



International Federation of Accountants

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Agenda Item 2

Committee: IAASB

Meeting Location: London

Meeting Date: December 4–8, 2006

Audit Documentation

Objective of Agenda Item

1. To approve the proposed clarity redraft of ISA 230, “Audit Documentation,” for public exposure.

Task Force Composition

2. The members of the redrafting task force are as follows:
 - John Kellas (Chair, IAASB Chairman)
 - Roberto Tizzano (IAASB Member)

Background

3. The IAASB issued ISA 230 as a revised standard under the former drafting conventions in September 2005 to be effective for audits of financial information for periods beginning on or after June 15, 2006. At the September 2006 meeting, the IAASB discussed proposed conforming changes to the document arising from revisions to the *Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services* relating to the Clarity project. Except for three remaining issues (discussed below), the IAASB agreed the proposed conforming changes, appropriately amended based on the discussions at the meeting. Agenda Item 2-C is the mark-up of the extant ISA conformed to the revised Preface as discussed at the September 2006 meeting.

Activities since Last IAASB Discussions

4. The task force has redrafted the conformed version of the extant ISA (i.e. Agenda Item 2-C) based on the agreed Clarity drafting conventions. Agenda Item 2-B is a mark-up draft showing the changes in redrafting the conformed extant ISA to a clarified version. **The IAASB is asked to review the mark-up draft of the clarified version (i.e. Agenda Item 2-B) for discussion at the meeting.**

Issues for IAASB's Consideration

OUTSTANDING ISSUES FROM THE SEPTEMBER 2006 MEETING

- A. *Documentation Issues Relevant to Consideration of the Achievement of the Objectives Specified in Relevant ISAs*
5. At the September meeting, the Clarity task force proposed to include guidance to the effect that the preparation of a summary of significant matters identified during the audit (a "completion memorandum"), already a suggestion in the current ISA 230, may also assist the auditor's consideration of the achievement of the objectives specified in relevant ISAs (see paragraph 20, Agenda Item 2-C).
6. It was noted that there is a risk that some could interpret this additional guidance to mean that the auditor would have to document how the auditor has achieved the individual objectives specified in the relevant ISAs, although it was acknowledged that this was not what was intended. Accordingly, it was suggested that the additional wording be deleted.
7. After due consideration, the task force concluded that the proposed guidance remains appropriate (see paragraph A11, Agenda Item 2-B). Nothing in the wording, or elsewhere in the ISA, suggests a specific requirement for the auditor to document how the objectives specified in the relevant ISAs have been achieved. However, preparing a good summary of significant matters is likely to help the auditor to consider whether, in light of the audit procedures performed and conclusions reached, there is any individual relevant ISA objective that the auditor has not met or cannot meet that would prevent the auditor from achieving the auditor's overall objective. The task force believes the proposed wording is consistent with paragraph 15¹ of the revised Preface.

Matter for IAASB Consideration

- Q1. Does the IAASB agree that the wording proposed at the September 2006 meeting should be retained?

B. *Audit Documentation Relating to the Use of Professional Judgment*

8. As part of the conforming amendments to ISA 230, the Clarity task force proposed that the audit documentation the auditor prepares should also enable an understanding of the significant professional judgments made in reaching conclusions on the significant matters arising during the audit (see paragraph 8 of Agenda Item 2-C). It also proposed the following explanatory material on the documentation relating to the use of professional judgment:

¹ Paragraph 15 of the revised Preface states the following:

"Each ISA contains an objective or objectives, which provide the context in which the requirements of the ISA are set. The auditor aims to achieve these objectives, having regard to the interrelationships amongst the ISAs. For this purpose, the auditor uses the objectives to judge whether, having complied with the requirements of the ISAs, sufficient appropriate audit evidence has been obtained in the context of the overall objective of the auditor. Where an individual objective has not been or cannot be achieved, the auditor considers whether this prevents the auditor from achieving the auditor's overall objective."

19. Matters for which the auditor may consider it appropriate to prepare audit documentation relating to the use of professional judgment include:

- Those matters considered by the auditor that were important in forming the relevant professional judgment when a requirement provides that the auditor ‘should consider’ certain information or factors.
- The basis for the auditor’s conclusions where the auditor considered it necessary to obtain further audit evidence by performing significant further audit procedures in addition to those necessary to meet the requirements of an ISA.
- The basis for the auditor’s conclusion on the reasonableness of areas of subjective judgments (e.g., the reasonableness of significant accounting estimates).
- The basis for the auditor’s conclusions about the authenticity of a document when further investigation is undertaken in response to conditions identified during the audit that caused the auditor to believe that the document may not be authentic.

9. At the September meeting, it was suggested that the use of the words “may consider” in that guidance is inconsistent with the nature of the circumstances set out in the last three bullets of the guidance. That is, the “may consider” formulation could allow auditors to choose not to prepare any documentation at all in these circumstances when documentation should be necessary. Accordingly, it was suggested that these three bullets should be elevated to requirements.
10. The task force agrees that in the circumstances set out in the last three bullets above, there should be documentation relating to the use of professional judgment. However, the task force’s view is that these bullets are illustrations of the application of the requirement in paragraph 8(c) of Agenda Item 2-C (i.e. documentation to enable an understanding of significant matters arising during the audit, and significant professional judgments made in reaching conclusions thereon), and do not represent new principles. Accordingly, the task force believes these three types of circumstances should continue to be treated as application guidance. However, to eliminate the ambiguity caused by the “may consider,” the task force proposes that the lead-in part of the guidance be redrafted as follows:

“Examples of matters for which it would be appropriate to prepare audit documentation relating to the use of professional judgment include:” (See paragraph A9 of Agenda Item 2-B)

11. With regard to the first bullet, the task force notes that the emphasis is on the *important* matters that the auditor considered when forming the relevant professional judgment in a “should consider” requirement, and not on all matters that went into that consideration. This reflects the need for the auditor to record the important matters on which the auditor based the consideration to support an understanding of the significant professional judgments that were made. Accordingly, the task force believes this bullet continues to be an appropriate part of that guidance.

Matter for IAASB Consideration

- Q2. Does the IAASB agree with the way the guidance has been redrafted as shown in paragraph A9 of Agenda Item 2-B?

C. Specific Documentation Requirements in Other ISAs

12. The task force has added paragraph A6 (Agenda Item 2-B) after the discussion at the September meeting indicated some uncertainty amongst IAASB members about when an ISA might include a documentation requirement. The paragraph seeks to clarify that such requirements are designed to ensure documentation is prepared at important points of the process, and that the absence of such a requirement in any standard is not intended to suggest that nothing need be documented.

Matter for IAASB Consideration

- Q3. Does the IAASB agree with the inclusion of this new paragraph?

ISSUES ARISING FROM REDRAFTING

D. Experienced Auditor vs Experienced Reviewer

13. Paragraph 8 of the extant ISA (Agenda Item 2-C) specifies the test of adequacy of audit documentation in terms of what an “experienced auditor”² would need to understand the work performed, audit evidence obtained, and significant matters arising during the audit and related significant professional judgments made.
14. However, in commenting on the October 2005 Clarity exposure drafts, a respondent indicated that it believed that the test of adequacy of audit documentation by reference to an experienced auditor showed a bias in favor of peer review rather than regulatory monitoring.
15. The task force notes that this was not the IAASB’s intention, as the ISA does make clear that one of the purposes of audit documentation is to enable an experienced auditor to conduct external inspections in accordance with applicable legal, regulatory or other requirements (see paragraph 4(f) of Agenda Item 2-C). The task force acknowledges, however, that the current term perhaps inadvertently conveys the impression that only peer reviews are envisaged. Therefore, to clarify the intended meaning, the task force proposes that the term “experienced auditor” be changed to “experienced reviewer,” which would be more neutral (see paragraphs 2, 5 and 7 of Agenda Item 2-B). The task force believes that this change does not affect the substance of the requirements and guidance in the ISA.
16. The task force also proposes to clarify the definition to indicate that an experienced reviewer is an individual who has *relevant audit experience* (see paragraph 5 of Agenda Item 2-B). This would reinforce the need for the reviewer to have appropriate audit experience to be able to serve in that role. The change would also be consistent with the EC’s revised 8th Directive,

² The same term is also used in a similar context in the audit documentation standards of the PCAOB and the AICPA’s Auditing Standards Board.

which requires persons who carry out quality assurance reviews to have relevant experience in statutory audit.

Matter for IAASB Consideration

- Q4. Does the IAASB agree that it would be appropriate to replace the term “experienced auditor” with “experienced reviewer” in the ISA, and to refine the definition as proposed above?

E. Departure from a Relevant Requirement

17. Paragraph 10 of the redrafted ISA (Agenda Item 2-B) requires the auditor to document how the alternative audit procedures performed achieve the aim of a relevant requirement if, in exceptional circumstances, the auditor judges it necessary to depart from that requirement.
18. Paragraph A16 (Agenda Item 2-B) explains that “[i]f the auditor judges it necessary to depart from a relevant requirement, the auditor’s documentation explains how the alternative procedures performed were sufficient and appropriate to replace that requirement.”
19. The task force is of the view that the guidance in paragraph A16, which is derived from paragraph 13 of the conformed extant ISA (Agenda Item 2-C), may not be necessary as the substance seems to be already reflected in the requirement in paragraph 10.

Matter for IAASB Consideration

- Q5. What are the IAASB’s views regarding the necessity of retaining the guidance above?

F. IAPS 1005 – Small Entity Considerations

20. The task force has reconsidered whether the small entity guidance relating to audit documentation in IAPS 1005 (see Agenda Item 2-F) needs to be incorporated in the redrafted ISA.
21. The task force believes that it would be helpful to clarify specific considerations relating to documentation techniques for smaller audits to highlight that the use of flowcharts and narrative descriptions may be efficient for such audits. In addition, the task force felt that it would be helpful to clarify that it may be efficient for the auditor of a smaller entity to record various aspects of the audit (e.g. the understanding of the entity, overall audit strategy, risk assessments and significant matters identified) together on a single working paper, with cross-references to other working papers where appropriate (see paragraphs A14-A15 of Agenda Item 2-B).

Matters for IAASB Consideration

- Q6. Does the IAASB agree that it would be helpful to provide the specific considerations described in paragraphs A14-A15 for smaller audits?
- Q7. Does the IAASB agree that the smaller entity considerations in IAPS 1005 have otherwise

been dealt with in ISAs 230 and 315?

G. Applicability of ISA 230 to Other Assurance Engagements

22. The task force considered, as a separate matter, whether the scope of ISA 230 could be extended to include other assurance engagements. The task force is of the view that the requirements of ISA 230 are generally applicable to other assurance engagements. Accordingly, the task force believes that ISA 230 could be refined to create a standard covering other assurance engagements.

Matters for IAASB Consideration

- Q8. Does the IAASB agree that ISA 230 could be used as the basis for a standard for other assurance engagements?
- Q9. Should the explanatory memorandum to the exposure draft include a specific question on whether IAASB should take this matter forward?

Material Presented

Agenda Item 2-A (Pages 2795 – 2804)	Proposed Redrafted ISA 230 (Clean)
Agenda Item 2-B (Pages 2805 – 2816)	Proposed Redrafted ISA 230 (Markup from Conformed Extant ISA Post-Montreal to Clarity Version)
Agenda Item 2-C (Pages 2817 – 2826)	ISA 230 (Extant ISA Conformed to Revised Preface as Discussed in Montreal - Markup)
Agenda Item 2-D (Pages 2827 – 2836)	Mapping Document
Agenda Item 2-E (Pages 2837 – 2838)	Disposition of the Present Tense
Agenda Item 2-F (Pages 2839 – 2840)	IAPS 1005 Considerations

Action Requested

23. The IAASB is asked to consider the issues highlighted above and approve the redrafted ISA 230 for public exposure.