that the “unmodified” present tense may be variously interpreted as being more, or less, definitive than possibly intended by the IAASB. The use of the present tense has also been found to be problematic when translating standards.

In parallel, however, concerns have been raised that an interpretation of the use of the present tense as giving rise to an imperative for performance (conceptually equating it to a “should” statement) bears the almost inevitable risk of generating a significant increase in the number of “shoulds” within the standards, thereby transforming the audit into an overly procedural, compliance-focussed process – an approach generally considered by the IAASB to be undesirable.

Consequently, there is a need to reconsider how IAASB standards identify and articulate professional requirements of the auditor and how these requirements are distinguished from material that is explanatory in purpose, such that the status of all material is clear.

LENGTH AND COMPLEXITY OF STANDARDS

The IAASB's objective to serve the public interest by setting high quality auditing and assurance standards, and thereby enhancing the quality and uniformity of practice throughout the world, especially when endeavoring to achieve behavioural change in an increasingly complex world, has recently resulted in adding to the length and complexity of the standards through more required procedures, detailed guidance and explanations.

Several national auditing standard setters have expressed particular concern over the present trend towards longer, more detailed standards, and have raised the following issues:

(a) Adoption by the national standard setters

Lengthy and detailed standards may be acceptable in some jurisdictions where such standards are already accepted by auditors, and where they are appropriate to the legal environment. In other jurisdictions, however, length and detail are likely to prove obstacles to their acceptance. This has created a major difficulty for national standard setters who have to adopt the standards, or at least "converge" to them. In particular:

- National standards setters must create standards that are appropriate to their own jurisdictions and capable of being effectively introduced. In some countries, for example, national legislation is giving legal backing to International Standards on Auditing (ISAs), sometimes incorporating them into national law. It has been observed that the more explanatory text inserted in the standards which is not by nature suitable for inclusion in a legal instrument, the more difficult it will be to converge such national standards with international standards. Consequently, there is a need to consider whether the current structure of an ISA, in its entirety, is suitable in such jurisdictions.
- The length and complexity of the ISAs may hinder their integration into national auditing standards, particularly where such characteristics are viewed as representing an overly procedural approach that may obstruct the use of professional judgment and prove to be a less effective way to conduct an audit. On the other hand, however, the lack of a certain amount of detail may be regarded in other jurisdictions as making the standards less effective in achieving consistent high quality audits. Consequently, the right balance needs to be found such that the global acceptability of international standards can be enhanced.
- In those countries where IAASB standards must be translated into the national language before being integrated into the national standards, the longer and more detailed the standards, the greater the translation problems will be. This difficulty has led some countries to adopt a solution by which they were redrafting the standards in order to be understood by their auditors.

(b) Implementation in practice

Some national standard setters have indicated that concern is being expressed by some of their constituents about the difficulty in trying to keep up with the unprecedented pace at which international standards are being established, a problem that is being further compounded by the level of effort required to read and understand relatively lengthy and complex standards. These factors may increase the risk that practitioners do not give full consideration to the standards and may not therefore apply them consistently.

This effect may be particularly acute for small- and medium-sized practices (although not only for them) who may perceive from the complexity of the IAASB standards that they are

not applicable to them and their clients. In many countries, the majority of audits are of small or medium sized private companies, and such concerns are therefore widely held.

PRINCIPLES OF AUDITING

IAASB's standards are premised on the auditor's understanding of the principles underlying an audit and the exercise of professional judgement in applying the requirements of the ISAs. At present, IAASB standards use a bold type lettering convention and the word "should" to identify 'basic principles and essential procedures.' The basic principles, however, are not separated from the essential procedures in the text of IAASB standards and, in some cases, a bold type lettered sentence may be a mix of both.

To continue to support the philosophy of a 'principles-based' approach to standards and to assist in the application of professional judgment in applying the professional requirements of an ISA, it seems desirable, if practicable, for the IAASB to clarify what those principles are, demonstrate their linkage with the standards that are issued, and publish them in a concise form.

IV. Proposal to Improve the Clarity of IAASB Standards

The following proposal seeks to respond in a comprehensive and integrated way to the concerns raised, and suggestions made, by certain regulators, national auditing standard setters and others.

To help ensure IAASB standards are clear and understandable and have a greater chance to drive behaviour in practice, the overall objective of the proposal is to improve the clarity of IAASB standards such that:

- (a) the professional requirements or obligations contained therein are clearly ascertainable;
- (b) their length and complexity are managed; and
- (c) their overall construction assists national adoption or convergence.

In working to achieve this objective, it is not the intention of any aspect of this proposal to weaken the effect, or reduce the applicability of, IAASB's standards. On the contrary, the proposal endeavors to strengthen these standards through achieving greater clarity as to their requirements.

The proposal comprises three interrelated aspects:

- A. **Fundamental Principles of Auditing** – Identifying and communicating the fundamental principles of auditing, and improving the linkages between these principles and the professional requirements contained in the ISAs.
- B. **Professional Requirements or Obligations** – Clarifying the professional requirements or obligations of the standards and interpreting the current use of the present tense in explanatory material.
- C. **Restructuring of ISAs** – Distinguishing professional requirements more clearly from explanatory material to improve the understandability of the standards.

Section V of this Paper illustrates the application of the proposal. Section VI of this Paper describes possible approaches to implementation.

Although IAASB's standards comprise more than ISAs, this proposal principally focuses on ISAs given their importance to the public interest. The concepts behind the proposal, however, can be equally applied in the future to other International Standards issued by the IAASB.

The Task Force recognizes that there may be a consequential impact of the proposals on Practice Statements (in particular, International Auditing Practice Statements (IAPs) which cover a broad range of topics), and that there may be a need to reconsider the purposes, authority, drafting conventions and future use of Practice Statements. The Task Force has concluded that attention must first be placed on determining how IAASB standards can be improved and once a direction is clear, a more systematic review of Practice Statements can be undertaken separately. Accordingly, it is recommended that the present system for Practice Statements be retained for the time being.

IV (A) Fundamental Principles of Auditing

To support the philosophy that ISAs are ‘principles-based,’ it is proposed that the IAASB clarify what those principles are by determining the “fundamental principles of auditing”, demonstrate their linkage with the ISAs, and publish them in a concise form.

The advantages of codifying the “fundamental principles of auditing” include:

- The clearer identification of the principles that ultimately drive the auditor’s professional judgment, within the corpus of ISAs by distinguishing them from the procedural requirements.
- The communication of the principles that underlie the professional requirements contained in ISAs.
- The establishment of a ‘guide’ that may assist the IAASB in determining the nature and type of professional requirements to be established in ISAs.

Working Framework

Fundamental principles may be described as comprising the high ideals of professional conduct, representing the essential qualities of an audit. Conceptually, fundamental principles should:

- Reflect the underlying objective(s) of an audit. The principles would be achieved by using professional judgment in fulfilling the related professional requirements contained in ISAs.
- Be easily understood.
- Be drafted at a sufficiently broad level to be universally applicable such as to avoid the need for revision as ISAs are updated, and to prevent auditor override.
- Be sufficiently specific to be meaningful and relevant.

To reinforce the importance of the principles as the underpinning to the requirements of the ISAs and the concept that auditors are not expected to depart from or override the principles, an appropriate level of authority must also attach to the principles and the level of adherence thereto must be clearly ascertainable.

PROPOSED “FUNDAMENTAL PRINCIPLES OF AUDITING”

Based on the above working framework, a proposed statement of authority and a set of “fundamental principles of auditing” are presented below. They would be given effect within an amended ISA 200.

In drafting the principles, the Task Force has had regard to the Assurance Framework, and to principles, or similar statements, in a number of national auditing standards. It is important to

note that the following “fundamental principles of auditing” are based on the preliminary view of the Task Force and may not represent the final set of principles that ultimately might be adopted.

In carrying out an audit of financial statements and in complying with ISAs, the auditor shall comply with the fundamental principles of auditing. The fundamental principles of auditing comprise (a) the fundamental principles of professional ethics established by Part B of the IFAC Code of Ethics for Professional Accountants, and the related requirement for independence, and (b) those fundamental principles that underlie the objective of an audit, as follows.

Fundamental Principles of Professional Ethics

- (a) **Integrity**
A professional accountant shall² be straightforward and honest in all professional and business relationships.
- (b) **Objectivity**
A professional accountant shall not allow prejudices or bias, conflict of interest or undue influence of others to override professional or business judgment.
- (c) **Professional Competence and Due Care**
A professional accountant has a continuing duty to maintain professional knowledge and skill at a level required to ensure that a client or employer receives the advantage of the provision of competent professional service based on current developments in practice, legislation and techniques. A professional accountant shall act diligently and in accordance with applicable technical and professional standards in all professional and business relationships.
- (d) **Confidentiality**
A professional accountant shall respect the confidentiality of information acquired as a result of professional or business relationships and shall not disclose any such information to third parties without proper and specific authority unless there is a legal or professional right or duty to disclose. Confidential information acquired as a result of professional and business relationships shall not be used for the personal advantage of the professional accountant or third parties.
- (e) **Professional Behavior**
A professional accountant shall comply with relevant laws and regulations and shall avoid any action that discredits the profession.

In addition to the above, and in accordance with Section 8 of Part B of the IFAC Code of Ethics for Professional Accountants, for assurance engagements provided to an audit client, the members of the assurance team, the firm and network firms shall be independent of the client, independence being defined as: (i) independence of mind – the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism; and (ii) independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party, having knowledge of all relevant information, including any

² These principles have been taken verbatim from the IFAC Code of Ethics, with the exception that the Code uses the word “should” to describe the responsibility of the professional accountant. For purposes of consistency with the proposal contained in section IV (B), the word “shall” has been used in place of the word “should.”

safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's, integrity, objectivity or professional skepticism has been compromised.

Fundamental Principles Underlying the Objective of an Audit

(f) Association

The auditor shall not be associated with, or allow the use of the auditor's name or report to be associated with, information known by the auditor to be misleading unless reporting as such thereon.

(g) Responsibility

The auditor shall take responsibility for the audit opinion, maintaining an adequate level of involvement in the audit engagement, properly supervising assistants, if any, and evaluating the work of experts or others upon whom reliance is placed.

(h) Quality Control

The auditor shall implement quality control procedures, including consultation with others as necessary, in support of the provision of high quality service.

(i) Rigor and Skepticism

The auditor shall plan and perform an audit with thoroughness and with an attitude of professional skepticism, critically assessing with a questioning mind the validity and reliability of evidence obtained, recognizing that circumstances may exist that cause the financial statement to be materially misstated.

(j) Professional Judgment

The auditor shall apply professional judgment in fulfilling the auditor's responsibilities and, taking account of materiality, reducing audit risk to an acceptably low level such that the auditor obtains reasonable assurance as the basis for the auditor's report.

(k) Knowledge

The auditor shall possess a sufficient understanding of the entity and its environment to appropriately plan and perform the audit, interpret audit findings and report on the financial statements.

(l) Evidence

The auditor shall obtain sufficient appropriate evidence to afford a reasonable basis for expressing an opinion on the financial statements.

(m) Documentation

The auditor shall document matters that are important in providing evidence to support the audit opinion.

(n) Communication

The auditor shall communicate significant matters affecting the entity's financial statements to management, those charged with governance, and others where, in compliance with local laws and regulations and while respecting the confidentiality of information, additional communication is needed having regard to the wider public interest.

(o) Reporting

The auditor's report shall contain a clear expression of opinion in writing setting out information necessary for a proper understanding of the opinion and basis thereof.

OTHER PRINCIPLES

In formulating the proposed the “fundamental principles of auditing”, the possibility of whether other ‘lower-level’ principles exist in specific ISAs, and if so whether they should be identified separately within ISAs, was considered.

To avoid the introduction of a concept of tiers to the principles and adding unnecessary complexity to the standards, it is proposed that ‘lower-level’ principles, if they do exist beyond those encompassed by the identified fundamental principles, are not to be identified separately.

Action Requested

The IAASB is asked to:

- Consider the proposed “fundamental principles of auditing” and advise on their completeness and appropriateness.
- Consider the proposed authority to be afforded the proposed fundamental principles of auditing and advise thereon.

IV (B) Professional Requirements or Obligations

CATEGORIES OF PROFESSIONAL REQUIREMENTS OR OBLIGATIONS

To clarify and communicate the professional requirements or obligations of a standard, it is proposed that ISAs adopt, and specify, two categories of professional requirements and the related description of authority attaching thereto, as follows:

1. *Requirements Derived from the Fundamental Principles of Auditing*

The auditor is obliged to accomplish such requirements in all cases in which the circumstances exist to which the requirement applies. ISAs use the word “shall” to indicate a requirement derived from the fundamental principles of auditing.

2. *Other Requirements*

The auditor is obliged to accomplish such requirements unless, in exceptional circumstances, the auditor judges it necessary to depart from the requirement to achieve more effectively the objective of the engagement. When such a situation arises, the auditor shall justify the departure in writing.

Such other requirements are indicated by the use of the “should.” If an ISA provides that a procedure or action is one that the auditor “should consider,” the consideration of the procedure or action is required, while carrying out the procedure or action is not.

An auditor complies with the professional requirements of those ISAs that are relevant to the engagement. An ISA is considered relevant when matters exist in a particular engagement that would make the requirements of the standard applicable and such matters are not immaterial. An auditor should not represent compliance with ISAs unless the auditor has complied fully with all of those relevant to the engagement.

The above categories of professional requirements are not dissimilar to those being proposed by the U.S. Public Company Accounting Oversight Board (PCAOB). However, they differ in two important respects:

- The PCAOB has proposed the use of the words “must,” “shall,” and “is required” to indicate unconditional obligations which the auditor must accomplish in all cases in which the circumstances exist to which the obligation applies. While the nature of the obligation being proposed by both the Task Force and the PCAOB is identical, the Task Force proposes that for ISAs, such mandatory or unconditional obligation be based on, and for purposes of giving effect to, those essential obligations inherent in the fundamental principles of auditing. In contrast, the PCAOB has not specified the basis upon which unconditional obligations will be specified.
- The PCAOB has proposed the use of the word “should” to indicate obligations that are presumptively mandatory, along with stringent documentation requirements for departures therefrom. The PCAOB’s proposal states that the auditor must comply with presumptively mandatory obligations “unless the auditor can demonstrate, by verifiable, objective, and [contemporaneously] documented evidence, that alternative actions he or she followed in the circumstances were sufficient to achieve the objectives of the standard and serve adequately to protect the interests of investors and further the preparation of informative, fair, and independent audit reports.”

In contrast, the proposed obligation that would be imposed by a “should” statement within an IAASB standard, as proposed above and as drawn from the existing description of the status attaching to “should” statements in the Preface, arguably is stronger in the sense that deviations must be *necessary* for the purpose of achieving more effectively the objective of the engagement. While recognizing the benefit of aligning directly with the proposals of the PCAOB, the Task Force is of the view that doing so would appear to have the effect of weakening the effect of the requirements of ISAs. It would also entail a stringent documentation requirement relating to highly subjective considerations. The Task Force, therefore, believes that maintaining the continuity of the present description of “should” statements is appropriate.

As noted above, it is being proposed that when, in exceptional circumstances, the auditor judges it necessary to depart from the requirement to achieve more effectively the objective of the engagement, the auditor shall “justify the departure in writing.” This contrasts to the present requirement in the Preface which requires the professional accountant “to be prepared to justify the departure.”

The Task Force recommends that this change be considered by the IAASB on the grounds that such a change responds to the public interest and is appropriate for what should be a rare occurrence.

It is proposed that these categories of professional requirements be established for IAASB’s standards by way of an amendment to the *Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services* (Preface) and, for specific application to ISAs, by amendment to ISA 200, *Objective and General Principles Governing an Audit of Financial Statements* (ISA 200).

EXISTING “SHOULD” STATEMENTS

The application of the proposed categories of professional requirements to existing ISAs would entail a determination by the IAASB of whether each existing requirement identified in bold type lettering and using the word “should” represents: (a) a requirement that is derived from, or directly relates to, one or more fundamental principles of auditing, thereby requiring a change to a

“shall” statement; or (b) another professional requirement that is expected to be complied with, thereby requiring no change.

This determination would be done on a case-by-case basis.

INTERPRETING THE PRESENT TENSE

To clarify ISAs in terms of what procedures and actions are expected of the auditor, and in applying the proposed categories of professional requirement to the entirety of an ISA, it is proposed that the use of the present tense in existing ISAs be reviewed to determine whether each identified procedure or action:

- *Is essential in driving expected auditor behavior and necessary to achieve the objective of the audit or the specific ISA, and therefore is effectively a professional requirement.* In such cases, the action or procedure described in the present tense would be reconstituted as a “should” statement (as a separate statement or within an existing bold type lettered paragraph); or
- *Is strictly explanatory in nature.* In such cases, no substantive change would be made.

In applying the above to two recent substantial ISAs, only a relatively modest increase in the number of new professional requirements in an ISA (i.e., new “should” statements) has been observed. See Section V – Application of the Proposal.

Action Requested

The IAASB is asked whether it agrees with:

- **The proposed categories of professional requirements, and with how they would be applied to existing ISAs.**
- **The requirement for auditors to justify departures in writing where, in exceptional circumstances, such departures are judged necessary more effectively to meet the objectives of the engagement.**

IV (C) Restructuring of ISAs

The preceding two aspects of the proposal have endeavored to identify the fundamental principles of auditing, to more closely align the professional requirements of ISAs with those principles, and to improve the clarity with which professional requirements within ISAs are articulated.

A further aspect of the proposal is intended to achieve a clearer communication of the professional requirements of ISAs, to improve their flow and to assist in convergence and implementation. Essentially, it is proposed that ISAs be restructured to further distinguish the professional requirements within an ISA from material that is explanatory in nature by ensuring that there is a distinct separation between the two.

In developing an approach to restructuring ISAs, it is recognized that the professional requirements themselves should be in a form that is likely to be appropriate for incorporation into legislation, where that is required. Equally, for convergence purposes, it is possible to envisage that it might be appropriate to require adoption of ISAs to involve the verbatim adoption of all professional requirements (including, where necessary, in translation) while accepting that a

certain amount of flexibility is needed in terms of adapting explanatory material to local circumstances³ (and, in particular, more freely translated).

RESTRUCTURING OPTIONS

In considering how ISAs could be restructured taking account of the objectives noted above, the Task Force considered three options:

1. *Retain the present format of ISAs whereby professional requirements and explanatory material are intermingled and together constitute the Standard. This option could be pursued with or without the use of the bold type lettering convention.*

This option meets the needs of those whose priority is the clarification of the language, and avoids some of the difficulties foreseen with some of the other options as described below. It does nothing, however, to tackle some of the other issues surrounding clarity, including in particular concerns expressed over length and complexity. Retaining this approach may become increasingly difficult as additional “should” statements are identified through the process of applying the proposed categories of professional obligations (see Section IV(B)); that is, such professional requirements may become deeply embedded within the document (especially for those ISAs that are particularly long) and therefore capable of being overlooked. Certainly, it would seem desirable to retain the black lettering convention, though this itself may be an issue with some commentators.

2. *Establish two separate documents comprising: (i) an ISA; and (ii) a separate, but closely-related document that would contain the related explanatory material.*

These two documents would need to be closely aligned, exposed together and eventually presented together within the IAASB Handbook with the same effective dates. An appropriate authority would need to be attached to the second document in such a way as to require the auditor’s consideration of the material contained therein. The Task Force has considered this option and has concluded, on balance, that the establishment of a secondary document may send a message that such material is of such lesser standing that it can be overlooked or ignored.

3. *Retain both the professional requirements and explanatory material within one document, but position each within separate sections: the first section would set out the standards, and the second section the material that is explanatory in nature to support proper application. It may be for further consideration whether the term ‘International Standards on Auditing’ would strictly apply to the standards section, or would be deemed to refer to the entire document.*

While not a consensus view, the Task Force believes that the third option identified is the most practical and effective way to restructure ISAs such that there is a clear distinction between professional requirements and explanatory material, both types of material are contained within one authoritative document, and yet minimum but essential flexibility may be facilitated.

³ Such as, for example, to give recognition to different corporate governance structures, to permit the exclusion of material that is unquestionably irrelevant or which, if included, may result in confusion, or to incorporate and give consideration to national laws or regulations.

CHARACTERISTICS OF THE RESTRUCTURED ISA

Under the recommended approach, each of the ISAs would be divided into two sections, presented together as a single document. It is proposed that the first section of a restructured ISA would essentially contain⁴:

- Where practicable, reference to the fundamental principles of auditing to which the ISA relates and how the standard is designed to achieve them.
- Professional requirements, as proposed in Section IV(B);
- Explanatory material, where considered essential in explaining the topic of the ISA and its purpose, in context;
- Definitions for, or explanation of, specific concepts being introduced; and
- The effective date of the ISA.

The second section of the ISA would contain all other explanatory or application material, including but not limited to:

- Fuller discussion of the objectives of the standard and the context in which it is set.
- The objective of the professional requirement(s) contained in the first section of the standard.
- The responsibilities of management and others.
- Auditor considerations when exercising professional judgment, including examples and suggested procedures.
- Public sector and small- and medium-sized practices considerations.
- Appendices.

The link between the professional requirements of the ISA and the related application material would be demonstrated through descriptive headings and detailed cross-references within the application material.

Consistent with the present description of the authority attaching to ISAs, auditors would be required to comply with the ‘standards’ section of the ISAs, and to read and consider the ‘application material’ section as part of understanding and applying the requirements of the ISA.

From an adoption or convergence point of view, national standard setters would need to adopt the first section verbatim and adopt, and if necessary adapt, application material in the second section of the ISA. However, it would be made clear that the adoption, translation and, if relevant, adaptation of the application material would have to be such that the guidance achieves the same effect of the material that is presented in an ISA. In addition, where additional guidance is added, such guidance must be entirely consistent with the standards and application material as a whole and must not serve to undermine or contradict the effect of the standards. Essentially, adoption, translation or adaptation should not result in a loss of the content of the standard, but may provide for interpretation in light of regulatory or other circumstances. This position is consistent with an IFAC translation policy under consideration.

⁴ This guide may be modified as more experience is gained.

It may be argued that this proposed restructuring is little more than reshuffling of material and of little benefit. There are however distinct advantages:

- The professional obligations are clearly and unambiguously stated in a way that would be freed, or at least separated from, some of the complexities that will inevitably be involved in the implementations of the requirements. Auditors, and particularly those dealing with smaller and less complex businesses, should therefore be able to understand the requirements more clearly.
- The standards will be less intimidating.
- While the application guidance is essential, many experienced auditors will find it familiar or self-evident and, for them and for those auditors who do not need the complexity, effort can be focused on identifying their obligations rather than searching for obligations that may be deeply embedded in a lengthy document, and therefore capable of being overlooked.

DESCRIBING THE RESTRUCTURED ISA

In exploring the restructuring of an ISA into two distinct sections, the Task Force deliberated how those sections should be described. One view was that the document itself, in its entirety, is the ISA, and that the ISA contains a section comprising standards (i.e., the professional requirements) and a separate section comprising the application⁵ guidance. If this were to be accepted, which is consistent with the current definition of an ISA, the following statement might be used to describe the restructured ISA and form part of a revised Preface⁶ giving effect to the proposal:

An International Standard establishes profession requirements that are to be fulfilled by the auditor and may include related application material, including appendices, that provide essential application guidance on the professional requirements. The professional requirements of an International Standard are to be understood and applied in the context of the application material. It is therefore necessary to consider the whole text of an International Standard to understand and apply the professional requirements.

The alternative view was that the section containing the professional requirement is, in effect, the standard or the ISA. Accordingly, the application material would be considered supplemental to the standard. If this were to be accepted, the following statement might be used to describe the restructured ISA and form part of a revised Preface giving effect to the proposal:

An International Standard comprises the professional requirements that are to be fulfilled by the auditor and may be accompanied by related application material, including appendices, that provide essential application guidance on the professional requirements of the International Standard. An International Standard is to be understood and applied in the context of the accompanying application material, if any. It is therefore necessary to consider the text of an International Standard and that of any accompanying related

⁵ The Task Force proposes that the present term “explanatory material” be replaced by the term “application material” as part of the restructuring proposal, as the latter term was felt to be more meaningful and representative of the nature of the material to be included in ISAs.

⁶ Paragraph 16 of the Preface states: “The IAASB’s Standards contain basic principles and essential procedures (identified in bold type lettering) 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 provide guidance for their application. It is therefore necessary to consider the whole text of a Standard to understand and apply the basic principles and essential procedures.”

application material to understand and apply the professional requirements of the International Standard.

The Task Force did not reach a decision on this matter.

BOLD TYPE LETTERING

As a result of the proposal to clarify the professional requirements of a standard, and to separate explanatory material into a separate section of the standard, the bold type lettering convention would no longer be necessary and therefore its use discontinued.

Actions Requested

The IAASB is asked to comment and advise on the above proposal to restructure ISAs. In doing so, the IAASB should consider the proposed application of this aspect of the proposal, as described in Section V of this Paper.

V. Illustrative Application of the Proposal

ISA 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, and ISA 240, *The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements*, have been selected to demonstrate the application of the proposal contained in this Discussion Paper, as they typify the general style in which recent ISAs are drafted and interrelate. The new drafts accompany this paper, as agenda items 2-B and 2-D.

In applying the proposal to these ISAs, each sentence of the ISAs has been analyzed to determine its treatment as either a professional requirement or as application material (particularly the explanatory material using the present tense), and thereby guiding the determination of which section within the restructured ISA the material is presented.

As noted in Section II of this Paper, one of the concerns raised by the IAASB in relation to modifying its use of the present tense was the risk of an unreasonable increase in the number of “should” statements. In comparison, extant ISA 315 contained 22 “should” statements while the restructured New ISA 315 contains four new “shall” statements and 25 “should” statements. The new obligations to perform or consider audit procedures have, of course, been drawn from the former explanatory material and re-characterized as part of the professional obligations of the auditor.

Similarly, extant ISA 240 contained 30 “should” statements while the restructured New ISA 240 contains five new “shall” statements and 41 “should” statements.

In drafting the new documents, the Task Force endeavored to create a *New ISA* that: (a) presents the professional requirements of the standard in a way that would be viewed as complete and intelligible by an experienced professional auditor (i.e., intelligible on their own, while bearing in mind their relationship to the application material); and (b) reflects within the standards section those provisions of the extant explanatory material that, based on their nature, are effectively requirements that an auditor would be expected to fulfill.

It is important to consider, in reviewing and discussing this material, that it has not been the intention of the project to redraft or otherwise revise the material except as strictly necessary to change present tense into clearer expressions of obligation, where appropriate, or to ensure that in the restructured form the documents read logically and are self-explanatory. It should not therefore be necessary to discuss the underlying substance of the documents, except to the extent

required to agree upon whether all appropriate obligations have been identified as such and whether material has been appropriately placed in the restructured documents.

IAASB Discussion Points and Actions Requested

Agenda Item 2-C contains a ‘mapping’ document, of a type that the Task Force proposes to use, to demonstrate and explain the treatment of each paragraph of original ISA 315 as it is clarified and restructured into either the section of the ISA containing the professional requirements, or into the section containing the application material. The objective of this approach is to demonstrate that every paragraph of the original ISA has been considered, that there is no weakening of the standards and that there is no substantive change to their content. As the Task Force works through further ISAs, such ‘mapping’ documents would be used for task force and IAASB deliberative purposes, but as they are essentially working documents it is not proposed that they be made more widely available.

For IAASB’s review purposes, the explanatory material in original ISA 315 that describes an auditor action or procedure using the present tense has been highlighted in the mapping document, so that its treatment in the new structure can be considered. As similar document is presented for ISA 240 for IAASB’s consideration (Agenda Item 2-E).

The IAASB is asked to review the ISA 315 and ISA 240 ‘mapping’ documents in parallel with the *New ISAs*. In doing so, the IAASB is asked to agree on:

- The treatment of the extant bold type requirements, particularly the proposed identified “shall” statements.**
- The treatment of extant explanatory material, particularly where the Task Force has, and has not, identified possible a new “should” statements.**
- The split of the explanatory material, particularly whether any additional explanation should be retained in the section of the *New ISA* containing the professional requirements to provide sufficient context to enable them to be reasonably understood by an experienced auditor.**

VI. Approaches to Implementing the Proposal

INITIAL CONSULTATION

Recognizing the need for input at an early stage, and as the first step in informing users, regulators and others of the proposed direction to improve the clarity of IAASB standards and in obtaining feedback thereon, it is recommended that the proposal, related discussions and illustrative material (i.e., proposed restructured New ISA 315 and 240) contained or referred to in this Discussion Paper be issued as a IAASB Consultation Paper.

The Consultation Paper would not be intended to represent the final view of the IAASB; indeed, there are aspect of the proposal where the IAASB may not be able to put forward an agreed solution (for example, the IAASB may find that it cannot agree upon the description of the new material, as discussed in IV(C) above). This however should not preclude consultation. Rather,

the objective of the consultation would be to seek additional input to the proposal for purposes of determining a framework which could be used to begin the clarity improvement process.

If the IAASB approves the direction being taken, it is envisioned that a proposed Consultation Paper, revised to reflect comments from the IAASB, could be put forward by the Task Force for ballot voting by the end of June. A comment period ending mid-October 2004 would provide the IAASB with an opportunity to understand the major views of stakeholders in December 2004.

IMPLEMENTATION OF THE PROPOSAL

When the first proposal to clarify the authority of, and conventions used in, IAASB's standards was considered by the IAASB in 2003, it was recommended that the proposal be implemented on a prospective basis, with the proposed drafting conventions to be applied to standards issued after a specified date. At that time, the IAASB expressed a preference for issuing a complete set of revised standards at one point in time. This preference reflected a desire to avoid possible confusion that may arise during a transitional period when standards drafted under the existing style and authority, and standards drafted under the new style and authority were both in issue.

Similar options to moving forward in implementing the new proposal exist, as follows:

Prospective Transition – Standards that are issued after a specified date would be written in accordance with the agreed-upon proposals. An existing standard would be clarified and restructured as and when it is otherwise considered to revise the standard, or in accordance with a rolling revisions programme. This approach would be least disruptive to the IAASB's current project plan.

Modified Prospective Transition – This approach is similar to the “prospective transition” approach in that the proposal would be adopted prospectively. However, a limited number of “key” standards would be subject to clarification and restructuring (but not otherwise revised) and exposure on a priority basis. These ISAs would be those issued relatively recently by the IAASB that have attracted comment about their length and complexity.

“Big bang” Conversion – This approach would call for the development of a complete package of clarified and restructured ISAs, along with an amended Preface, for purposes of a one-time exposure. A date would be determined on which the revised structure would come into effect in its entirety. The benefits of this approach are that the IAASB and users would be able to assess a complete package for approval, and ISAs redrafted in the early stage of the process could be amended, if necessary, as more experience is gained but before they become effective. The major drawback is that it would require a substantial level of effort by the IAASB over the immediate future. It would also result in a fairly enormous package for exposure at one point in time.

The Task Force was divided between the “Prospective” and the “Big bang” Conversion approaches. On balance, although not a consensus view, the Task Force recommends the “Modified Prospective Transition” approach as the one that would generally give the best and most practicable effect to the proposals, taking account of relevant pressures, including current project timetable, resources and ISA adoption initiatives.

Whatever the approach, IAASB Project Task Forces that are developing new or revised ISAs for exposure before conclusion of the clarity project would be asked to endeavor to draft ISAs using the new conventions for language, but bearing in mind that subsequent restructuring may need to be applied.

Action Requested

The IAASB is asked to consider and agree on the proposed way forward.