



**International Federation of Accountants**

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## Agenda Item

# 6

**Committee:** IAASB

**Meeting Location:** New York

**Meeting Date:** September 13-17, 2004

### **Improving the Clarity of IAASB Standards**

#### **Objectives of Agenda Item**

To review and approve for issue the draft Exposure Draft of a 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*.

#### **Task Force Members**

The IAASB Clarity of Standards Task Force comprises Mr Kellas (IAASB Chairman), Ms Esdon (IAASB Vice Chair), and Messrs Fogarty, Plaistowe, Sylph (IAASB Technical Director) and Trémolière. Mr Grant, technical advisor to Mr Plaistowe, has participated in each of the meetings of the Task Force.

#### **Activities since Last IAASB Discussion**

The Task Force has met twice since the June 2004 meeting of the IAASB. As agreed by the IAASB, the Task Force has recast the Discussion Paper presented to the IAASB in June as:

- A draft Exposure Draft proposing to establish categories of professional requirements and identify related terms, and to explain the purpose and intended meaning of explanatory material. The draft Exposure Draft follows the style of the proposed Policy Statement presented to the IAASB in December 2003.

A draft explanatory memorandum, including preliminary questions to be asked of respondents on the issues, is included for IAASB consideration.

- A draft Consultation Paper addressing the length and structure of ISAs, the identification of the “fundamental principles of auditing” and related considerations for Practice Statements. It is intended to provide a balanced discussion of the issues that have been raised by the IAASB and other commentators.

For the purposes of encouraging debate and soliciting responses to the exposure draft, IAASB staff has prepared an illustration of how the proposals in the Policy Statement might be applied to the first 40 paragraphs of ISA 315. Similarly, in relation to the consultation document, staff has prepared an illustrative restructured ISA 315 which has been carried forward from the material presented to the IAASB in June. These examples are presented as a “supplement” to the draft Exposure Draft and Consultation Paper. Appropriate caveats have been established.

In developing the drafts, the Task Force considered the final Rule issued by the US Public Company Accounting Oversight Board (PCAOB) regarding certain terms used in its auditing and related professional practice standards, as well as comments received from IOSCO, CAG, national standard setters, the IFAC SMP Task Force and others based on their review of the June IAASB agenda material.

## **Matters for the Attention of the IAASB**

### ***Draft Exposure Draft of a Proposed Policy Statement***

#### **EQUAL AUTHORITY**

In developing the proposed Policy Statement, the Task Force considered the need to clarify further 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’, with an explanation that this term means 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 Task Force found the term ‘equal authority’ problematic and subject to differing interpretation. An alternative, more acceptable term, was not identified.

The Task Force 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’ without the need to introduce a specific term. The Task Force believes that use of the term ‘equal authority’ would not further enhance the effect of the proposal and therefore has not adopted it.

#### **PRESUMPTIVELY MANDATORY REQUIREMENTS AND DEPARTURES THEREFROM**

In June, the US PCAOB adopted Rule 3101 that sets forth the terminology it will use to describe the degree of responsibility imposed on registered auditors by its standards. The Rule defines presumptively mandatory responsibilities as those that “the auditor must comply with unless the auditor demonstrates that alternative actions followed in the circumstances were sufficient to achieve the objectives of the standard.” It explains that “in the rare circumstances in which the auditor believes that the objectives of the standard can be met by alternative means, the auditor, as part of documenting the planning and performance of the work, must document the information that demonstrates that the objectives were achieved.”

In comparison, the current Preface requires professional accountants to comply with the basic principles and essential procedures of a standard (“should” statement) unless “in exceptional circumstances, the professional accountant judges it necessary to depart from a basic principle or essential procedure to achieve more effectively the objective of the engagement. When such a situation arises, the professional accountant should be prepared to justify the departure.”

The Task Force considered the option of retaining the present obligation imposed by a “should” statement for use in defining presumptively mandatory requirements (thereby achieving continuity in its use with existing standards). It also considered the definition adopted by the PCAOB. The Task Force has concluded that a definition of presumptively mandatory requirements similar to that of the PCAOB should be adopted, on the following grounds:

- It establishes an appropriate threshold for departure from a presumptively mandatory requirement in applying professional judgment, in light of the existence of a new category of mandatory requirements and the anticipated modest increase in the number of professional requirement as a result of applying the proposed categories of professional requirements.
- There are benefits to harmonizing the definition with that of the PCAOB.

The Task Force also proposes that a departure from a presumptively mandatory requirement should be appropriately documented.

#### BOLD TYPE LETTERING

The Task Force considered whether it should discontinue the use of bold type. In doing so, it observed that, of the 21 responses to the question “*Whether there is general support for retaining the distinction between bold and ordinary lettering?*” posed in the November 2002 ED on the Preface, a significant majority of the respondents (95%) expressed support for continued use of bold type lettering convention by the IAASB in the standards (71% indicated strong support while 24% did not object to its continued use). Among other comments received, it was noted that bold type improves readability and provides logical structure.

The Task Force has therefore concluded that the use of bold type lettering should be continued. To eliminate any confusion over the purpose of bold type lettering, the proposed Policy Statement explains that bold type lettering is used to identify when a professional requirement is established for the sole purpose of aiding overall readability.

Nevertheless, having regard to the proposals in the policy statement the Task Force considers it right to raise the issue again with respondents.

#### IMPLEMENTATION OF THE PROPOSED POLICY STATEMENT

The Task Force considered implementing the proposed Policy Statement following three possible approaches.

The first approach consisted of developing and issuing for exposure at a single point in time a complete package of all ISAs, revised following the conventions proposed in the Policy Statement, to avoid any suggestion that confusion 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 the central importance of these standards and the fact that they are unlikely to be revised again in the short term.) Remaining International Standards would adopt the drafting conventions as they are updated and revised.

The Task Force 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 concluded that the most appropriate way forward is a prospective approach whereby the new conventions are adopted for standards issued after a certain date.

However, the Task Force believes that the requirement for departures from presumptively mandatory requirements to be justified in writing should apply to departures from the basic principles and essential procedures of existing standards and recommends that the requirement be effective for engagements conducted in accordance with IAASB's International Standards for periods commencing on or after a specified date. The Task Force believes the requirement to justify such departures in writing responds to the public interest and is appropriate for what are expected to be rare occurrences.

**Does the IAASB agree with:**

- **The proposed treatment of the issue of 'equal authority'?**
- **The continued use of the bold type lettering convention?**
- **The proposed definition of, and related documentation requirements for, presumptively mandatory obligations?**
- **The applicability and implementation of the proposed Policy Statement on a prospective basis?**

***Draft Consultation Paper***

**ISSUE ADDRESSED**

In developing the draft Consultation Paper, the Task Force endeavoured to present a balanced discussion of the issues raised, and the differing view that have been expressed, on the need to seek further change to the way in which IAASB standards are drafted.

**Does the IAASB believe the draft Consultation Paper appropriately reflects, and presents a balanced discussion of, the significant issues?**

**Does the IAASB agree with the questions to be asked of respondents to the Consultation Paper?**

**WONG MISSION**

IFAC has undertaken a study (the "Wong Mission") on the views of individual professional accountants and others on the extent to which they have seen challenges and successes in the adoption and implementation of both International Financial Reporting Standards (IFRS) and ISAs within national environments. Although the Task Force has been made aware of the preliminary findings of the study, it has not seen the detailed report which is expected to be released in mid-September. The draft Consultation Paper therefore recognizes the fact that an IFAC study has been undertaken and that the preliminary findings suggest the need for standard setters to consider issues surrounding the trend towards longer and more complex standards.

The Task Force does not believe that the issuance of the draft Consultation Paper should be delayed pending final publication of the report of the Wong mission. If possible, however, the Task Force suggests that giving greater emphasis to the findings from the Wong Mission in the Consultation Paper might enhance the discussion of, and evidence supporting, the issues surrounding the clarity of other aspects of IAASB standards. If the final report is available in September, it is proposed that reference to the main findings of the Wong Mission be included within the Consultation Paper. The

IAASB would then be provided with a revised version of the document by the end of September for ballot voting on those changes only.

**Does the IAASB agree with the proposed way forward in relation to the anticipated Wong report?**

### **Material Presented**

Agenda Item 6-A (Pages 1775–1808)	Draft Exposure Draft of a Proposed Policy Statement, <i>Certain Terms and Conventions Used in International Standards Issued by the IAASB</i> , and Draft Consultation Paper, <i>Improving the Clarity and Structure of IAASB Standards and related Considerations for Practice Statements</i> .
Agenda Item 6-B (Pages 1809–1852)	Supplement to IAASB Exposure Draft and Consultation Paper: Illustrative Examples

### **Action Requested**

The IAASB is asked to review and approve for issue the draft Exposure Draft and draft Consultation Paper.

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