

IFAC
International
Auditing
and Assurance
Standards Board

[Date 200x]

Draft Exposure Draft and Consultation Paper

Response Due Date [xx, 200x]

Draft Exposure Draft

**Proposed Policy Statement, *Certain
Terms and Conventions Used in
International Standards Issued by
the IAASB***

And

Draft Consultation Paper

**Improving the Clarity and Structure
of IAASB Standards and related
Considerations for Practice
Statements**

Issued for Comment by
the International
Federation of
Accountants



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REQUEST FOR COMMENTS

The enclosed exposure draft, “Proposed Policy Statement, *Certain Terms and Conventions Used in International Standards Issued by the IAASB*,” and consultation paper, “Improving the Clarity and Structure of IAASB Standards and related Considerations for Practice Statements,” of the International Auditing and Assurance Standards Board (IAASB) were approved for publication in [date 200x]. The proposed Policy Statement may be modified in light of comments received before being issued in final form.

Introduction

In serving the public interest, the IAASB aims to set high quality international auditing and assurance standards that are understandable, clear and capable of consistent application, thereby serving to enhance the quality and uniformity of practice worldwide. In doing so, the IAASB seeks to balance the needs of a wide range of users that operate in different legal, cultural and business environments.

In seeking continually to improve its standards, and in responding to developments affecting the demands and expectations of professional accountants, recent IAASB’s standards have included more specific essential procedures and detailed guidance on how to apply the basic principles and essential procedures in differing circumstances. This trend has arisen primarily from the need to increase the quality and consistency of auditor performance globally. A further factor is the increasing complexity of business and financial reporting. As a consequence, the standards are longer, and in some instances more prescriptive and more complex, than those issued in the past.

In 2003 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. In doing so, the IAASB initially considered three principal issues:

- whether the distinction between bold type and plain type lettering was appropriate and helpful, and their respective authority sufficiently clear;
- the language used to describe the responsibilities of the professional accountant; and
- whether actions expressed in the present tense contain obligations for professional accountants, and how to address the concern that some professional accountants may interpret this material as being optional while others may view it as being mandatory.

During consideration of these issues, the IAASB also considered other wider aspects of clarity arising from concerns variously expressed by some IAASB members, national standard setters and respondents to recent exposure drafts about the length and complexity of standards and the way in which they are structured.

The IAASB has reached agreement on how to address the three issues identified above and has concluded that it should seek input on its proposal through the attached exposure draft.

Whether and how other aspects of IAASB standards might be improved as part of the clarity review has proved a more difficult question. The IAASB concluded that this issue requires further consultation and that additional information is needed to assist the IAASB in its deliberations. The IAASB has therefore issued a consultation paper seeking further input on this aspect of the

project, on the concerns that have been raised on certain aspects of IAASB standards, and on the options that should be considered by the IAASB to respond to these concerns.

The language and structure of standards are viewed by some as interrelated aspects of clarity. The exposure draft and consultation paper have therefore been issued together, and the IAASB will consider comments received on both documents concurrently. The IAASB has determined, however, that a delay in resolving the issues addressed in the consultation paper should not preclude the adoption of the proposals in the exposure draft, subject to comments received on exposure.

Comments on the Exposure Draft and Consultation Paper

The IAASB welcomes comments on the enclosed exposure draft and consultation paper. In responding, respondents are requested to refer to the relevant paragraphs within the exposure draft and consultation paper. The responses should include the reasons for the comments, and, in the case of the proposed Policy Statement, specific suggestions for any proposed changes to wording.

The IAASB is seeking comments on all matters addressed herein. In particular, the IAASB is interested in comments on the questions asked of respondents contained in the explanatory memorandum to the exposure draft. Specific matters in the consultation paper on which the IAASB is seeking comment are highlighted therein.

Supplement to the Exposure Draft and Consultation Paper: Illustrative Examples

For the purposes of encouraging debate and soliciting responses to the exposure draft and consultation paper, IAASB staff has prepared an illustration of how the proposals in the Policy Statement and the restructuring of an ISA contemplated in the consultation paper might be applied to an ISA. This supplement does not form part of either the exposure draft or consultation paper nor does it represent actual or contemplated changes that might arise from their application. Comments on this material are welcome in so far as they relate to the proposed Policy Statement and the issues contained in the consultation paper for which the IAASB is seeking input. Since the changes contained therein do not reflect the views of, nor a proposal by, the IAASB, comments on the specific changes are not sought from respondents.

Response Due Date

To be considered, comments on the exposure draft of the proposed Policy Statement and on the consultation paper should be submitted so as to be received by **[Date], 200X**, preferably by e-mail or on computer disk, or in writing. All comments will be considered a matter of public record.

IFAC
International
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and Assurance
Standards Board

[Date] 200x

Draft Exposure Draft

Response Due Date [xx, 200x]

Proposed Policy Statement

**Certain Terms and Conventions
Used in International Standards
Issued by the IAASB**

Issued for Comment
by the International
Federation of
Accountants



EXPLANATORY MEMORANDUM TO THE DRAFT EXPOSURE DRAFT

Introduction

This memorandum provides some background to, and explanation of, the proposed Policy Statement approved for exposure by the International Auditing and Assurance Standards Board (IAASB).

Background

International standards that are clear and capable of consistent application should contain no ambiguity about the professional requirements a professional accountant must fulfill.

It has been suggested that there is some confusion over the authority of the plain type lettering (containing explanatory and other material), as compared with text presented in bold type. In particular, some constituents have questioned whether professional accountants are expected to perform the procedures described in the present tense, noting that the present tense may be interpreted as being more, or less, definitive than possibly intended by the IAASB.

The IAASB is proposing to reaffirm the responsibility of the professional accountant to consider all aspects of a standard, not just the bold type sentences, and to clarify the language used to describe the responsibilities of the professional accountant, including the use of the word “should,” and whether material presented in the present tense in fact contains a professional requirement.

Proposed Changes

Categories of Professional Requirements

The IAASB believes that the use of clear, concise, consistent and definitive imperatives is essential to the consistent application of International Standards. Accordingly, the proposed Policy Statement not only reaffirms the responsibility of the professional accountant to consider all aspects of a standard, but establishes that the obligations imposed on the professional accountant are to be communicated by the use of specific language. To achieve this, the Policy Statement proposes to clarify the professional requirements of a standard by specifying and defining two categories of professional requirements: mandatory requirements and presumptively mandatory requirements.

A mandatory requirement is a requirement to be fulfilled in all cases where the relevant circumstances apply; such a requirement will be identified by the use of the word “shall.” A presumptively mandatory requirement, identified by the word “should,” is a requirement to be fulfilled in all cases in which the circumstances exist to which the requirement applies unless, in rare circumstances, the professional accountant departs from a presumptively mandatory requirement and demonstrates that the alternative actions followed in the circumstances were sufficient to achieve the objectives of the standard.

The obligation imposed by a presumptively mandatory requirement differs from that imposed by use of the word “should” in existing standards. The latter permits departure only where a professional accountant judges it necessary to achieve more effectively the objectives of the engagement. The IAASB believes that the change reflects the establishment of an appropriate

threshold for departure from a presumptively mandatory requirement in applying professional judgment, in light of the new category of mandatory requirements and of an anticipated modest increase in the number of professional requirement as a result of applying the proposed categories of professional requirements. In addition, it is proposed that there will be additional documentation requirements in the case of such departures, as explained below.

Departure from a Presumptively Mandatory Requirement(s)

The Policy Statement proposes that, when a professional accountant departs from a presumptively mandatory requirement, the professional accountant shall justify the departure in writing. The professional accountant would do so by recording why the professional accountant decided to depart from the presumptively mandatory requirement, and how the alternative procedure(s) performed sufficiently achieved the objectives of the standard. This proposed requirement is more rigorous than the present requirement for the professional accountant to “be prepared to justify the departure.” The IAASB believes the requirement to justify departures in writing responds to the public interest and is appropriate for what are expected to be rare occurrences.

Use of the present tense

Under the current drafting convention, the formulation ‘the auditor should [do something]’ is restricted to the basic principles and essential procedures set out in bold type. Explanatory material set out in plain type uses the present tense. This material includes definitions and explanations, but also refers to actions of the professional accountant (for example, ‘the auditor considers [this or that]’, or ‘the auditor tests a control’). It is this latter type of statement over which there seems to be confusion – does it impose an obligation on the professional accountant, or is it in fact optional?

The IAASB proposes to discontinue the use of the present tense in relation to actions by the professional accountant. In future, such statements would be redrafted so as to make any requirement clear (by using “shall” or “should”), or to make it clear that there is no intention to create a requirement, by using alternative language that appropriately explains the IAASB’s intentions.

Changes consequent on the above

It follows from the above proposals that all requirements that a standard imposes on the professional accountant will be identifiable by the use of “shall” or “should” statements. The IAASB proposes to refer to these as the ‘requirements’ of a standard, and to discontinue the use of the terms ‘basic principles and essential procedures.’ The latter terms may have implied that there were other principles (possibly, but not necessarily, in the standards), and that other procedures (again, whether in the standards or not) might not be ‘essential.’

Other Matters

The IAASB considered whether it should discontinue the use of bold type. In doing so, it observed that respondents to the November 2002 draft Preface were overwhelmingly of the view that bold type should be retained. The IAASB has concluded that it should continue to use bold type as a convention to assist the professional accountant in identifying the requirements of a standard. The IAASB recognizes, however, that the proposals in the exposure draft differ from the circumstances in November 2002. It is therefore appropriate to ask respondents to give their views on the issue.

The exposure draft also clarifies the purpose and intended use of explanatory material contained in International Standards and the authority of appendices.

Once finalized, the provisions of the Policy Statement will be adopted through amendment to the Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services.

Application of the Policy Statement

Subject to comments on exposure, it is proposed that the requirement for professional accountants to justify a departure from a presumptively mandatory requirement in writing be effective for engagements conducted in accordance with IAASB's International Standards for periods commencing on or after [date]. For this purpose only, the basic principles and essential procedures contained in existing standards will carry the status of presumptively mandatory requirements until such time as the relevant standards are revised in line with the proposed policy.

The remaining provisions of the Policy Statement are to be applied on a prospective basis and it is proposed that they be effective for all new or revised International Standards, including exposure drafts, issued on or after [date].

Alternative approaches to implementation

The IAASB considered implementing the proposed Policy Statement following three alternative approaches.

The first approach consisted of developing and issuing for exposure at a single point in time a complete package of all International Standards on Auditing (ISAs)¹, revised following the conventions proposed in the Policy Statement, to avoid any suggestion of confusion that might arise during a transitional period when standards would exist in both the existing and new style of drafting.

The second approach consisted of redrafting and issuing for exposure (but not otherwise revising), on a priority basis, the recently issued audit risk and fraud ISAs under the proposed conventions. (This would reflect their central importance and the fact that they would not otherwise be expected to be revised in the short term.) Applying the proposed categories of professional requirements to these ISAs would entail a determination by the IAASB whether each existing requirement identified in bold type lettering and using the word "should" represents: (a) a mandatory requirement, requiring a change to a "shall" statement; or (b) a presumptively mandatory requirement, requiring no drafting change. It would also entail a review of the use of the present tense in existing ISAs and a determination whether each procedure or action is necessary to achieve the objective of the specific ISA and therefore a professional requirement, or strictly explanatory in nature. In the latter case, the present tense might be modified or the sentence restructured to make it clear that there is no intention to create a professional requirement. Remaining International Standards would adopt the drafting conventions as they are updated and revised.

¹ 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 IAASB concluded that the application of the Policy Statement following either of the above approaches would not be practicable, as both approaches would consume a significant amount of IAASB agenda time and require existing projects to be put on hold during that period. Recognizing the importance of completing projects currently underway, the IAASB has concluded that the most appropriate way forward is a prospective approach whereby the new conventions would be applied to all standards issued after a certain date.

Questions for Respondents

While the IAASB is seeking comments on all matters addressed in the exposure draft, the IAASB is interested in comments on the following issues:

Equal Authority

1. In developing the proposed Policy Statement, the IAASB considered the need to clarify the responsibility of the professional accountant to consider all aspects of a standard, not just the bold type sentences. It considered the option of stating that the entire text of an International Standard has ‘equal authority’, this term to be explained as meaning that there is no difference in the level of authority between the different paragraphs within an International Standard regardless of whether the paragraph is presented in plain type or bold type lettering. The IAASB found the term ‘equal authority’ problematic and subject to differing interpretation. An alternative, more acceptable term, was not identified.

The IAASB believes that the proposed Policy Statement – which reaffirms the responsibility of the professional accountant to consider all aspects of a standard, and combines this with the use of clearly defined categories of professional requirements and the clarification of the use of the present tense and explanatory material – achieves the same effect as the concept of ‘equal authority,’ but without the need to introduce a specific term. Accordingly, the IAASB believes that use of the term ‘equal authority’ would not further enhance the effect of the intended changes and has not adopted it.

Do respondents agree with the view of the IAASB, or would a statement of ‘equal authority’ assist in clarifying the responsibilities of the professional accountant?

Categories of Professional Requirements

2. **Do respondents agree with the proposed categories of professional requirements and the related obligations they would impose on professional accountants? Please state the reasons in support for your response.**
3. **Will the proposed terms “shall” and “should” result in translation difficulties? The IAASB had considered the word “must” as an alternative to “shall” – would this alternative resolve any identified translation difficulties?**
4. **Do respondents agree with the proposed requirement for professional accountants to justify departure from a presumptively mandatory requirement(s) in writing? If so, do respondents agree with the applicability of this requirement to existing International Standards before they are revised?**

Bold Type Lettering

5. **Do respondents agree with the decision of the IAASB to retain the bold type convention?**

Implementation of the Proposals

6. **Do respondents agree that the IAASB should apply the proposals on a prospective basis? Please state the reasons in support for your response**

PROPOSED POLICY STATEMENT²
CERTAIN TERMS AND CONVENTIONS USED IN INTERNATIONAL STANDARDS
ISSUED BY THE IAASB

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Introduction

1. This Policy Statement, in conjunction with the Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services³ (Preface), sets forth the meaning of certain terms and conventions used in International Standards issued by the IAASB in describing the professional requirements imposed on professional accountants.

Certain Terms and Conventions Used in International Standards

PROFESSIONAL REQUIREMENTS

2. International Standards contain professional requirements together with related guidance in the form of explanatory and other material, including appendices. The professional requirements contained in International Standard are to be understood and applied in the context of the explanatory and other material that provides guidance for their application. Professional accountants have a responsibility to consider the entire text of an International Standard in carrying out their work on an engagement and in understanding and applying the professional requirements of the relevant International Standard(s).
3. Not every paragraph of an International Standard carries a professional requirement that the professional accountant is expected to fulfill. Rather, the requirements are communicated by the language and the meaning of the words used in the International Standard and as described in this Policy Statement.

² Once finalized, the provisions of this Policy Statement will be adopted through amendment to the Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services (Preface).

³ The IAASB Exposure Draft, "Amendments to the Preface to the International Standards on Quality Control, Auditing, Assurance and Related Services – *IAASB Due Process and Working Procedures*," issued in July 2004 proposes that the title of the Preface be amended to "Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services" to align it with the structure of the Handbook adopted by the IAASB.

4. International Standards adopt, and specify, two categories of professional requirements, as follows:

Mandatory requirements – The professional accountant is required to comply with a mandatory requirement in all cases in which the circumstances exist to which the requirement applies. International Standards use the word “shall” to indicate a mandatory requirement.

Presumptively mandatory requirements – The professional accountant is required to comply with a presumptively mandatory requirement in all cases in which the circumstances exist to which the requirement applies unless, in rare circumstances, the professional accountant departs from a presumptively mandatory requirement and demonstrates that the alternative actions followed in the circumstances were sufficient to achieve the objectives of the International Standard. When such a situation arises, the professional accountant shall justify the departure in writing. The professional accountant does so by recording why the professional accountant decided to depart from the presumptively mandatory requirement, and how the alternative procedure(s) performed sufficiently achieved the objectives of the specific International Standard.

International Standards use the word “should” to indicate a presumptively mandatory requirement. If an International Standard provides that a procedure or action is one that the professional accountant “should consider,” the consideration of the procedure or action is presumptively mandatory, while carrying out the procedure or action is not.

The professional requirements of an International Standard are to be understood and applied in the context of the explanatory and other material that provides guidance for their application.

5. A professional accountant complies with the professional requirements of International Standards that are relevant to the engagement, that is, when material matters exist that make the requirements of the standard applicable. A professional accountant should represent compliance with International Standards only upon complying with all relevant International Standards.
6. Bold type lettering is used in paragraphs within an International Standard to identify when a professional requirement is established for the sole purpose of aiding overall readability.

EXPLANATORY MATERIAL

7. International Standards contain explanatory material that is intended to provide further explanation and guidance on the professional requirements. Such explanatory material is intended to be descriptive rather than imperative. That is, it explains why the professional accountant should consider or employ particular procedures, depending on the circumstances, and provides additional information for the professional accountant to consider in exercising professional judgment in performing the engagement.
8. Explanatory material may also identify and describe other procedures or actions relating to the activities of the professional accountant. While professional accountants have a responsibility to consider the whole text of an International Standard in carrying out their

work on an engagement, such guidance is not intended to impose a professional requirement for the professional accountant to perform the suggested procedures or actions. Rather, these procedures or actions require the professional accountant's attention and understanding; how and whether the professional accountant carries out such procedures or actions in the engagement will depend on the exercise of professional judgment in the circumstances consistent with the objective of the standard.

APPENDICES

9. Appendices are an integral part of an International Standard and carry the same authoritative weight as the body of the International Standard, since both are developed and approved following the same due process. The purpose and intended use of an appendix are clearly explained in the body of the related International Standard or within the title and introduction of the appendix itself. The use of appendices may vary depending on the subject of the International Standard.

Applicability to Existing International Standards

10. The IAASB and its predecessor, the International Auditing Practices Committee, did not previously expressly define certain of the terms and conventions as set out herein for use when drafting International Standards, which therefore may be subject to different interpretation. Accordingly, the existing description of the authority and conventions of International Standards contained in the Preface will remain applicable, except as noted below, to existing International Standards until such time as all International Standards have been revised and drafted in accordance with the provisions of this Policy Statement.
11. The IAASB believes, however, that the requirement for the professional accountant to justify in writing departure from a presumptively mandatory requirement responds to the public interest and is appropriate for what should be rare occurrences. Accordingly, this requirement will apply to departures from the basic principles and essential procedures of the existing International Standards.

Effective Date

12. The requirement for professional accountants to justify departure from a presumptively mandatory requirement (or a basic principle or essential procedure) in writing is effective for engagements for periods commencing on or after [date] (or, where there is no such period, for reports issued on or after [date]) that are conducted in accordance with IAASB's International Standards. The remaining provisions of this Policy Statement are applicable on a prospective basis and are effective for all new or revised International Standards, including exposure drafts, issued on or after [date].

IFAC
International
Auditing
and Assurance
Standards Board

[Date] 200x
Draft Consultation Paper

Response Due Date [xx, 200x]

Consultation Paper

Improving the Clarity and Structure of IAASB Standards and related Considerations for Practice Statements

Issued for Comment
by the International
Federation of
Accountants



Improving the Clarity and Structure of IAASB Standards and related Considerations for Practice Statements

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Appendix 1: Characteristics of a Restructured ISA

Appendix 2: International Auditing Practice Statements (IAPSs)

I. Introduction

1. This Consultation Paper has been issued by the International Auditing and Assurance Standards Board (IAASB) to seek input on improving the clarity and structure of IAASB standards. It also seeks input on related considerations for Practice Statements.

II. Background

2. The objective of the 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.*” This objective means that the IAASB endeavours to issue standards that, among other things, are:
 - (a) understandable by those who perform the relevant engagements;
 - (b) clear and capable of consistent application;
 - (c) recognized by the various regulators around the world;
 - (d) accepted by the profession at the international and national levels; and
 - (e) applicable to and applied in practice by all professional accountants for all engagements, regardless of the size and structure of their firm or of the entity subject to the engagement.
3. In seeking continually to improve its standards, the IAASB undertook in 2003 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 its standards. The review also reflected the continuing need for the IAASB to issue standards that are as comprehensive as appropriate and that promote effective audits, recognizing the need to strike a balance between detailed rules and retaining the ability for auditors to apply professional judgment appropriately.
4. In carrying out the review, the IAASB considered the views expressed by the International Organization of Securities Commissions (IOSCO) and other stakeholders on the need to clarify certain aspects of its standards⁴, and consulted representatives of national auditing standard setters about how to improve the clarity of the standards. The IAASB also considered elements arising from a review of UK auditing standards commissioned by the UK Auditing Practices Board from the British Standards Institute and solicited preliminary views from other regulators, the IAASB’s Consultative Advisory Group and some IFAC committees, including the IFAC Small- and Medium-Sized Practices Task Force.
5. The review identified several aspects of IAASB standards where possible improvement in clarity might be made. Of particular importance were issues related to bold type and plain type lettering and the drafting conventions followed by the IAASB. The IAASB’s proposals

⁴ Based on responses to the IAASB’s November 2002 Exposure Draft, *Proposed Terms of Reference, Preface and Operations Policy No 1 – Bold Type Lettering*.

on these issues are set out in the exposure draft, Proposed Policy Statement, *Certain Terms and Conventions Used in International Standards Issued by the IAASB* (Exposure Draft).

6. Other important aspects were also identified for consideration by the IAASB. These aspects relate primarily to the understandability of the IAASB's International Standards on Auditing (ISAs) in light of their increased length and perceived complexity. The identification of the principles of auditing upon which the professional requirements of ISAs are set was also identified for consideration. These matters are the subject of this consultation paper.
7. More recently, the International Federation of Accountants has undertaken a study on the views of individual professional accountants and others on the extent to which they have faced challenges and achieved successes in the adoption and implementation of both International Financial Reporting Standards (IFRS) and ISAs within their national environments. Although the final recommendations are yet to be published, preliminary findings of the study emphasise the need for the IAASB to consider other aspects of clarity of its standards, such as matters relating to their length and perceived complexity, in order to enhance their understandability and universal applicability.
8. The issue of whether there is a need to change the way in which IAASB standards are drafted, and if so how, has proved difficult to resolve. Contrasting views have been expressed amongst members of the IAASB and amongst some national standard setters and members of the regulatory community. These views may represent the different objectives of the constituents, and thereby expectations of different outcomes; they may also reflect the differing environments in which they practise. They are nevertheless matters that the IAASB needs to weigh and consider. The IAASB therefore concluded that further consultation is warranted and that additional information is needed in order to assist the IAASB's deliberations.

III. Understandability of IAASB Standards

Present Situation

9. Early international auditing and assurance standards were generally fairly brief documents, typically comprising 15-35 paragraphs. They included a limited number of basic principles and essential procedures, supplemented by explanatory material where considered necessary. This drafting style reflected the view that standards that contain high-level principles and procedures provide a sufficient framework for the auditor to understand, and apply professional judgment in determining, the essential procedures required in carrying out a high quality audit.
10. Over time, however, practitioners and regulators have called for the IAASB to issue standards that bring more specificity to the procedures expected and more guidance as to how they might be carried out. These demands have arisen primarily from the need to increase the quality and consistency of auditor performance globally.
11. In seeking to improve its standards, and in responding to developments affecting the demands and expectations of auditors, recent IAASB's standards have included more specific essential procedures, and more detailed guidance on how to apply the basic principles and essential procedures in differing circumstances. As a consequence, the resulting standards are longer, and in some instances are perceived as more prescriptive and

more complex, than those issued in the past. The aim of the IAASB, however, has been to continue to focus on the principles and essential procedures (albeit that there may be more of them) necessary in carrying out a high quality audit and the application by professional accountants of appropriate professional judgment.

12. Some stakeholders have expressed support for the way IAASB's standards are drafted, observing that they are an appropriate reflection of today's business environment, with the additional guidance now provided considered a useful, and indeed essential, characteristic of high quality standards. However, some respondents to exposure drafts, while recognizing the reasons for such a trend, requested the IAASB to consider how best this trend could be managed to avoid perceived difficulties with long and complex standards, especially amongst smaller practices and those who audit small and mediums sized entities.
13. More recently, preliminary findings from the IFAC study on the challenges and successes in the adoption and implementation of both International Financial Reporting Standards (IFRS) and ISAs within national environments show a widely held view that international standards are becoming longer and more complex, along with a belief that length and complexity affect, sometimes adversely, both their adoption and implementation. Despite these views, however, a need for interpretive guidance was expressed.

Viewpoints

14. The following outlines some of the views expressed by certain national standard setters, regulators, IFAC Committees and others to the IAASB on how to improve the clarity of other aspects of IAASB standards. The views expressed below are not necessarily shared by all members of a particular group, nor do they represent the views of IAASB; however, some IAASB members may agree with the observations being made.

CONCERNS

15. Several national auditing standard setters and some others have expressed particular concern over the present trend towards longer, more detailed standards. To improve their understandability, they have urged changes to how standards are written (a) to help make it easier for auditors to identify and understand professional requirements or obligations; (b) to control their length and complexity; and (c) to assist in national adoption and implementation. In this regard, the following views have been expressed:
 - 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 may prove obstacles to their acceptance. This has created difficulty not only for some national standard setters who have to adopt the standards, or at least converge to them, but arguably also for practitioners who must implement them, and for quality or compliance bodies who must monitor their application.
 - National standards setters must create standards that are appropriate for their own jurisdictions and capable of being effectively introduced. Some countries, for example, support ISAs by incorporating them into national law. Some national standard setters argue that the more explanatory text (not by nature suitable for inclusion in a legal instrument) that is included in international standards, the more difficult it will be to

converge 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 trend towards longer and more detailed ISAs may hinder their integration into national auditing standards, particularly where such characteristics are viewed as representing a procedural approach that may be thought to hinder the use of professional judgment.

- In those countries where IAASB standards must be translated into the national language before integration into, or adoption as, national standards, the longer and more detailed the standards, the greater the translation problems. This difficulty has led some countries to redraft the standards during translation for better understanding by their auditors. Accordingly, while it might be appropriate to require the adoption of all professional requirements (in translated form, where necessary), a certain amount of flexibility may be needed to assist in (a) adapting explanatory material to local circumstances, and (b) translating explanatory material. Specific issues raised in this context have included the need to accommodate references to different corporate governance structures and to permit the exclusion of material that is unquestionably not applicable to a particular jurisdiction and which, if included, may result in confusion.
- Some practitioners have raised concerns about the difficulty in trying to keep up with the unprecedented pace at which international standards are being issued. Some argue that this situation may be aggravated by the trend towards relatively lengthy and complex standards. Further, detailed requirements, which some may view as adding a layer of complexity, may result in a compliance mentality and in inconsistency in interpretation. Consequently, some believe that these factors may increase the risk that practitioners will not fully consider the standards and may not apply them consistently. This effect may be particularly acute for small- and medium-sized practices (although not only for them) who may believe that complex IAASB standards are not relevant to them and their clients. These concerns seem to be prevalent in many countries where the majority of audits are of small or medium sized private companies.

SUPPORT FOR THE PRESENT STYLE OF IAASB STANDARDS

16. In contrast to the above views, some individuals and groups support the style in which recently issued ISAs are written. In their view, the ISAs are in fact quite readable and the more specific and expanded guidance contained therein is generally in line with what the regulators and others are seeking in standards. It is argued that the recently issued standards are not unduly complex or “rules-based,” and that length is not necessarily a negative characteristic. In this regard, the following views have been expressed:
 - Today’s ISAs are very understandable and their length is a reflection of the complexities of the business environment and higher expectations of auditors. In this regard, the last few years have resulted in significant changes in the financial reporting environment, and in the public expectations of companies and their auditors. In this environment, more detail is required in standards to make them effective in achieving consistently high quality audits.
 - Audit firms are responding to the new demands by increasing the guidance and training given to their staff, and developing specific firm-wide audit practices and quality control

systems. Similar increases in the specificity and amount of guidance should therefore occur in audit standards setting. Auditor judgment will, and should, continue to be important, but it would seem that standards will need to include both general principles and specific application guidance to guide the exercise of sound professional judgment.

- Recent ISAs provide good guidance for small firms. For example, the level of guidance in the audit risk standards makes it easier for small firms to train their staff and to implement the standards.
- The issue of length is separate and distinct from the issue of clarity; it would be possible to make improvements in clarity without change to the style or structure of the standards affecting their overall length; it would also be possible to make standards shorter and more general, without achieving improvement in clarity. Accordingly, it is questionable whether the views that the length and complexity of standards hinder clarity and understandability are in fact valid or compelling enough to warrant a change to the style and structure of the standards.
- In response to the view that change to the structure, or reconsideration of the length and style of the standards, is necessitated by legal requirements in jurisdictions, it has been observed that some jurisdictions have two-level auditor guidance in place today to accommodate their particular legislative environments. In other jurisdictions, auditing and accounting standards are incorporated into law by reference. Accordingly, it is questioned whether such legislative or legal requirements in themselves warrant a change to the current structure of the standards. While the IAASB should remain cognizant of the manner in which the standards may be adopted by various jurisdictions, views on the real significance of national legislative approaches should be sought in the first instance before the IAASB agrees to changes in its practice. This is particularly important if such changes were in any way to affect the quality of its standards.

Questions to Respondents

Recently issued ISAs have addressed complex issues. In developing those standards, the IAASB has sought to create standards that are as comprehensive as possible and that promote effective audits, while striking a balance between detailed rules and retaining the ability for auditors to apply professional judgment.

1. **Has the length and style of these standards aided or impaired their understandability and clarity? Please explain the reasons that are persuasive in reaching your view and provide examples that help illustrate your view.**
2. **If there is concern over the length of the standard, please also explain what you believe is problematic – the amount of explanatory guidance provided, the scope of matters addressed or other aspects of the standards.**
3. **Has the degree of detail provided in the standards aided or hindered adoption or implementation of ISAs? Please provide specific details of the circumstances that have arisen as a result of the style in which ISAs are written.**

Options For Consideration

17. As explained in paragraph 5, the IAASB has decided to revise the conventions used in drafting its standards in order to improve their clarity and the consistency of their application. If the responses to this discussion paper indicate that the other concerns expressed above about clarity are not shared by respondents, the IAASB will not pursue other options.
18. If, on the other hand, the responses to this discussion paper indicate that there is a need to take further action to improve the clarity of its standards, the IAASB will consider other options. Pending the results of this consultation, the IAASB has not reached a conclusion about what should be done in these circumstances. However, it is anticipated that any further changes would require a restructuring of the standards. In order to assist respondents, some options are presented below; they are not intended, however, to restrict the range of options that respondents might suggest.
19. Under the restructuring options discussed below, all professional requirements of ISAs (that is, those requirements that are presently identified in existing ISAs as well as those identified through the application of the proposed Policy Statement in the accompanying Exposure Draft) would be retained. Restructuring would have the effect however of separating professional requirements from the related explanatory material. In considering the restructuring options, it is important to note that the IAASB would not allow any aspect of restructuring to weaken the requirements, or reduce the applicability, of its standards. On the contrary, any restructuring that seeks to respond to the concerns raised over the length and complexity of ISAs would be expected to strengthen the effect of the standards by more clearly expressing their requirements and improving the ability of practitioners to understand and implement them.

Restructuring Option A

20. *Retain the present structure of an ISA (including all professional requirements contained therein), but move a large part of the explanatory material to a related International Auditing Practice Statement (IAPS).*

The resulting ISAs would be more concise as they would include mainly the professional requirements of the auditor. The related IAPS would include a large part of the explanatory material presently included in ISAs, and could also incorporate interpretive guidance, industry considerations, additional guidance for small- and medium-sized practices, and public sector matters. The IAPSs could also be issued or revised to address emerging issues without the need to revise the related ISA.

The use of IAPSs for explanatory material related to ISAs would require a careful and systematic review of the existing IAPSs (which cover a broad range of topics), as well as a review of the authority, drafting conventions and future use of Practice Statements to ensure that they are considered and applied, where applicable, during an audit.⁵

This option would also require consideration of whether the bold type lettering convention should continue to be used in the ISAs.

Restructuring Option B

21. *Retain both the professional requirements and explanatory material in one document, but separated into two distinct sections: the first section (the ‘standards section’) would set out the professional requirements of the ISA (again, all professional requirements contained therein); the second section (the ‘application material’ section) would contain explanatory material that supports proper application of the ISA. Whether the term ‘International Standards on Auditing’ would apply only to the standards section, or would refer to the entire document, requires further consideration. The need for the current bold type lettering convention would no longer exist and therefore its use would be discontinued.*

Consistent with the current authority attaching to ISAs, the auditor would be required to (a) comply with the standards section, and (b) consider the application material section as part of understanding and applying the professional requirements. This option would clearly distinguish professional requirements from explanatory material, but within one authoritative document.

Appendix 1 provides an outline of the type of material that would be included within the standards section and application material section of a restructured ISA following this approach. For the purposes of encouraging debate and soliciting responses to this paper, an illustration of how ISA 315 might have been issued under this option has been attached as a supplement to this paper (see Exhibit 2 of the document “*Supplement to the Exposure Draft and Consultation Paper: Illustrative Examples*”).

Related Issues and Considerations

22. A related issue is whether any restructuring alternative might provide more flexibility for national standard setters in adopting, or converging to, international standards. For example, national standard setters would be required to adopt the first section in its entirety (the ISA in the case of option A, the professional requirements or standards sections in the case of options B), translating if necessary. As for the related material (the IAPS, related explanatory or application material), national standard setters might be allowed to adapt the material to deal with translation difficulties or local circumstances. However, national standard setters would not be allowed to undermine or contradict the effect of the standards. In other words, adoption, translation, adaptation, or added guidance should not result in a

⁵ There are some national regulators that are considering the adoption of ISAs, but not necessarily all IAPSs. In absence of assurance that IAPSs would be adopted also, greater use of IAPSs may be seen as a weakening of the standards issued by the IAASB. On the other hand, greater use of IAPSs as a means to issue guidance on the application of an ISA, together with appropriate adjustments to their authority, may serve to give them a higher profile and reduce the chance that guidance in an IAPS is overlooked, and could therefore have a double benefit.

loss of any content of a standard, although it may have the effect of interpreting the content in light of regulatory or other local circumstances.

23. In addition to the above restructuring options, an alternative way of enhancing the understandability of ISAs has been considered by the IAASB, as follows:

Issue an ISA made up of two separate documents: (i) the first document would contain the professional requirements; and (ii) the second document would contain the related explanatory material as well as additional background to, and explanation of, the IAASB's basis for its conclusions in developing the ISA.

This model is different to the restructuring options above as it contemplates a document not currently being issued by the IAASB.

The second document would contain additional explanatory or application guidance that helps support the application of the professional requirements. It would also contain the IAASB's basis for the conclusions reached in formulating the professional requirements. These two documents would be closely aligned, exposed together and eventually presented together in the IAASB Handbook with the same effective dates. The second document would be considered an integral part of the standard, with appropriate authority attaching thereto such that the auditor would be required to consider the explanatory material.

There is always a possibility that this second document may be perceived as having a lesser standing and therefore be overlooked or ignored. This risk, however, may exist irrespective of how well its authority is described. In addition, there may be confusion, or lack of clarity, from intermingling explanatory guidance in support of the application of the professional requirements with a discussion of the basis for IAASB's conclusion thereon.

Viewpoints on Possible Restructuring

24. The following outlines some of the views that the IAASB has received from those national standard setters, regulators, IFAC Committees that have been consulted on their preliminary views of whether restructuring of IAASB standards is needed and, if so, the implications thereof.

SUPPORT FOR RESTRUCTURING

25. While some may argue that restructuring is little more than a reshuffling of material offering little benefit, it has several distinct advantages in relation to the users of the standards:
- Professional requirements are clearly and unambiguously stated, separated from the more detailed guidance dealing with the implementing of the requirements. Auditors, particularly those dealing with smaller and less complex businesses, should therefore be able to focus on and understand the requirements more easily.
 - The requirements of the ISAs will be presented in a less intimidating, more concise and user-friendly manner.
 - Although the guidance in the application material is essential, many experienced auditors may find it familiar or self-evident. For them, and for those audit situations for which more detailed guidance is not required, auditors can focus effort on the standards

sections that identify their obligations, rather than searching for requirements in a long document.

- The format lends itself to further innovation that will assist the widespread adoption and use of international standards such as a web-based application with the ability to “drill-down” from the professional requirements to the application guidance.
 - Restructuring may further assist in national adoption or implementation of ISAs, providing national standard setters with scope to incorporate national requirements and guidance within the ISA framework. It would also enable their incorporation into legislation, where that is required.
26. In support of these benefits, some observers also note that audit failure occurs when auditors do not focus on what is important, rather than because the auditor overlooked some explanatory guidance. Restructuring ISAs therefore may help the auditor to focus on the principal things that the auditor needs to do and know, thereby enhancing the quality of audits.
27. It has also been observed that the process of applying the proposed categories of professional requirements outlined in the accompanying Exposure Draft may increase the number of professional requirements included in standards. As a result, such professional requirements may become so deeply embedded within the document (especially in the longer ISAs) that they could be overlooked. The effective application of that Policy Statement would therefore require consideration of the style and structure of ISAs; that is, the issue of clarity of language cannot be addressed in isolation, but in tandem with the reconsideration of the structure of the ISAs.

CONCERNS OVER RESTRUCTURING

28. Of particular concern to some over restructuring is that by separating professional requirements and explanatory material (either by way of two sections within one document or two separate documents), overall clarity may in fact be reduced because the auditor may overlook explanatory material. This would be true particularly if the standards omitted context-sensitive material provided by the related explanatory material such that they could not be interpreted and understood on a stand-alone basis. In this regard, the ISAs need to explain both what the auditor is required to do, and why, as such explanations are integral to the auditor’s undertaking of a “shall” or “should” requirement; one cannot gain a full understanding of the standard without such explanations.
29. It has been further noted that the objective to accommodate legislative options whereby the standards sections only are to be included in legislation may provide even more reason to expect that practitioners may overlook the explanatory material. The possible perception that the explanatory and guidance document or section is of lesser authority than the “standards” may be considered unacceptable. This risk may exist irrespective of how well the authority of the explanatory material is described.
30. The practicalities and consequences of implementation have also been questioned. ISAs are being translated and are embedded in training and audit methodologies. In particular, the revised European Commission 8th Directive is expected to require the use of ISAs throughout the European Union for statutory audit. The concern is that restructuring may

entail a major translation effort and that the impact on standard setters, firms, educators and practitioners would be significant. This concern is one of the major factors that suggest that any change of this nature should be implemented on a prospective basis.

Questions for Respondents

1. **Do respondents believe that the IAASB should continue with its present style of ISAs, or is there a need for ISAs to be restructured? What are the reasons that are persuasive in reaching your view?**
2. **If ISAs are to be restructured, which option should be pursued and why? Are there other options that the IAASB should consider, particularly in helping ensure that ISAs are applicable to auditors of both large and small-and medium-sized entities?**

Pursuing a Restructuring Approach

31. The IAASB has proposed that the Policy Statement in the accompanying Exposure Draft be applied on a prospective basis and become effective for all new or revised International Standards, including exposure drafts, issued on or after [date], because this approach would not disrupt the IAASB's work on other important projects.
32. Should a restructuring occur (that option may be pursued if the comments received on this consultation paper support a move in that direction), for practical reasons, the restructuring of ISAs would need to be carried out when the proposed Policy Statement would be implemented. The revision to an ISA, to accomplish both the clarification of language and a restructuring, would therefore only be done once.

Questions for Respondents

Notwithstanding the decisions of the IAASB regarding the proposed Policy Statement (see accompanying Exposure Draft), in the event there is strong support for the restructuring of ISAs, do respondents agree that any such restructuring should be applied on a prospective basis? Or should restructuring be applied prospectively, but on a priority basis first to a limited number of ISAs that have attracted concerns about their length and complexity, namely the IAASB's recently issued audit risk and fraud ISAs? If so, what are the reasons that are persuasive in reaching your view?

IV. Fundamental Principles Underlying an ISA Audit**Present Situation**

33. IAASB's standards are said to be 'principles-based,' but although they contain 'basic principles and essential procedures,' the distinction between the two has never been made. Accordingly, the principles upon which ISAs are based have never been separately enunciated.

Discussion

SUPPORT FOR IDENTIFYING FUNDAMENTAL PRINCIPLES UNDERLYING AN ISA AUDIT

34. To continue to support a ‘principles-based’ approach to standards and to assist auditors in using professional judgment in following an ISA’s requirements, it may be desirable for the IAASB to articulate what those principles are, and to demonstrate their linkage with the standards that are issued. Accordingly, one possibility would be for the IAASB to identify and communicate the “fundamental principles underlying an ISA audit,” and to align the professional requirements of ISAs more closely with those principles.
35. The advantages of codifying the “fundamental principles underlying an ISA audit” include more clearly identifying and communicating the principles that underlie the professional requirements contained in ISAs and that ultimately drive the auditor’s professional judgment. Absent a professional requirement within an ISA guiding the auditor’s conduct in a specific circumstance or in relation to a specific matter, the auditor might be able to refer to and work from the principles in guiding professional judgment and in determining an appropriate course of action.
36. The identification of the “fundamental principles underlying an ISA audit” would also create a framework to assist the IAASB in determining the professional requirements to be established in ISAs, particularly in relation to the determination of whether a procedure is to be considered a mandatory requirement (a “shall” statement) or a presumptively mandatory requirement (a “should” statement) as proposed in the accompanying Exposure Draft.

CONCERNS

37. Although there may be some support conceptually for identifying and communicating “fundamental principles underlying an ISA audit,” some question the practicality of attempting to identify and reach agreement on them at an international level, the manner in which they should be expressed, and the ultimate value to be derived therefrom. In regard to their development, some argue that a theoretical basis supported by research is needed to determine such principles. The development of, and agreement on (if indeed possible), fundamental principles may therefore require significant resources that otherwise may better serve the public interest if applied to the development of high quality ISAs. In addition, while the principles may be of assistance to the IAASB and standard setters, they may not be useful to practitioners.

Possible Fundamental Principles Underlying an ISA Audit

38. To assist in the consideration of whether “fundamental principles underlying an ISA audit” should be identified and communicated, the IAASB has formulated a general working framework for the development and codification of such principles and a preliminary list of possible principles.
39. In drafting the principles, the IAASB has considered the Assurance Framework, the basic principles and essential procedures within existing ISAs and principles or similar statements in a number of national auditing standards. It is important to note that the following “fundamental principles underlying an ISA audit” are based on the preliminary view of the IAASB and may not represent the final set of principles that ultimately might be adopted.

40. The following is not intended to suggest that the IAASB will pursue the development of a final set of principles; that decision will be taken in light of the comments received.

WORKING FRAMEWORK

41. Fundamental principles may be described as comprising the high ideals of professional conduct and the essential qualities underpinning every ISA audit. Conceptually, fundamental principles should:
- Underlie the objective(s) of an audit, and help drive the behavior of the auditor in using professional judgment to fulfill the professional requirements of the ISAs.
 - Be easily understood both by professional accountants and other readers of ISAs.
 - Be universally applicable to all audits.
 - Represent those expectations which auditors are not expected to depart from or override.
42. To reinforce the importance of the principles and the expectation that auditors will not depart from or override the principles, the principles would need to be positioned within a document having an appropriate level of authority (that is, an ISA, for example ISA 200, “Objectives and General Principles Governing an Audit of Financial Statements”), with the requirement to comply with these principles clearly communicated.
43. Based on above working framework, a proposed statement of authority and a set of “fundamental principles underlying an ISA audit”, are presented below:

Authority of Fundamental Principles Underlying an ISA Audit

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

Fundamental Principles of Professional Ethics

(a) Integrity

A professional accountant should⁶ be straightforward and honest in all professional and business relationships.

(b) Objectivity

A professional accountant should not allow prejudices or bias, conflict of interest or undue influence of others to override professional or business judgment.⁷

⁶ These principles have been taken verbatim from the IFAC Ethics Committee’s Exposure Draft, “Proposed Revised Code of Ethics for Professional Accountants,” issued July 2003. Subject to the comments on the accompanying Exposure Draft, the IAASB would encourage the IFAC Ethics Committee to adopt the word “shall” in place of the word “should.”

⁷ In addition, as required by Section 8 of Part B of the IFAC Code, the members of the assurance team, the firm and network firms should be independent of the client.

(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 should act diligently and in accordance with applicable technical and professional standards in all professional and business relationships.

(d) **Confidentiality**

A professional accountant should respect the confidentiality of information acquired as a result of professional or business relationships and should 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 should not be used for the personal advantage of the professional accountant or third parties.

(e) **Professional Behavior**

A professional accountant should comply with relevant laws and regulations and should avoid any action that discredits the profession.

Fundamental Principles Underlying the Objective of an ISA Audit

(f) **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.

(g) **Responsibility**

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

(h) **Quality Control**

The auditor shall follow quality control procedures, including consultation with others as necessary, that support the issuance of an audit report that is appropriate in the circumstances.

(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, and recognizing that circumstances may cause the financial statement to be materially misstated.

(j) **Professional Judgment**

The auditor shall exercise professional judgment, within the bounds of the fundamental principles and the applicable professional requirements, in fulfilling the auditor's responsibilities.

(k) Evidence

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

(l) Documentation

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

(m) Communication

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

(n) 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 the auditor reports on the information and how it is misleading.

(o) Reporting

The auditor shall report to those that have appointed the auditor to the engagement. The auditor's report shall contain a clear expression of opinion in writing, and set out all information necessary for a proper understanding of the opinion and its basis.

Questions for Respondents

1. Do respondents believe there is a need to identify and publish "fundamental principles underlying an ISA audit"? Please give reasons for your answer. If so, should the establishment of such principles be consider a high, medium or low priority of the IAASB for the immediate future?
2. Do respondents consider the proposed fundamental principles to be complete and appropriate, and do respondents believe the method by which they have been derived to be appropriate? If not, what matters do respondents believe should be considered in development of the fundamental principles?
3. Do respondents believe that the fundamental principles should be expanded to serve as a basis for all assurance engagements?
4. Do respondents agree with the proposed authority to be afforded the fundamental principles?

V. PRACTICE STATEMENTS**Present Situation**

44. Paragraphs 20 and 21 of the Preface describe Practice Statements and the authority attaching thereto as follows:

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.

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 basic principles and essential procedures⁸ in the IAASB's Engagement Standard(s) addressed by the Practice Statement have been complied with.

45. Practice Statements are generally developed and approved following the same due process afforded International Standards issued by the IAASB, unless the IAASB considers in a specific case that exposure of a draft IAPS is not required.
46. Appendix 2 summarises the existing IAPSs. There are three main types of IAPS:
 - IAPSs that provide detailed guidance on information technology. These are not closely related to any specific ISA.
 - IAPSs that deal with particular issues such as derivatives, electronic commerce and reporting on compliance with International Financial Reporting Standards.
 - IAPSs which seek to interpret the application of ISAs across groups of auditors (e.g., the auditors of banks, auditors of small entities, and, under exposure, group auditors).

Matters for Further Consideration

47. The IAASB recognizes that adopting the proposals contained in the accompanying Exposure Draft or in this consultation paper may affect Practice Statements (in particular, IAPSs which cover a broad range of topics). The IAASB may therefore need to reconsider the purposes, authority, drafting conventions and future use of these Statements. The IAASB has concluded, however, that it must first focus on improving ISAs. Once a direction is clear, the IAASB can undertake a more systematic review of Practice Statements.
48. In exploring the future role of Practice Statements, notwithstanding the need to study the treatment of existing Practices Statements, there are several options which could be considered:
 - Maintain the present system for, and authority of, Practice Statements.
 - Expand the use of Practice Statements to provide the vehicle whereby a large part of the explanatory material currently contained in ISAs would be communicated, (as envisioned by Restructuring Option A – see paragraph 20).
 - Use Practice Statements to extend the professional requirements of International Standards (e.g., ISAs), and explain how such requirements apply, to specific industries or

⁸ The phrase 'basic principles and essential procedures' would be changed to 'professional requirements' under the proposed Policy Statement in the accompanying exposure draft, subject to comments received on exposure.

circumstances. As more direct extensions of ISAs, such Practice Statements could carry equal authority to the International Standard(s) to which they relate and could contain additional professional requirements that would be directly derived from those contained in the related International Standard(s).

- Modify the authority of Practice Statements such that they may be issued by the IAASB following an expedited approval process (for example, approval by a simple majority, rather than the present two-thirds majority requirement of the IAASB, or permit issue without public exposure in all cases), thereby allowing the IAASB to issue practical guidance to promote good practice in a more timely and flexible manner.
- Discontinue their use.

Questions for Respondents

Existing Practice Statements and their Authority

1. **Do respondents believe the present description of the authority of Practice Statements to be clear and understandable? If so, do respondents agree with the authority that is afforded them? If not, what should be the authority of Practice Statements?**
2. **Given that the existing authority of Practice Statements and their use in providing additional guidance to International Standards, should the IAASB change the style in which Practice Statements are written? To the extent they are derived from professional requirements contained in an International Standard, should Practice Statements enunciate professional requirements?**

Future role for Practice Statements

3. **Taking account of the options identified above, what future role should the IAASB consider for Practice Statements? Are there other options that the IAASB should consider? Please explain why a particular option is being suggested and how it might be of benefit.**

APPENDIX 1

Characteristics of a Restructured ISA

This appendix provides an outline of the structure that an ISA might take following Restructuring Option B described in paragraph 21 of the consultation paper.

Restructuring Option B suggests a possible approach to restructuring an ISA whereby both the professional requirements and explanatory material would be retained in one document, but separated into two distinct sections: the first section (the ‘standards section’) would set out the professional requirements of the ISA; the second section (the ‘application material section’) would contain explanatory material that supports proper application of the ISA.

Following this approach, the standards section would contain⁹:

- The topic of the ISA and its purpose, including where practicable, reference to the fundamental principles underlying an ISA audit¹⁰ to which the ISA relates and how the ISA is designed to achieve them.
- The professional requirements of the ISA.
- Definitions or explanation of specific terms and concepts introduced in that ISA.
- The effective date of the ISA.

The application material section would contain all other explanatory or application material, including:

- A fuller discussion of the objectives of the ISA and the context in which it is set.
- Explanation of the objective of the professional requirement(s) contained in the standards section above.
- 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.

Descriptive headings and appropriate cross-references would link the professional requirements of the ISA and the related application material.

The separation of the professional requirements from explanatory material would make continued use of the current bold type lettering convention unnecessary. Its use would therefore be discontinued.

⁹ This guide would be modified as more experience is gained.

¹⁰ Such reference would be made if the IAASB determines that a final set of “fundamental principles underlying an ISA audit” are to be developed and published.

APPENDIX 2

International Auditing Practice Statements (IAPs)

As of September 2004

- 1000 Inter-Bank Confirmation Procedures
- 1001 IT Environments—Stand-alone Personal Computers
- 1002 IT Environments—On-line Computer Systems
- 1003 IT Environments—Database Systems
- 1004 The Relationship Between Bank Supervisors and Banks' External Auditors
- 1005 The Special Considerations in the Audit of Small Entities
- 1006 Audits of the Financial Statements of Banks
- 1008 Risk Assessments and Internal Control—CIS Characteristics and Considerations
- 1009 Computer-assisted Audit Techniques
- 1010 The Consideration of Environmental Matters in the Audit of Financial Statements
- 1012 Auditing Derivative Financial Instruments
- 1013 Electronic Commerce—Effect on the Audit of Financial Statements
- 1014 Reporting by Auditors on Compliance With International Financial Reporting Standards

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