



**International Federation of Accountants**

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**Agenda Item**

**4**

**Committee:** IAASB  
**Meeting Location:** London  
**Meeting Date:** December 4-8, 2006

**Proposed Revised ISA 200**

**Objective of the Meeting**

1. To undertake a second read of proposed ISA 200, “Overall Objective of the Independent Auditor, and Fundamental Concepts Relevant to an Audit of Financial Statements,” revised in response to comments received during the September IAASB meeting.

**Task Force Members**

2. The members of the Clarity Task Force are as follows:

John Kellas (Chairman)	IAASB Chairman
Denise Esdon	IAASB Deputy Chair
John Fogarty	IAASB Member
Jon Grant	IAASB Technical Advisor
Bodo Richardt	IAASB Member
Jim Sylph (ex-officio)	IAASB Technical Director
G�rard Tr�moli�re	IAASB Member

**Background**

3. At its September meeting, the IAASB undertook a first read of the proposed revised ISA 200. The Task Force has revised the proposed ISA in response to comments received. It has also updated the document to reflect the agreed amendments to the Preface.

**Main Issues for IAASB Consideration**

REASONABLE ASSURANCE

4. In September, the IAASB deliberated the meaning of, and how ISA 200 expresses, the concept of reasonable assurance. The IAASB was concerned about the proposed use of the word “high” in the definition of reasonable assurance without further explanation of the complexity of the concept, including its relative nature and the context in which it is to be understood. Accepting that it is not the intention of the IAASB to revisit the framework on which the ISAs are based, the IAASB asked that the Task Force consider further the following:

- How best to convey the fact that reasonable assurance is a relative concept, which deals with the financial statements as a whole and involves in certain instances a greater exercise of professional judgment than in others, depending on the circumstances.
- Inclusion within the definition of reasonable assurance reference to the fact that there are inherent limitations of an audit.

#### *Definition and Discussion of Reasonable Assurance*

5. The Task Force has deliberated the definition of reasonable assurance, and possible alternative wording to refine it to address the concerns noted by the IAASB. Based on these deliberations, the Task Force recommends that the definition of reasonable assurance should remain consistent with that included in the Glossary of Terms in the Handbook, being ‘...a high, but not absolute, level of assurance...’
6. This recommendation reflects the Task Force’s conclusion that it is not possible to address adequately the varying concerns raised at the September IAASB meeting through change to the definition of reasonable assurance. Nor does the Task Force believe it appropriate to attempt to do so within the scope of this project, as even minor changes to the definition are likely to raise questions about whether there is an intention to change the nature of reasonable assurance, which there is not. For example, the change suggested at the September IAASB meeting along the lines of ‘...a high, but not absolute *due to the inherent limitations of an audit*, level of assurance...’ raised questions by the Task Force about whether in fact there are other factors that affect how reasonable assurance is, or should be, understood. Other possible refinements to the definition raised further issues.
7. The Task Force believes, however, that amplification of some aspects of the discussion of reasonable assurance in ISA 200 may be helpful in explaining the concept, without altering its meaning. It recommends that the following matters be emphasized in the application and other explanatory material of the ISA:
  - That reasonable assurance is a concept relating to the accumulation of sufficient appropriate audit evidence, and that it requires the exercise of professional judgment throughout the audit in identifying and assessing risks of material misstatement, in performing audit procedures in response to the assessed risks in order to obtain sufficient appropriate audit evidence, and in forming conclusions based on an evaluation of that evidence. (See changes in paragraphs 8 and A14 in Agenda Item 4-A.)
  - That the ISAs are designed in relation to the achievement of reasonable assurance (i.e., to acknowledge that it is the Standards themselves that determine what reasonable assurance is). (See changes in paragraphs 8 and 9 in Agenda Item 4-A.)
8. The Task Force also considered whether it would be of benefit to relate more closely the identified fundamental concepts of professional judgment, professional skepticism and sufficiency and appropriateness of audit evidence with reasonable assurance. It concluded that doing so would obscure the clarity of how these concepts are dealt with in the ISAs.
9. The Task Force believes that to go further in any discussion of reasonable assurance would involve a re-examination of the concept. It was previously agreed that work on a conceptual framework (and by implication on such concepts as reasonable assurance) should not form

part of the project. Further, any further consideration would have to be undertaken in consultation with national standard setters, regulators and other stakeholders through a systematic and broader-based study. This is beyond the scope of the work to clarify ISA 200.

#### *Inherent limitations*

10. Related to the above, the Task Force believes that some further amplification of the discussion of the inherent limitations of an audit is necessary to provide an adequate understanding of reasonable assurance. Accordingly, it recommends that the discussion of inherent limitations include the fact that:

- To form an opinion on the financial statements within a reasonable period of time and at a reasonable cost, the auditor needs to make an assessment of the risks of material misstatement, which is a matter of judgment rather than a precise measurement. (See changes in paragraph A19 in Agenda Item 4-A.)
- Some financial statement items involve subjective decisions by management in applying the requirements of the financial reporting framework to the circumstances of the entity. (See paragraph A22 in Agenda Item 4-A.)

#### **Action Requested**

**Having regard to the scope of the clarification of ISA 200, does the IAASB agree with the recommendation of the Task Force to retain the existing definition of reasonable assurance from the Glossary of Terms?**

**Does the IAASB view the proposed changes to the discussion of reasonable assurance and the inherent limitation of an audit as appropriate and adequate? Are there other fundamental inherent limitations of an audit that should be considered by the Task Force?**

#### PROFESSIONAL SKEPTICISM

11. The IAASB suggested in September that the concept of professional skepticism should be included and presented in connection with the concept of professional judgment.
12. The Task Force concluded that professional skepticism it is in fact a fundamental concept relevant to an audit of financial statements. Accordingly, it recommends that most of the application material relating to the requirement for the auditor to plan and perform an audit with an attitude of professional skepticism be moved to the section dealing with the fundamental concepts. The Task Force observes that this change also helps improve the linkage between the concepts and requirements sections of ISA 200. The Task Force did not view professional skepticism as a subset of professional judgment (although the latter is necessary to the former). (See paragraphs 9 and A27-A28 in Agenda Item 4-A).

#### PROFESSIONAL JUDGMENT

13. The Task Force understands that there is concern by some about the potential for professional judgment to be used as a fall-back basis for decisions when questions are raised about how conclusions have been drawn (i.e., judgment becoming a 'black-box' to those responsible for inspection or reviews). The Task Force therefore believes that the discussion of professional

judgment in ISA 200 should explain that a ‘test’ of whether the exercise of professional judgment would be regarded as reasonable would be whether other experienced auditors can agree that the exercise of professional judgment in any particular case was reasonable based on the facts and circumstances at the time the judgment was made. Paragraph A26 in Agenda Item 4-A contains proposed wording to this effect.

**Action Requested**

**Does the IAASB agree with the recommended changes to the material relating to professional skepticism and professional judgment in ISA 200?**

**Material Presented (Note: Agenda Item 4-A will be used for purposes of the discussions at the meeting.)**

Agenda Item 4-A            Proposed Revised ISA 200 (Mark-up from September IAASB Meeting)  
(Pages 2895 – 2914)

Agenda Item 4-B            Proposed Revised ISA 200 (Clean)  
(Pages 2915 – 2932)

**Action Requested**

The IAASB is asked to consider the above issues and recommendations, and the accompanying proposed revised ISA 200.

The Task Force intends to present a revised draft for approval as an exposure draft at the April 2007 IAASB meeting.