

Exhibit I**Proposed Revised Amendments to the Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services
(Mark-up Showing Changes from Exposure Draft)**

(Effective as of [Date])¹

[There are no proposed amendments to paragraphs 1 – 9 of the extant Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services (Preface). These paragraphs have therefore not been reproduced.]

NOTE: Further changes are being proposed by the ISA 800 Task Force; the amendments shown here and to extant ISA 200 take no account of such proposals.]

The Authority Attaching to International Standards Issued by the International Auditing and Assurance Standards Board

10. International Standards on Auditing (ISAs) are to be applied in the audit of historical financial information.
11. International Standards on Review Engagements (ISREs) are to be applied in the review of historical financial information.
12. International Standards on Assurance Engagements (ISAEs) are to be applied in assurance engagements dealing with subject matters other than historical financial information.
13. International Standards on Related Services (ISRSs) are to be applied to compilation engagements, engagements to apply agreed upon procedures to information and other related services engagements as specified by the IAASB.
14. ISAs, ISREs, ISAEs and ISRSs are collectively referred to as the IAASB's Engagement Standards.
15. International Standards on Quality Control (ISQCs) are to be applied for all services falling under the IAASB's Engagement Standards.

International Standards on Auditing² ~~[Issued/Effective] After [Date]~~

16. ISAs are written in the context of an audit of financial statements³ by an independent auditor⁴. They also apply, adapted as necessary in the circumstances, to audits of other historical financial information.

¹ [Note: This date would be the date when the set of redrafted ISAs come into effect, assuming a single effective date for all redrafted ISAs.]

² The terms and concepts in this Preface are explained further in the ISAs.

³ Unless otherwise stated, "financial statements" mean financial statements comprising historical financial information.

⁴ Referred to hereafter as "the auditor."

17. The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. ISAs, taken together, provide the standards for the auditor's work in fulfilling this objective.
18. In conducting an audit, the overall objective of the auditor shall be to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to report in accordance with the auditor's findings and the requirements of the engagement. In all cases when this overall objective has not been or cannot be achieved, the ISAs require that the auditor modifies the auditor's report accordingly or withdraws from the engagement.
19. The ~~auditor professional accountant is required to shall~~ consider the entire text of each of the ISAs ~~a Standard relevant to the audit in carrying out work on an engagement. An ISA is relevant when the ISA is in force and the circumstances addressed by the ISA exist.~~
2048. The ISAs deal with the general responsibilities of the auditor, as well as the auditor's further considerations relevant to the application of those responsibilities to specific topics. ~~International Standards [issued/effective] after [date] They~~ contain objectives and requirements together with related guidance in the form of application ~~and other explanatory material, including appendices. They may also contain introductory material and definitions that provide context essential to a proper understanding of the ISAs.~~

ISA Objectives

2149. Each ISA contains an objective or objectives, which provide the context in which the requirements of the ISA are set. ~~The auditor professional accountant shall aim to must achieve these objectives, having regard to the interrelationships amongst the ISAs stated at the beginning of each Standard that is relevant in the circumstances of the engagement. For this purpose, tThe auditor professional accountant shall use achieves the objectives to judge whether, having by complieding with the requirements of the ISA Standard, any and by performing other further audit evidence procedures that, in the professional accountant's professional judgment, are is necessary in the context of the overall objective of the auditoreircumstances. Where an individual objective has not been or cannot be achieved, the auditor shall consider whether the circumstances prevent the auditor from achieving the auditor's overall objective.~~

Requirements

220. The requirements ~~of each ISA~~ are contained in a separate section ~~of each Standard. They and are expressed using identified by the word "shall."~~ If a Standard provides that a procedure or action is one that the professional accountant "shall consider," the consideration of the procedure or action is required, while carrying out the procedure or action is not. The auditor shall understand and apply the requirements ~~are to be understood and applied in the context of the other material included in the ISA stated objective and the application material that provides guidance for their application.~~
234. The ~~auditor shall comply with the~~ requirements of an ISA ~~Standard are to be applied~~ in all cases where they are relevant in the circumstances of the ~~audit engagement.~~ In exceptional

circumstances, however, the ~~auditor professional accountant~~ may judge it necessary to depart from a relevant requirement ~~by performing alternative audit procedures in order to~~ achieve the ~~aim purpose~~ of that requirement. ~~When such a situation arises, the professional accountant is required to document how the alternative procedure(s) performed achieves the purpose of the requirement, and, unless otherwise clear, the reasons for the departure.~~ The need for the ~~auditor professional accountant~~ to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit engagement, that procedures would be ineffective.

24. A requirement is not relevant only in the cases where: the ISA is not relevant; or the circumstances envisioned do not apply because the requirement is conditional and the condition does not exist. The auditor is not required to comply with a requirement that is not relevant in the circumstances of the audit; this does not constitute a departure from the requirement.

Application and Other Explanatory Material

252. The application and other explanatory material contained in an ISA Standard is an integral part of the ISA, as it intended to provides further explanation of, and guidance for carrying out, the requirements of an ISA, along with background information on the matters addressed in the ISA further explanation and guidance on the requirements. It, and may include examples of identify and describe other procedures or actions relating to the activities of the professional accountant, some of which the auditor may judge to be appropriate in the circumstances. Such guidance is, however, not intended to impose a requirement. While the professional accountant has a responsibility to consider the whole text of a Standard in carrying out an engagement, such guidance is not intended to impose a 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; 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 stated in the Standard.
263. Appendices, which form part of the application and other explanatory material, are an integral part of an ISA Standard. The purpose and intended use of an appendix are clearly explained in the body of the related ISA Standard or within the title and introduction of the appendix itself.

Introductory Material and Definitions

27. Introductory material may include, as needed, such matters as explanation of: the purpose and scope of the ISA, including how the ISA relates to other ISAs; the subject matter of the ISA; specific expectations on the auditor and others; and the context in which the ISA is set.
28. An ISA may include, in a separate section under the heading 'Definitions', a description of the meanings attributed to certain terms for purposes of the ISAs. These are provided to assist in the consistent application and interpretation of the ISAs, and are not intended to override definitions that may be established for other purposes, whether in law, regulation or otherwise. Meanings of individual terms are provided only in those ISAs that deal principally

with the subject matter to which the terms are most relevant. Unless otherwise indicated, those terms will carry the same meanings throughout the ISAs. The Glossary of Terms in the Handbook contains a complete listing of terms defined in the ISAs. It also includes description of other terms found in ISAs to assist in common and consistent interpretation and translation.

International Standards on Quality Control

29. ISQCs are written to apply to firms in respect of all their services falling within the scope of International Standards issued by the IAASB. Paragraphs 19-28 above apply also to the ISQCs, but are to be interpreted in the context of a firm rather than an individual professional accountant or engagement.

Other International Standards ~~Issued/Effective~~ ~~Before~~ ~~Date~~

3016. The International Standards identified in paragraphs 11-13 ~~issued/effective~~ before ~~date~~ contain basic principles and essential procedures (identified in bold type lettering and by the word “~~should~~**shall**”) together with related guidance in the form of explanatory and other material, including appendices. The basic principles and essential procedures are to be understood and applied in the context of the explanatory and other material that provides guidance for their application. It is therefore necessary to consider the entire text of a Standard to understand and apply the basic principles and essential procedures.
3147. The basic principles and essential procedures of a Standard are to be applied in all cases where they are relevant in the circumstances of the engagement. In exceptional circumstances, however, a professional accountant may judge it necessary to depart from a ~~relevant basic principle or~~ essential procedure in order to achieve the purpose of that ~~basic principle or essential~~ procedure. When such a situation arises, the professional accountant is required to document how the alternative procedure(s) performed achieves the purpose of the ~~basic principle or essential~~ procedure, and, unless otherwise clear, the reasons for the departure. The need for the professional accountant to depart from a relevant essential procedure is expected to arise only where, in the specific circumstances of the engagement, that procedure would be ineffective.
32. Appendices, which form part of the application material, are an integral part of a Standard. The purpose and intended use of an appendix are clearly explained in the body of the related Standard or within the title and introduction of the appendix itself.

Professional Judgment

3324. The nature of the International Standards requires the professional accountant to exercise professional judgment in applying them.

Applicability of the International Standards

34. The scope, effective date and ~~a~~Any specific limitation of the applicability of a specific International Standard is made clear in the Standard. Unless otherwise stated in the International Standard, the professional accountant is permitted to apply an International Standard before the effective date specified therein.

- ~~3525.~~ International Standards are applicable to engagements in the public sector. When additional guidance is appropriate for the public sector, such guidance is included within the body of an International Standard, ~~or International Standards issued prior to January 2005 provided additional guidance for the public sector~~ by means of a Public Sector Perspective (PSP), where considered necessary, appearing at the end of the International Standard.

The Authority Attaching to Practice Statements Issued by the International Auditing and Assurance Standards Board

- ~~3626.~~ 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.
- ~~3727.~~ 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 requirements in the ISAs; or
 - the basic principles and essential procedures in the IAASB's other Engagement Standard(s), ~~for those [issued/effective] before [date]; or~~
 - ~~the requirements in the IAASB's Engagement Standards, for those [issued/effective] after [date]~~

addressed by the Practice Statement have been complied with.

[Except for renumbering, there are no proposed amendments to paragraphs 22 – 29 of the extant Preface. These paragraphs have therefore not been reproduced.]

Exhibit II

**Proposed Amendments to ISA 230 (Revised), “Audit Documentation”
(Mark-Up Showing Changes from Extant ISA 230 (Revised))**

Introduction

1. The purpose of this International Standard on Auditing (ISA) is to establish standards and provide guidance on audit documentation. The Appendix lists other ISAs containing subject matter-specific documentation requirements and guidance. Laws or regulations may establish additional documentation requirements.
2. **The auditor should prepare, on a timely basis, audit documentation that provides:**
 - (a) **A sufficient and appropriate record of the basis for the auditor’s report; and**
 - (b) **Evidence that the audit was performed in accordance with ISAs and applicable legal and regulatory requirements.**
3. Audit documentation that meets the requirements of this ISA will demonstrate the auditor’s reasons for conclusions about the achievement of the overall objective of the auditor. Preparing sufficient and appropriate audit documentation on a timely basis helps to enhance the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained and conclusions reached before the auditor’s report is finalized. Documentation prepared at the time the work is performed is likely to be more accurate than documentation prepared subsequently.
- ~~4. Compliance with the requirements of this ISA together with the specific documentation requirements of other relevant ISAs is ordinarily sufficient to achieve the objectives in paragraph 2.~~
45. In addition to these ~~se above~~ above objectives, audit documentation serves a number of purposes, including:
 - (a) Assisting the audit team to plan and perform the audit;
 - (b) Assisting members of the audit team responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with ISA 220 (Revised), “Quality Control for Audits of Historical Financial Information;”
 - (c) Enabling the audit team to be accountable for its work;
 - (d) Retaining a record of matters of continuing significance to future audits;
 - (e) Enabling an experienced auditor to conduct quality control reviews and inspections⁵ in accordance with ISQC 1, “Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements;” and

⁵ As defined in ISA 220 (Revised).

- (f) Enabling an experienced auditor to conduct external inspections in accordance with applicable legal, regulatory or other requirements.

[Note: Except for paragraph numbering, there are no proposed amendments to paragraphs 6-8 of extant ISA 230 (Revised).]

Form, Content and Extent of Audit Documentation

89. The auditor should prepare the audit documentation so as to enable an experienced auditor, having no previous connection with the audit, to understand:

- (a) The nature, timing, and extent of the audit procedures performed to comply with ISAs and applicable legal and regulatory requirements;
- (b) The results of the audit procedures and the audit evidence obtained; and
- (c) Significant matters arising during the audit and the reasons for the professional judgments made in reaching conclusions ~~reached~~ thereon.

940. The form, content and extent of audit documentation depend on factors such as:

- The nature of the audit procedures to be performed;
- The identified risks of material misstatement;
- ~~The extent of judgment required in performing the work and evaluating the results;~~
- The significance of the audit evidence obtained;
- The nature and extent of exceptions identified;
- The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained; and
- The audit methodology and tools used.

~~It is, however, neither necessary nor practicable to document every matter the auditor considers during the audit.~~

104. Oral explanations by the auditor, on their own, do not represent adequate support for the work the auditor performed or conclusions the auditor reached, but may be used to explain or clarify information contained in the audit documentation.

Documentation of the Audit Procedures Performed and Audit Evidence Obtained ~~Identifying Characteristics of Specific Items or Matters Being Tested~~

Documentation of Compliance with the Requirements of ISAs

11. For purposes of audit documentation, compliance with the requirements of this ISA together with the specific documentation requirements of other relevant ISAs is ordinarily sufficient in the circumstances. The specific documentation requirements of other relevant ISAs do not limit the application of this ISA.

12. It is important that audit documentation demonstrates that the audit complies with the requirements of the ISAs. However, it is neither necessary nor practicable for the auditor to document every matter considered in an audit. Further, it is unnecessary for the auditor to maintain a checklist to record compliance with every requirement or to document separately compliance with matters for which compliance is self-evident within the audit file. For example, in most cases, the existence of a documented audit plan demonstrates that the auditor has planned the audit.

Documentation of Departures from a Requirement~~Basic Principles or Essential Procedures~~

1320. [As explained in [Proposed] ISA 200, “Overall Objective of the Independent Auditor, and General Concepts Relevant to an Audit of Financial Statements,”] T~~he objectives and requirements basic principles and essential procedures~~ in ISAs are designed to assist the auditor~~in~~ in meeting the overall objective of the audit~~or~~. Accordingly, other than in exceptional circumstances, the auditor complies with each requirement~~basic principle and essential procedure~~ that is relevant in the circumstances of the audit.
1424. **Where, in exceptional circumstances, the auditor judges it necessary to depart from a relevant requirement**~~basic principle or an essential procedure that is relevant in the circumstances of the audit~~**, the auditor shall**~~should~~ **document how the alternative audit procedures performed achieve the aim of that requirement**~~objective of the audit~~**, and, unless otherwise clear, the reasons for the departure. This involves the auditor documenting how the alternative audit procedures~~performed~~ **were sufficient and appropriate to replace that requirement**~~basic principle or essential procedure~~**.****
1522. The documentation requirement does not apply~~ies only~~ to requirements~~basic principles and essential procedures~~ that are not relevant in the circumstances. ISA 200 provides guidance in determining whether a requirement is relevant in the circumstances, i.e., where the circumstances envisaged in the specified basic principle or essential procedure do not apply. For example, in a continuing engagement, nothing in ISA 510, “Initial Engagements—Opening Balances,” is relevant. Similarly, if an ISA includes conditional requirements, they are not relevant if the specified conditions do not exist (for example, the requirement to modify the auditor’s report where there is a limitation of scope).

Documentation of the Identifying Characteristics of Specific Items or Matters Being Tested

162. **In documenting the nature, timing and extent of audit procedures performed, the auditor should record the identifying characteristics of the specific items or matters being tested.**
173. **Recording the identifying characteristics serves a number of purposes. For example, it enables the audit team to be accountable for its work and facilitates the investigation of exceptions or inconsistencies. Identifying characteristics will vary with the nature of the audit procedure and the item or matter being tested. For example:**
- For a detailed test of entity-generated purchase orders, the auditor may identify the documents selected for testing by their dates and unique purchase order numbers.
 - For a procedure requiring selection or review of all items over a specific amount from a

given population, the auditor may record the scope of the procedure and identify the population (for example, all journal entries over a specified amount from the journal register).

- For a procedure requiring systematic sampling from a population of documents, the auditor may identify the documents selected by recording their source, the starting point and the sampling interval (for example, a systematic sample of shipping reports selected from the shipping log for the period from April 1 to September 30, starting with report number 12345 and selecting every 125th report).
- For a procedure requiring inquiries of specific entity personnel, the auditor may record the dates of the inquiries and the names and job designations of the entity personnel.
- For an observation procedure, the auditor may record the process or subject matter being observed, the relevant individuals, their respective responsibilities, and where and when the observation was carried out.

Significant Matters

18. An important factor in determining the form, content and extent of audit documentation is the extent of professional judgment required in performing the work and evaluating the results. Documentation of the reasons for the professional judgments made, where significant, serves to explain the auditor's conclusions and to reinforce the quality of the judgment. Such matters are of particular interest to those responsible for reviewing audit documentation, including those carrying out subsequent audits when reviewing matters of continuing significance (e.g., when performing a retrospective review of accounting estimates).
19. Matters and circumstances where 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 judgment, when a requirement provides that the auditor 'shall consider' certain information or factors.
 - The conclusions reached on matters 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 reasons for the auditor's conclusion on the reasonableness of areas of subjective judgments (e.g., the reasonableness of significant accounting estimates).
 - The reasons 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.
2014. Judging the significance of a matter requires an objective analysis of the facts and circumstances. Significant matters include, amongst others:
 - Matters that give rise to significant risks (as defined in ISA 315, "~~Understanding the Entity and its Environment and Identifying and~~ Assessing the Risks of Material

Misstatement Through Understanding the Entity and Its Environment").

- Results of audit procedures indicating (a) that the financial information could be materially misstated, or (b) a need to revise the auditor's previous assessment of the risks of material misstatement and the auditor's responses to those risks.
- Circumstances that cause the auditor significant difficulty in applying necessary audit procedures.
- Findings that could result in a modification to the auditor's report.

2145. The auditor may consider it helpful to prepare and retain as part of the audit documentation a summary (sometimes known as a completion memorandum) that describes the significant matters identified during the audit and how they were addressed, or that includes cross-references to other relevant supporting audit documentation that provides such information. Such a summary may facilitate effective and efficient reviews and inspections of the audit documentation, particularly for large and complex audits. Further, the preparation of such a summary may assist the auditor's consideration of the significant matters, as well as the auditor's consideration of the achievement of the objectives specified in relevant ISAs and the auditor's overall objective in light of the entirety of the audit documentation for the engagement.

2246. **The auditor should document discussions of significant matters with management and others on a timely basis.**

2347. The audit documentation includes records of the significant matters discussed, and when and with whom the discussions took place. It is not limited to records prepared by the auditor but may include other appropriate records such as agreed minutes of meetings prepared by the entity's personnel. Others with whom the auditor may discuss significant matters include those charged with governance, other personnel within the entity, and external parties, such as persons providing professional advice to the entity.

2448. **If the auditor has identified information that contradicts or is inconsistent with the auditor's final conclusion regarding a significant matter, the auditor should document how the auditor addressed the contradiction or inconsistency in forming the final conclusion.**

2549. The documentation of how the auditor addressed the contradiction or inconsistency, however, does not imply that the auditor needs to retain documentation that is incorrect or superseded.

Exhibit III**Draft ISA Objectives**

Note to Readers: The proposed overall objective of the independent auditor and the objectives for ISAs 240, 300, 315 and 330 (shown below) relate to redrafting or revision of ISAs for which the IAASB Clarity Task Force is responsible. The Clarity Task Force has developed the draft objectives for the other ISAs to demonstrate their possible form and content, and for passing to the task forces responsible for individual ISAs. They have not been reviewed or considered by those other task forces and, accordingly, they may be subject to further refinement as the individual ISAs are revised or redrafted.

In addition, the following does not set out other material contained in the ISAs (such as their scope or related application material, if any, explaining the context in which the ISAs are set) that may be relevant to a proper understanding of the objectives.

For purposes of the following, the proposed general form of objectives is:

“The objective of the auditor is to [achieve outcome] [through some path, if specifying the means to achieving the outcome is considered necessary]”

Objective of an Audit (as per ISA 200)

The objective of an audit of financial statements is to enable the independent auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

**Overall Objective of the Independent Auditor**

In conducting an audit, the overall objective of the independent auditor is to obtain reasonable assurance about whether the financial statements taken as a whole are free from material misstatement, whether due to fraud or error, and to report in accordance with the auditor’s findings and the requirements of the engagement.



The following ISAs deal with general responsibilities of the auditor in conducting an audit in accordance with ISAs:

Acceptance and Terms of Audit Engagements (ISA 210):⁶

The objective of the auditor is to accept an engagement only when it is appropriate to do so, through:

- (a) Establishing whether necessary preconditions for an audit are present; and
- (b) Confirming that there is a common understanding between the auditor and the entity of the terms of the audit engagement and of the respective responsibilities of the auditor, management and those charged with governance.

⁶ It is proposed that this ISA be redrafted to feature engagement acceptance, in addition to agreement on the terms of the engagement.

Quality Control (ISA 220):

The objective of the auditor is to achieve an audit that complies with professional standards and regulatory and legal requirements, through the application of the firm's quality control policies and procedures at the engagement level.

Documentation (ISA 230):

The objective of the auditor is to have a sufficient and appropriate record of the basis for the auditor's report, and evidence that the audit was performed in accordance with ISAs and applicable legal and regulatory requirements.

Planning (ISA 300):

The objective of the auditor is to plan the audit so that it will be performed in a manner that is effective in obtaining sufficient appropriate audit evidence.

Materiality (ISA 320):

The objective of the auditor is to determine an appropriate materiality level or levels to enable the auditor to plan and perform the audit.

Identifying and Assessing the Risks of Material Misstatement (ISA 315):

The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, through understanding the entity and its environment, including the entity's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatements.

Auditor's Responses to Assessed Risks (ISA 330):

The objective of the auditor is to obtain sufficient appropriate audit evidence, through designing and implementing responses to the assessed risks of material misstatements.

Fraud (ISA 240):

The objectives of the auditor are:

- (a) To identify and assess the risks of material misstatement of the financial statements due to fraud;
- (b) To obtain sufficient appropriate audit evidence, through designing and implementing responses to the assessed risks of material misstatement due to fraud; and
- (c) To respond appropriately to identified or suspected fraud.

Evaluation of Misstatements Identified During an Audit (ISA 450):

The objective of the auditor is to evaluate the effect of [uncorrected] misstatements on the financial statements.⁷

Forming an Opinion (Possible New ISA XXX)

The objective of the auditor is to form an opinion on the financial statements, through:

- (a) Evaluating whether the financial statements as a whole are free from material misstatement; and
- (b) Evaluating whether sufficient appropriate audit evidence has been obtained.

Communications with Those Charged with Governance (ISA 260):

The objectives of the auditor are:

- (a) To communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, and the scope and timing of the audit;
- (b) To provide those charged with governance with timely observations arising from the audit that are relevant to their responsibility to oversee the financial reporting process; and
- (c) To obtain from those charged with governance information relevant to the audit.

Auditor's Report – General Purpose: Unmodified and Modified Opinions (ISAs 700 & 705):⁸

The objective of the auditor is to express clearly the opinion that the auditor has formed, if any, through including the opinion in a report that contains sufficient information about the basis of that opinion.

Auditor's Report – EOM and Other Paragraphs (ISA 706):

The objective of the auditor is to determine whether additional communication in the auditor's report is appropriate to draw users' attention to a matter in the financial statements, and to any other matter which may be of relevance to the users' understanding of the report.



⁷ The draft objective anticipates inclusion of 'evaluation of whether f/s as a whole are free from material misstatement' in possible new ISA XXX.

⁸ This assumes that there is merit in combining ISAs 700 and 705. This is to be considered by the IAASB in September in discussion of proposed ISA XXX.

The following ISAs deal with further considerations relevant to the application of the auditor's general responsibilities to specific topics:

Obtaining Appropriate Audit Evidence (ISA 500):⁹

The objective of the auditor is to obtain audit evidence that is appropriate, through considering the relevance and reliability of possible audit evidence and the manner in which it is to be obtained.

Audit Sampling and Other Means of Testing (ISA 530):

The objective of the auditor is to obtain audit evidence that is sufficient, through using appropriate bases for selecting items for testing.

Confirmations (ISA 505) (based on the extant ISA):

The objectives of the auditor are:

- (a) To determine whether it is necessary to use external confirmations; and, if so
- (b) To obtain appropriate audit evidence through their effective use.

Analytical Procedures (ISA 520):¹⁰

The objective of the auditor is, when using analytical procedures as substantive procedures, to obtain appropriate audit evidence through their effective use.

Experts (ISA 620):

The objectives of the auditor are:

- (a) To determine whether an expert needs to be involved in the audit for the purposes of obtaining sufficient appropriate audit evidence; and, if so
- (b) To obtain appropriate audit evidence through evaluating the work done by the expert.

Using the Work of Internal Auditing (ISA 610):

The objective of the auditor is to determine the relevance of the activities of internal auditing and their effect, if any, on external audit procedures.

⁹ It is proposed that ISA 200 deal with the concept of sufficient appropriate audit evidence, with ISA 500 featuring the considerations necessary to ensure that audit evidence obtained is appropriate.

¹⁰ It is proposed that the scope of ISA 520 be changed to focus on the auditor's use of analytical procedures as substantive procedures. The extant requirement to use analytical procedures as a risk assessment procedure is already in ISA 315, and it may be that the extant requirement to use analytical procedures at the end of the audit should be repositioned to new ISA XXX as part of the auditor's overall evaluation of audit evidence.

Representations (ISA 580):

The objective of the auditor is to obtain appropriate audit evidence that those responsible for the financial statements (or if necessary for specific information therein) consider that they have fulfilled their responsibilities, through obtaining written representations.

Laws and Regulations (ISA 250):

The objectives of the auditor are:

- (a) To obtain sufficient appropriate audit evidence about whether the entity is in compliance with relevant laws and regulations that may have a material effect on the financial statements; and
- (b) To respond appropriately to identified or suspected non-compliance.

Service Organizations (ISA 402) *(based on the extant ISA)*:

The objective of the auditor is to obtain sufficient appropriate audit evidence regarding activities of a service organization that are of significance to the entity and of relevance to the audit.

Subsequent Events (ISA 560):

The objective of the auditor is to obtain sufficient appropriate audit evidence about whether events up to the date of the auditor's report that may require adjustment of, or disclosure in, the financial statements have been identified and properly reflected in the financial statements.

Going Concern (ISA 570):

The objective of the auditor is to obtain sufficient appropriate audit evidence about whether management's use and disclosure of the going concern assumption in the preparation of the financial statements is appropriate.

Estimates (ISA 540)¹¹:

The objective of the auditor is to obtain sufficient appropriate audit evidence about whether the accounting estimates, including those measured at fair value, and related disclosures in the financial statements are reasonable.

Related Parties (ISA 550):

The objective of the auditor is to obtain sufficient appropriate audit evidence about whether related party relationships and transactions have been properly accounted for and disclosed in the financial statements.

¹¹ Note: The Estimates Task Force proposes that ISAs 540 and 545 be combined.

Group Audits (ISA 600):

The objectives of the auditor are:

- (a) To determine whether the auditor is able to act as the group auditor; and
- (b) To obtain sufficient appropriate audit evidence for the group financial statements, through considering the involvement of other auditors, instructing them appropriately and participating in and evaluating their work to the extent necessary.

Initial Engagements – Opening Balances (ISA 510):

The objective of the auditor conducting an initial engagement is to obtain sufficient appropriate audit evidence about whether:

- (a) The opening balances and the prior period's closing balances contain misstatements that materially affect the current period's financial statements; and
- (b) The application of the entity's accounting policies is consistent with that of the prior period.

Comparatives (ISA 710):

The objective of the auditor is to obtain sufficient appropriate audit evidence about the comparatives.

Other Information in Documents Containing Audited Financial Statements (ISA 720):

The objective of the auditor is to avoid association with misleading information, through:

- (a) Considering whether other information in documents containing audit financial statements is consistent with those statements; and
- (b) Responding appropriately to identified material inconsistencies with the audited financial statements or material misstatements of fact in the other information of which the auditor becomes aware.

Specific Items (ISA 501):¹²

The objective of the auditor is to obtain sufficient appropriate audit evidence regarding:

- (a) The existence and condition of inventory comprising the account balances included in the financial statements;
- (b) Litigation and claims involving the entity which may result in a material misstatement of the financial statements;
- (c) The valuation and disclosure of long term investments included in the financial statements; and
- (d) The presentation and disclosure of segment information in accordance with the applicable financial reporting framework.

¹² There is very little in the ISA on (c) and (d); they are also very framework specific. It may make sense to withdraw this ISA, and reposition the material on (a) to ISA 500, and (b) to ISA 250 or ISA 505.

Exhibit IV**Proposed Draft Revised ISA 200 (Mark-up from Extant ISA 200)****Overall Objective of the Independent Auditor, and General Concepts Relevant to Principles Governing an Audit of Financial Statements****Introduction****Scope of this ISA**

1. ~~The purpose of t~~This International Standard on Auditing (ISA) establishes the independent auditor's overall responsibilities when conducting an audit in accordance with ISAs to establish standards and provide guidance on the objective and general principles governing an audit of financial statements. It also describes management's responsibility for the preparation and presentation of the financial statements and for identifying the financial reporting framework to be used in preparing the financial statements, referred to in the ISAs as the "applicable financial reporting framework."
- 2.¹³ ISAs are to be applied in the audit of historical financial information.¹⁴ They are written in the context of an audit of financial statements and require to be adapted, as necessary in the circumstances, to audits of other historical financial information.

Effective Date

- ~~352.~~ This ISA is effective for audits of financial statements for periods beginning on or after [date].

Overall Objective of the an Independent Auditor of Financial Statements

4. In conducting an audit, the overall objective of the independent auditor¹⁵ is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to report in accordance with the auditor's findings and the requirements of the engagement.
2. ~~The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.~~

¹³ [Note: This paragraph does not contemplate changes being suggested by the ISA 800 Task Force, which will be subject to debate in September in connection with that project.]

¹⁴ Unless otherwise stated, "financial statements" mean financial statements comprising historical financial information.

¹⁵ Referred to hereafter and in the ISAs as "the auditor."

General Concepts Relevant to an Audit of Financial Statements

5. The overall objective of the auditor can only be understood properly in light of the general concepts relevant to an audit. These include the following, which are described further in paragraphs A1-A36 of the application and other explanatory material of this ISA:

- Independence
- Reasonable assurance, including the inherent limitation of an audit
- Professional judgment
- Sufficiency and appropriateness of audit evidence
- Materiality and audit risk
- Responsibility for the financial statements.

The Objective of an Audit and its Relationship to the Overall Objective of the Auditor

63. An audit of financial statements is an assurance engagement, as defined in the International Framework for Assurance Engagements. The Framework defines and describes the elements and objectives of an assurance engagement. The ISAs apply the Framework in the context of an audit of financial statements and contain the basic principles and essential procedures, together with related guidance, to be applied in such an audit. Paragraphs 34-35 in this ISA discuss the meaning of the term “financial statements” and management’s responsibility for such statements. As discussed in the Framework, a condition for acceptance of an assurance engagement is that the criteria referred to in the definition are “suitable criteria” and available to intended users. Paragraphs 37-48 in this ISA discuss suitable criteria and their availability to intended users for an audit of financial statements through the auditor’s consideration of the acceptability of the financial reporting framework. The financial statements are prepared and presented by the management of the entity, with oversight from those charged with governance. The auditor is engaged for purposes of expressing an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. The objective of an audit, therefore, is to enable to auditor to express that opinion.

7. The overall objective of the auditor restates the objective of an audit in a way that can more readily be related to the auditor’s work and the requirements of ISAs. Their equivalence may be explained as follows. If the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework, then they must be free from material misstatement. If the auditor’s opinion is to be worthwhile, it must be supported by sufficient appropriate audit evidence, whereby the auditor obtains assurance about whether the financial statements are free from material misstatement; the level of assurance required by ISAs is that described as reasonable assurance. The opinion is expressed in a report from the auditor.

8. The objective of an audit cannot be fulfilled unless the auditor achieves the overall objective stated in paragraph 4. In all cases when the overall objective of the auditor has not been or cannot be achieved, the ISAs require that the auditor modifies the auditor’s report accordingly or withdraws from the engagement.

Definitions

9. For purposes of the ISAs, the following terms have the meanings attributed below:

- (a) Audit evidence – All of the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements, and other information.
- (b) Audit risk – The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated.¹⁶
- (c) Detection risk – The risk that the auditor’s procedures will not detect a misstatement that exists ~~in an assertion~~ that could be material, individually or when aggregated with other misstatements.
- (d) Financial statements – A structured representation of the financial information, which ordinarily includes accompanying notes, derived from accounting records and intended to communicate an entity’s economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The term can refer to a complete set of financial statements, ~~or but it can also refer to a single financial statement¹⁷, for example, a balance sheet, or a statement of revenues and expenses, and related explanatory notes.~~
- (e) Misstatement – A difference, arising from fraud or error, between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. When the auditor expresses an opinion on whether the financial statements give a true and fair view or are presented fairly, in all material respects, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the auditor’s judgment, are necessary for the financial statements to give a true and fair view or present fairly, in all material respects.
- (f) Reasonable assurance – ~~In the context of an audit of financial statements,~~ a high, but not absolute, level of assurance, ~~expressed positively in the auditor’s report as reasonable assurance, that about whether~~ the financial statements ~~information~~ subject to audit is free ~~from~~ material misstatement.
- (g) Risk of material misstatement – The risk that the financial statements are materially misstated. This risk consists of two components, described as follows at the assertion level:
 - Inherent risk – The susceptibility of an assertion to a misstatement that could be material, either individually or when aggregated with other misstatements, assuming that there are no related controls.

¹⁶ This definition does not include the risk that the auditor might erroneously express an opinion that the financial statements are materially misstated.

¹⁷ Examples of a single financial statement are listed in the Appendix of this ISA [not shown in this version].

- Control risk – The risk that a misstatement could occur in an assertion and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

Requirements

Ethical Requirements Relating to an Audit of Financial Statements

104. The auditor ~~shall~~ should comply with relevant ethical requirements, including those pertaining to independence, relating to audit engagements. (Ref: Para. A37-A38)

Professional Skepticism

1145. The auditor ~~shall~~ should plan and perform an audit with an attitude of professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated. (Ref: Para. A39-A40)

Conduct of an Audit ~~of Financial Statements~~ in Accordance with ISAs

- ~~6. The auditor should conduct an audit in accordance with International Standards on Auditing.~~
- ~~7. ISAs contain basic principles and essential procedures together with related guidance in the form of explanatory and other material, including appendices. The basic principles and essential procedures are to be understood and applied in the context of explanatory and other material that provide guidance for their application. The text of a whole Standard is considered in order to understand and apply the basic principles and essential procedures.~~
- ~~8. In conducting an audit in accordance with ISAs, the auditor is also aware of and considers International Auditing Practice Statements (IAPSS) applicable to the audit engagement. IAPSS provide interpretive guidance and practical assistance to auditors in implementing ISAs. An auditor who does not apply the guidance included in a relevant IAPS needs to be prepared to explain how the basic principles and essential procedures in the Standard addressed by the IAPS have been complied with.~~
12. The ISAs are together designed to support the achievement of the auditor's overall objective and accordingly, the auditor shall comply with all ISAs relevant to the audit. An ISA is relevant when the ISA is in force and the circumstances addressed by the ISA exist. The auditor shall consider the entire text of each such ISA. (Ref: Para. A41-A48)

Scope of an Audit of Financial Statements

- ~~10. The term "scope of an audit" refers to the audit procedures that, in the auditor's judgment and based on the ISAs, are deemed appropriate in the circumstances to achieve the objective of the audit.~~
- ~~11. In determining the audit procedures to be performed in conducting an audit in accordance with International Standards on Auditing, the auditor should comply with each of the International Standards on Auditing relevant to the audit.~~
- ~~14. The auditor should not represent compliance with International Standards on Auditing unless the auditor has complied fully with all of the International Standards on Auditing relevant to~~

~~the audit. The auditor may, in exceptional circumstances, judge it necessary to depart from a basic principle or an essential procedure that is relevant in the circumstances of the audit, in order to achieve the objective of the audit. In such a case, the auditor is not precluded from representing compliance with ISAs, provided the departure is appropriately documented as required by ISA 230 (Revised), “Audit Documentation.”~~

13. In conducting an audit in accordance with ISAs, the auditor shall aim to achieve the objectives set out in the individual ISAs, having regard to the interrelationships amongst the ISAs. For this purpose, the auditor shall use the objectives to judge whether, having complied with the requirements of the ISA, any further audit evidence is necessary in the context of the overall objective of the auditor. Where an individual objective has not been or cannot be achieved, the auditor shall consider whether the circumstances prevent the auditor from achieving the auditor’s overall objective. (Ref: Para. A49-A50)
14. In conducting an audit in accordance with ISAs, the auditor shall:
 - (a) Understand and apply the requirements (contained in a separate section in each ISA and expressed using the word “shall”) in the context of the other material included in the ISA; and
 - (b) Comply with the requirements of an ISA in all cases where they are relevant in the circumstances of the audit, unless, in exceptional circumstances, the auditor judges it necessary to depart from a relevant requirement by performing alternative audit procedures to achieve the aim of that requirement. (Ref: Para. A51-A52)

* * *

Application and Other Explanatory Material

General Concepts Relevant to an Audit of Financial Statements (Ref: Para. 5)

Independence

- A1. The independence of both the firm and the auditor from the entity whose financial statements are subject to audit allows the auditor to form an audit opinion without being affected by influences that might compromise the auditor’s integrity, objectivity and professional judgment. To reinforce independence, the auditor is subject to ethical requirements relating to audits of financial statements.
- A2. The concept of independence refers both to the state of mind of the auditor and, because of the relevance of an audit of financial statements to a wide range of users in particular, independence in appearance. The concept does not mean to imply that an auditor ought to be free from all economic, financial and other relationships; this is impossible as every member of society has relationships with others. Rather, it is the significance of the economic, financial and other relationships, considered in light of what a reasonable and informed third party having knowledge of all relevant information would reasonably conclude to be unacceptable.

Reasonable Assurance

17. ~~An auditor conducting an audit in accordance with ISAs obtains reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a concept relating to the accumulation of the audit evidence necessary for the auditor to conclude that there are no material misstatements in the financial statements taken as a whole. Reasonable assurance relates to the whole audit process.~~
- A418. The auditor's overall objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance relates to the whole audit process, and is a high level of assurance. An auditor cannot, however, obtain absolute assurance. This is because there are inherent limitations in an audit that affect the auditor's ability to detect material misstatements, whether due to fraud or error. 21. Accordingly, Bbecause of these limitations (described below)the factors described above, an audit is not a guarantee that the financial statements are free from material misstatement due to fraud or error, because absolute assurance is not attainable. Further, an audit opinion does not assure the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity. Consequently, some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with ISAs.¹⁸
- A423. The auditor obtains and evaluates audit evidence to obtain reasonable assurance about whether the financial statements give a true and fair view or are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. The concept of reasonable assurance therefore acknowledges the concept of that there is a risk the audit opinion is inappropriate. The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated is known as "audit risk," and may be regarded as its mathematical complement. 24. The auditor should plan and perform the audit to reduce audit risk to an acceptably low level that is consistent with the objective of an audit. The auditor reduces audit risk by designing and performing audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base an audit opinion. Reasonable assurance is obtained when the auditor has reduced audit risk to an acceptably low level. Audit risk is reduced by obtaining appropriate audit evidence; that audit evidence is sufficient when audit risk has been reduced to an acceptably low level.

Inherent Limitations of an Audit

- A5. There are several factors that give rise to the inherent limitations of an auditresult from factors. The following describes the principal such factors—such as the following:

¹⁸ 21.2 That is, Fthe subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not, in and of itself, indicate a failure to comply conduct an audit in accordance with ISAs. Whether the auditor has performed an audit in accordance with ISAs is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor's report based on an evaluation of that evidence.

- A6. ~~The use of testing.~~ Foremost, there is an expectation that the auditor will form an opinion on the financial statements within a reasonable period of time and at a reasonable cost. Underlying this expectation is the understanding that the auditor is not expected to address all information that may exist or to pursue every matter exhaustively on the assumption that information is in error or fraudulent until proved otherwise.
- A7. ~~One of the most important consequences of this expectation is that an audit requires the use of testing by using sampling approaches and other means of selecting items for testing. While it is well recognised that sampling may give the sampler a high degree of confidence in the results of the sample, nevertheless it is inevitable that there is a risk that the sample results may lead to an invalid conclusion.~~
- A8-19.1 ~~Similarly~~ Further, an audit ~~performed in accordance with ISAs~~ rarely involves the authentication of documents, nor is the auditor trained as or expected to be an expert in such authentication. Accordingly, unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine. However, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement (i.e., fraud) that ~~is concealed through collusion between or among one or more individuals among management, those charged with governance, employees, or third parties, or that involves, for example, falsified documentation,~~ which may cause the auditor to believe that audit evidence is valid persuasive when it is not, in fact, false. Because of these risks, ISA 240, “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements” contains specific requirements designed to assist the auditor in reducing them. ~~Unless the auditor has reason to believe the contrary, for example if conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, the auditor may accept records and documents as genuine.~~
- A9. ~~The inherent limitations of internal control (for example, the possibility of management override or collusion). In addition, the evidence available to the auditor includes information about the entity’s internal control. ISAs provide the conditions under which the auditor is required to, or may choose to, test the operating effectiveness of controls in determining the extent of substantive procedures to be performed. However, internal control, no matter how well designed and operated, can provide an entity with only reasonable assurance about achieving the entity’s financial reporting objectives, because of the limitations inherent in internal control. These include, for example, the possibility of human errors or mistakes and that controls may be circumvented by collusion or inappropriate management override. Neither the entity nor the auditor can overcome fully such inherent limitations.~~
- A10. ~~The fact that most audit evidence is persuasive rather than conclusive. Because of the above, and because of the nature of audit evidence and evidence gathering procedures, it is necessary for the auditor to form an opinion based on audit evidence that is persuasive rather than conclusive. However, while it is not possible to obtain conclusive evidence, it must be sufficient and appropriate to reduce audit risk to an acceptably low level.~~
- A11. ~~19 Use of judgment. Also~~ Further, the work undertaken by the auditor to form an audit opinion is permeated by professional judgment, in particular regarding decisions about materiality

~~and audit risk, the gathering of audit evidence, for example, in deciding the~~ the nature, timing and extent of audit procedures used to gather audit evidence, and the drawing of conclusions based on the audit evidence gathered, ~~for example, assessing the reasonableness of the estimates made by management in preparing the financial statements.~~ Judgment is also required by management in applying, and by the auditor in reviewing the application of, the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. Though professional judgment is an essential feature of auditing, it nevertheless contributes to the inherent limitations of an audit.

- A12. An audit is also necessarily limited by its objective, which is an expression of an opinion on the financial statements. For example, an audit opinion does not assure the future viability of the entity or the efficiency or effectiveness with which management has conducted the affairs of the entity.
- ~~20. Further, other limitations may also affect the persuasiveness of audit evidence available to draw conclusions on particular assertions (for example, transactions between related parties). In these cases certain ISAs identify specified audit procedures which will, because of the nature of the particular assertions, provide sufficient appropriate audit evidence in the absence of: (a) Unusual circumstances which increase the risk of material misstatement beyond that which would ordinarily be expected; or (b) Any indication that a material misstatement has occurred.~~

Professional Judgment

- A13. Professional judgment is essential to the proper conduct of an audit. The value of professional judgment is a function of both its importance and its quality, and each of these depends on the other. Professional judgment may be described in auditing as the application of relevant knowledge and experience, with an attitude of professional skepticism and within the context provided by auditing, accounting and ethical standards, in reaching decisions.
- A14. The importance of the proper exercise of professional judgment lies in the fact that no rule of general application can be phrased to suit all circumstances or combination of circumstances that may arise, nor is there any substitute for the exercise of professional judgment in the determination of what constitutes the appropriate action in a particular case.

Sufficiency and Appropriateness of Audit Evidence

- A15. Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits and a firm's quality control procedures for client acceptance and continuance. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. Most of the auditor's work in forming the audit opinion consists of obtaining and evaluating audit evidence.
- A16. Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the risk of misstatement (the higher the risk, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality,

the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality.

- A17. Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for, or detecting misstatements in, the financial statements. The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.
- A18. The sufficiency and appropriateness of audit evidence are interrelated. Whether sufficient appropriate audit evidence has been obtained during the evidence gathering process to enable the auditor to draw reasonable conclusions on which to base the audit opinion is a matter for the auditor to determine using professional judgment.

~~Audit Risk and Materiality and Audit Risk~~

- ~~22. Entities pursue strategies to achieve their objectives, and depending on the nature of their operations and industry, the regulatory environment in which they operate, and their size and complexity, they face a variety of business risks. Management is responsible for identifying such risks and responding to them. However, not all risks relate to the preparation of the financial statements. The auditor is ultimately concerned only with risks that may affect the financial statements.~~
- A1926. Material misstatements in the financial statements can arise from fraud or error. The auditor is concerned with material misstatements, and is not responsible for the detection of misstatements that are not material to the financial statements taken as a whole. In general, misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial information. The concept of materiality is used both in planning and performing the audit, and in evaluating the effect of identified misstatements on the financial information and the related auditor's report. The auditor considers whether the effect of identified uncorrected misstatements, both individually and in the aggregate, is material to the financial statements taken as a whole. Materiality and audit risk are related (see ISA 320, "Audit Materiality"). In order to design audit procedures to determine whether there are misstatements that are material to the financial statements taken as a whole, the auditor considers the risk of material misstatement at two levels: the overall financial statement level and in relation to classes of transactions, account balances, and disclosures and the related assertions.
- A2025. Audit risk is a function of the risk of material misstatement of the financial statements (or simply, the "risk of material misstatement") (i.e., the risk that the financial statements are materially misstated prior to audit) and the risk that the auditor will not detect such misstatement ("detection risk"), the assessment of which is a judgment rather than a precise measurement of risk. The auditor performs audit procedures to assess the risk of material misstatement and seeks to limit detection risk by performing further audit procedures based on that assessment (see ISA 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement" and ISA 330, "The Auditor's Procedures in Response to Assessed Risks"). The audit process involves the exercise of professional judgment in designing the audit approach, through focusing on what can go wrong (i.e., what

~~are the potential misstatements that may arise) at the assertion level (see ISA 500, “Audit Evidence”) and performing audit procedures in response to the assessed risks in order to obtain sufficient appropriate audit evidence. The risk of material misstatement may exist at two levels: at the overall financial statement level, and in relation to classes of transactions, account balances, and disclosures and the related assertions.~~

~~A2127. The auditor considers the r~~Risk of material misstatement at the overall financial statement level, ~~which~~ refers to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions. ~~Risks of this nature often relate to the entity’s control environment (although these risks may also relate to other factors, such as declining economic conditions), and are not necessarily risks identifiable with specific assertions at the class of transactions, account balance, or disclosure level. Rather, this overall risk represents circumstances that increase the risk that there could be material misstatements in any number of different assertions, for example, through management override of internal control. Such risks may be especially relevant to the auditor’s consideration of the risk of material misstatement arising from fraud. The auditor’s response to the assessed risk of material misstatement at the overall financial statement level includes consideration of the knowledge, skill, and ability of personnel assigned significant engagement responsibilities, including whether to involve experts; the appropriate levels of supervision; and whether there are events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern.~~

~~A2228. The auditor also considers the r~~Risk of material misstatement at the class of transactions, account balance, and disclosure level need to be considered because such consideration directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level necessary. ~~The auditor seeks to obtain sufficient appropriate audit evidence at the class of transactions, account balance, and disclosure level and thereby in such a way that enables the auditor, at the completion of the audit, to express an opinion on the financial statements taken as a whole at an acceptably low level of audit risk. Auditors use various approaches to accomplish that objective.~~¹⁹

~~A2329. The discussion in the following paragraphs provides an explanation of the components of audit risk.~~The risk of material misstatement at the assertion level consists of two components: as follows: inherent risk; and control risk. ~~30.~~Inherent risk and control risk are the entity’s risks; they exist independently of the audit of the financial statements. ~~The auditor is required to assess the risk of material misstatement at the assertion level as a basis for further audit procedures, though that assessment is a judgment, rather than a precise measurement of risk. When the auditor’s assessment of the risk of material misstatement includes an expectation of the operating effectiveness of controls, the auditor performs tests of controls to support the risk assessment.~~

¹⁹ The auditor may make use of a model that expresses the general relationship of the components of audit risk in mathematical terms to arrive at an appropriate level of detection risk. Some auditors find such a model to be useful when planning audit procedures to achieve a desired audit risk though the use of such a model does not eliminate the judgment inherent in the audit process.

- A24. ~~“Inherent risk” is the susceptibility of an assertion to a misstatement that could be material, either individually or when aggregated with other misstatements, assuming that there are no related controls. The risk of such misstatement is higher greater~~ for some assertions and related classes of transactions, account balances, and disclosures than for others. For example, ~~it may be higher for~~ complex calculations ~~or for are more likely to be misstated than simple calculations.~~ Accounts consisting of amounts derived from accounting estimates that are subject to significant measurement uncertainty ~~pose greater risks than do accounts consisting of relatively routine, factual data.~~ External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement. In addition to those circumstances that are peculiar to a specific assertion, factors in the entity and its environment that relate to several or all of the classes of transactions, account balances, or disclosures may influence the inherent risk related to a specific assertion. These latter factors include, for example, a lack of sufficient working capital to continue operations or a declining industry characterized by a large number of business failures.
- A25. ~~“Control risk” is the risk that a misstatement that could occur in an assertion and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity’s internal control. That risk~~ is a function of the effectiveness of the design and operation of internal control in achieving the entity’s objectives relevant to preparation of the entity’s financial statements. Some control risk will always exist because of the inherent limitations of internal control.
- A26. The ISAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the “risk of material misstatement.” ~~However~~ ~~Although the ISAs ordinarily describe a combined assessment of the risk of material misstatement,~~ the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risk of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.
- A27~~31.~~ ~~“Detection risk” is the risk that the auditor will not detect a misstatement that exists in an assertion that could be material, either individually or when aggregated with other misstatements.~~ Detection risk relates to the nature, timing, and extent of the auditor’s procedures that are determined by the auditor to reduce audit risk to an acceptably low level. It is therefore a function of the effectiveness of an audit procedure and of its application by the auditor. ~~32. Detection risk relates to the nature, timing, and extent of the auditor’s procedures that are determined by the auditor to reduce audit risk to an acceptably low level.~~ For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessment of the risk of material misstatement at the assertion level. The greater the risk of material misstatement the auditor believes exists, the less the detection risk that can be accepted. Conversely, the less risk of material misstatement the auditor believes exist, the greater the detection risk that can be accepted.

A28. ~~Detection risk cannot be reduced to zero because of the inherent limitation of an audit and the auditor usually does not examine all of a class of transactions, account balance, or disclosure and because of~~ other factors. Such other factors include the possibility that an auditor might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results. These other factors ordinarily can be addressed through adequate planning, proper assignment of personnel to the engagement team, the application of professional skepticism, and supervision and review of the audit work performed.

A2921.1 ~~Material misstatements in the financial statements can arise from fraud or error.~~ The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting a material misstatement resulting from error because fraud may involve sophisticated and carefully organized schemes to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor, with such concealment made even more difficult to detect when accompanied by collusion. Further, the risk of not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because management is frequently in a position to manipulate accounting records, present fraudulent financial information or override control procedures designed to prevent similar frauds by other employees.

Responsibility for the Financial Statements

A3033²⁰. ~~ISAs do not impose responsibilities on management and those charged with governance, and do not override laws and regulations that govern their responsibilities. However, underlying the concept of an independent audit is that the financial statements subject to audit are those of the entity, with~~ While the auditor ~~engaged for purposes of~~ is responsible for forming and expressing an opinion on the ~~m financial statements.~~ Accordingly, the ISAs are ~~written on the basis that~~ the responsibility for the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework, ~~including activities necessary for that purpose, as described further below,~~ is that of the management of the entity, with oversight from those charged with governance.²¹ ~~Where such responsibilities are not established by law or regulation, or not accepted by management and those charged with governance absent such law or regulation, the auditor may be unable to conduct an audit in accordance with ISAs.~~ The audit of the financial statements does not relieve management and those charged with governance of their responsibilities.

A3133.4 ~~In accordance with the above m~~ Management, with oversight from those charged with governance, is responsible for establishing a control environment and for ~~designing, implementing establishing~~ and maintaining controls ~~sufficient to enable them pertaining to the preparation of~~ the entity's financial statements and managing risks that may give rise to material misstatements, ~~whether due to fraud or error,~~ in those financial statements. Such

²⁰ [Note: The ISA 580 Task Force is considering wording that may be relevant to this paragraph, as it considers the issue of the nature and scope of management representations.]

²¹ The terms "management" and "those charged with governance" are described in ISA 260, "Communications with Those Charged with Governance."

controls reduce but do not eliminate the risks of misstatement. ~~33.2~~ Those charged with governance of the entity are responsible for ensuring, through oversight of management, that the entity designs, implements establishes and maintains internal control over to provide reasonable assurance with regard to the reliability of financial reporting, ~~effectiveness and efficiency of operations and compliance with applicable laws and regulations.~~

[**Note:** Paragraphs A32-A36 are held as placeholder for extant paragraphs ISA 200.34-51 and material relating to management's responsibilities for preparing and presenting the financial statements in accordance with the applicable financial reporting framework. That material is under consideration by the IAASB ISA 800 Task Force, the revision of which is scheduled for discussion by the IAASB in September.]

Ethical Requirements Relating to an Audit of Financial Statements (Ref: Para. 10)

A375. As discussed in ISA 220, "Quality Control for Audits of Historical Financial Information," ethical requirements relating to audits of financial statements ordinarily comprise Parts A and B of the International Federation of Accountants' Code of Ethics for Professional Accountants (IFAC Code) together with national requirements that are more restrictive.

A38. ISA 220 identifies the fundamental principles of professional ethics established by Parts A and B of the IFAC Code and sets out the engagement partner's responsibilities with respect to ethical requirements. ISA 220 recognizes that the engagement team is entitled to rely on a firm's systems in meeting its responsibilities with respect to quality control procedures applicable to the individual audit engagement ~~(for example, in relation to capabilities and competence of personnel through their recruitment and formal training; independence through the accumulation and communication of relevant independence information; maintenance of client relationships through acceptance and continuance systems; and adherence to regulatory and legal requirements through the monitoring process)~~, unless information provided by the firm or other parties suggests otherwise. Accordingly, International Standard on Quality Control (ISQC) 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements," requires the firm to establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements.

Professional Skepticism (Ref: Para. 11)

A3946. ~~Professional skepticism is a concept relating to the accumulation and assessment of the audit evidence.~~ An attitude of professional skepticism involves the ~~means the auditor makes a~~ critical assessment, with a questioning mind, of the validity of audit evidence obtained, recognizing that circumstances may exist that cause the financial statements to be materially misstated, and being ~~and is~~ alert to audit evidence that contradicts or brings into question the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. ~~For example, a~~ Maintaining an attitude of professional skepticism ~~is necessary~~ throughout the audit ~~process is necessary if for~~ the auditor is, for example, to reduce the risk of overlooking unusual circumstances, of over generalizing when drawing conclusions from audit observations, and of using faulty

assumptions in determining the nature, timing and extent of the audit procedures and evaluating the results thereof.

~~A40. When making inquiries and performing other audit procedures, the auditor is not satisfied with less-than-persuasive audit evidence based on a~~ belief that management and those charged with governance are honest and have integrity ~~does not relieve the auditor from maintaining an attitude of professional skepticism or allow the auditor to be satisfied with less-than-persuasive audit evidence. Accordingly, representations from management are not a substitute for obtaining sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.~~

Conduct of an Audit in Accordance with ISAs

Nature of ISAs (Ref: Para. 12)

~~A41. ISAs, taken together, provide the standards for the auditor's work in fulfilling the objective of an audit. The ISAs deal with the general responsibilities of the auditor, as well as the auditor's further considerations relevant to the application of those responsibilities to specific topics. The nature of the ISAs requires the auditor to exercise professional judgment in applying them.~~

~~A42. ISAs contain objectives and requirements together with related guidance in the form of application and other explanatory material, and may contain introductory material and definitions that provide context essential to a proper understanding of the ISA:~~

- ~~• The objective or objectives in each ISA provide the context in which the requirements of the ISA are set. These objectives support the overall objective of the auditor set out in paragraph 4 of this ISA.~~
- ~~• The requirements (contained in a separate section in each ISA and expressed using the word "shall") are designed to assist the auditor in meeting the objectives specified in the ISA and thereby, the overall objective of the auditor.~~
- ~~• The application and other explanatory material is an integral part of the ISA, as it provides further explanation of, and guidance for carrying out, the requirements of an ISA, along with background information on the matters addressed in the ISA. It may include examples of procedures, some of which the auditor may judge to be appropriate in the circumstances. Such guidance is, however, not intended to impose a requirement.~~
- ~~• Appendices, which form part of the application and other explanatory material, are an integral part of an ISA. The purpose and intended use of an appendix are clearly explained in the body of the related ISA or within the title and introduction of the appendix itself.~~
- ~~• Introductory material may include, as needed, such matters as explanation of: the purpose and scope of the ISA, including how the ISA relates to other ISAs; the subject matter of the ISA; specific expectations on the auditor and others; and the context in which the ISA is set.~~

- An ISA may include, in a separate section under the heading 'Definitions', a description of the meanings attributed to certain terms for purposes of the ISAs. These are provided to assist in the consistent application and interpretation of the ISAs, and are not intended to override definitions that may be established for other purposes, whether in law, regulation or otherwise. Meanings of individual terms are provided only in those ISAs that deal principally with the subject matter to which the terms are most relevant. Unless otherwise indicated, those terms will carry the same meanings throughout the ISAs. The Glossary of Terms in the Handbook contains a complete listing of terms defined in the ISAs. It also includes description of other terms found in ISAs to assist in common and consistent interpretation and translation.

A43. The scope, effective date and any specific limitation of the applicability of a specific ISA is made clear in the ISA. Unless otherwise stated in the ISA, the auditor is permitted to apply an ISA before the effective date specified therein.

A44~~12~~. In performing an audit, auditors may be required to comply with other professional, legal or regulatory requirements in addition to the ISAs. The ISAs do not override ~~the local~~ laws and regulations that govern an audit of financial statements. In the event that those laws and regulations differ from the ISAs, an audit conducted only in accordance with ~~the local~~ laws and regulations will not automatically comply with ISAs.

A45~~9~~. The auditor may also conduct the audit in accordance with both ISAs and auditing standards of a specific jurisdiction or country. ~~13~~. When the auditor conducts the audit in accordance with ISAs and auditing standards of a specific jurisdiction or country, in addition to complying with each of the ISAs relevant to the audit, it may be necessary for the auditor to ~~also performs any~~ additional audit procedures in order necessary to comply with the relevant standards of that jurisdiction or country.

Considerations Specific to Audits in the Public Sector ~~Perspective~~

A46. ISAs are applicable to engagements in the public sector. When additional guidance is appropriate for the public sector, such guidance is included within the body of an ISA.

A47~~1~~. Irrespective of whether an audit is being conducted in the private or public sector, the basic principles of auditing remain the same. What may differ for audits carried out in the public sector is the audit objective and scope. These factors are often attributable to differences in the audit mandate and legal requirements or the form of reporting (for example, public sector entities may be required to prepared additional financial reports).

A48~~2~~. ~~When carrying out audits of public sector entities, the auditor will need to take into account the s~~Specific requirements of any other relevant regulations, ordinances or ministerial directives may which affect the audit mandate and may include any special auditing requirements, including the need to have regard to issues of national security. Audit mandates may be more specific than those in the private sector, and often encompass a wider ranged of objectives and a broader scope than is ordinarily applicable in for the audit of the private sector ~~financial statements~~. The mandates and requirements may also ~~ea~~ffect, for example, the extent of the auditor's discretion in establishing materiality, in reporting fraud and error, and in the form of the auditor's report. ~~Differences in audit approach and style may also~~

~~exist.~~ However, these differences would not constitute a difference in the overall objective of the auditor~~the basic principles and essential procedures.~~

Objectives (Ref: Para. 13)

- A49. The objectives in individual ISAs provide a link between the requirements and the overall objective of the auditor, having regard to the need for the auditor to obtain reasonable assurance through gathering sufficient appropriate audit evidence.
- A50. The auditor's judgment about whether an objective has been achieved and the need to obtain further audit evidence in the context of the auditor's overall objective is made having regard to the fact that some ISAs deal with the general responsibilities of the auditor, while others address the auditor's further considerations relevant to the application of those responsibilities to specific topics. The ISAs are therefore interrelated, and the auditor bears this in mind in making the necessary judgments.

Compliance with Relevant Requirements (Ref: Para. 14(b))

- A51. The auditor is required to comply with the requirements of an ISA in all cases where they are relevant in the circumstances of the audit. In exceptional circumstances, however, the auditor may judge it necessary to depart from a relevant requirement to achieve the aim of that requirement. The need for the auditor to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective. In such circumstances, the auditor needs to perform alternative audit procedures that achieve the aim of that requirement. ISA 230, "Audit Documentation" establishes documentation requirements in those circumstances where the auditor departs from a requirement.
- A52. A requirement is not relevant only in the cases where:
- The ISA is not relevant (e.g., in a continuing engagement, nothing in ISA 510, "Initial Engagements—Opening Balances," is relevant); or
 - The circumstances envisioned do not apply because the requirement is conditional and the condition does not exist (e.g., the requirement to modify the auditor's report where there is a limitation of scope).

The auditor is not required to apply a requirement that is not relevant in the circumstances of the audit; this does not constitute a departure from the requirement.