

THE IAASB

RELEVANT TO ACCA QUALIFICATION PAPERS F8 AND P7 AND CAT

The International Auditing and Assurance Standards Board's (IAASB) Clarity Project has resulted in a new set of 'clarified' standards which are effective for audits of financial statements for periods beginning on or after 15 December 2009. This article provides a summary of the reasons for, and effects of, the Clarity Project from an international and a UK and Ireland perspective.

Background to the Clarity Project
In 2004, the IAASB began a comprehensive programme to enhance the clarity of its International Standards on Auditing (ISAs). The broad aim of the project was to enhance the understandability of the ISAs, which should encourage consistent application and lead to an improvement in audit quality worldwide. In addition to this enhanced understandability, many of the ISAs have been revised, resulting in substantive changes to the contents of the ISAs. A summary of the changes introduced by the Clarity Project are as follows:

- 19 ISAs and ISQC 1 have been redrafted to apply the new Clarity conventions and format (see discussion below) – these are referred to as 'Redrafted ISAs'
- 16 ISAs contain new and revised requirements, in addition to being redrafted to apply the new Clarity conventions and format – these are referred to as 'Revised and Redrafted ISAs'
- A standard has been issued on a new topic – ISA 265 *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*.

What is meant by a 'Redrafted' standard?

Redrafted means that a standard has a new structure, in which information is presented in separate sections: Introduction, Objective, Definitions, Requirements, and Application and Other Explanatory Material. Each of these is described below.

Introduction

Introductory material may include information regarding the purpose, scope and subject matter of the ISA, in addition to the responsibilities of the auditors and others in the context in which the ISA is set.

Objective

Each ISA now contains a clear statement of the objective of the auditor in the audit area addressed by that ISA.

Definitions

For greater understanding of the ISAs, applicable terms have been defined in each ISA.

Requirements

Each objective is supported by clearly stated requirements. Requirements are always expressed by the phrase 'the auditor shall'.

Application and Other Explanatory Material

The application and other explanatory material explains more precisely what a requirement means or is intended to cover, or includes examples of procedures that may be appropriate under given circumstances.

What improvements are expected as a result of redrafted standards?

It is hoped that the new format should make it easier for the auditor to understand the overall objectives when conducting an audit, and to understand his or her obligation in relation to that objective. The language used in the ISAs should clarify what is expected of the auditor, eg use of the word 'shall' is not ambiguous and indicates that something is expected of the auditor.

CLARITY PROJECT

PAPER 8 (INT AND UK)

The fact that the same format and type of wording is used in each standard reflects the fact that the ISAs are very much interrelated, and should not be considered in isolation from each other.

The IAASB is confident that the clarification of the ISAs will contribute significantly to enhancing the quality and uniformity of audit practice worldwide. In addition, the monitoring of audit quality should be easier, as a clear benchmark for audit activity is provided by the more prescriptive nature of the standards.

Further, it is hoped that the clarification will assist in the adoption of ISAs around the world, and facilitate international convergence. For audit firms that operate internationally, harmonisation of auditing standards is a great benefit.

What is the impact of the 'Revised and Redrafted' ISAs?

'Revised and Redrafted' ISAs include new or changed requirements and guidance that aim to strengthen audit practice in a number of areas. The improvements also reflect the latest developments and thinking in reporting and auditing. Examples of areas that have been affected by the redrafting process include:

- Materiality in planning and performing an audit and its use in evaluating misstatements

THE IAASB IS CONFIDENT THAT THE CLARIFICATION OF THE ISAS WILL CONTRIBUTE SIGNIFICANTLY TO ENHANCING THE QUALITY AND UNIFORMITY OF AUDIT PRACTICE WORLDWIDE. A CLEAR BENCHMARK FOR AUDIT ACTIVITY WILL BE PROVIDED BY THE STANDARDS' MORE PRESCRIPTIVE NATURE.

- Risk assessment and the gathering and evaluation of audit evidence
- The audit of accounting estimates including fair value disclosures, related party relationships and transactions, and an entity's use of a third party service organisation
- Audit evidence in relation to external confirmations and written representations
- Using the work of others in relation to the audit of group financial statements, including the work of component auditors, and the work of an auditor's expert
- Communication with those charged with governance
- Communicating deficiencies in internal control
- Modifications to the auditor's opinion and the use of Emphasis of Matter paragraphs
- Audit and reporting considerations in the context of special engagements.

ISA 200 (Revised and Redrafted) *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing* sets out the conventions followed in the standards and the obligations of the auditors. It clarifies that the auditor is required to have an understanding of the entire text of an ISA to understand its objectives and to apply its requirements properly. It explains that, in addition to

ISAs containing objectives and requirements, they also contain guidance for carrying out those requirements. The guidance may explain more precisely what a requirement means, or include examples of procedures that may be appropriate in the circumstances.

This guidance is not intended to be read as a requirement, but is relevant to the proper application of the requirements of the ISA.

The UK and Ireland perspective

In 2004, the UK's Auditing Practices Board (APB) took the decision to base UK and Irish auditing standards on ISAs. One of the reasons for this alignment was to benefit from future improvements to them. In 2008, the APB published a consultation paper seeking views on whether UK and Irish auditing standards should be updated as a result of the IAASB's Clarity Project. The consultation indicated strong support for adopting the clarified ISAs. At the time of writing, the majority of the IAASB clarified ISAs are issued as Exposure Drafts in the UK and Ireland, following an APB announcement in March 2009 that it would update its auditing standards based on clarified ISAs, and that these standards would apply for audits of accounting periods ending on or after 15 December 2010.

An issue specific to the UK and Ireland is that of the supplementary requirements added to the ISAs, which were considered necessary either to ensure compliance with legislation or other regulations, or to maintain the requirements and meaning of the previous UK and Ireland Statements of Auditing Standards. The APB wishes to minimise the use of these supplementary requirements, and because of the improvements made to ISAs as a result of the Clarity Project, it is hoped that there will be a significant reduction in the number of supplementary requirements in the UK and Irish standards.

With regard to auditors' reports, the APB has issued its own UK and Ireland-specific version of ISA 700, *The Auditor's Report on Financial Statements*. This has been published to effect changes arising from the Companies Act 2006, and to make improvements which should result in the report becoming more concise and more informative. However, the APB is proposing to adopt the clarified ISAs 705 and 706, which deal with modifications to the auditor's report, emphasis of matter paragraphs and other matter paragraphs.

THE NEXT FEW YEARS WILL SEE A CHANGE IN AUDITING PRACTICE, TO AN APPROACH WHICH ENCOURAGES UNIFORMITY AND REDUCES THE SCOPE FOR DELIBERATE UNDER-AUDITING. AUDIT FIRMS SHOULD BE BEGINNING TO PLAN FOR THEIR CONVERGENCE TO THESE NEW STANDARDS.

Rules and principles

The clarified ISAs appear more rules-based in their approach, as the obligations and requirements of the auditor are more prescribed in the wording of the standards. The use of the word 'shall' indicates that a requirement is mandatory, and that the requirement must be carried out regardless of other factors, such as complexity, risk, size or cost. The argument in favour of this approach is that it will lead to consistent application of the ISAs, and enhanced audit quality, as discussed above.

However, some commentators have argued that this prescriptive approach will lead to problems, because the auditor is less free to exercise judgment. For example, it would be easy for a small entity with simple transaction cycles to be over-audited, as the auditor is forced to carry out requirements which may not be necessary in the circumstances. Equally, complex issues could be under-audited, if the requirements of an ISA have been met and the auditor is not compelled to perform additional work.

Practical considerations for audit firms

All audit firms must consider how they will be affected by the introduction of the clarified ISAs. Successful implementation of the clarified ISAs will need significant planning and monitoring by firms of all size. Some of the practical issues facing firms include:

- ▣ a review and update of the firm's audit methodologies, documentation, manuals and software
- ▣ a review of amendments needed to audit programmes and procedures
- ▣ development of training programmes for audit staff of all levels of seniority.

The measures outlined above, to ensure compliance with the clarified ISAs, is likely to be costly. Firms may need to consider passing on some of this cost to their clients through an increase in fees.

Conclusion

The IAASB is confident that, as a result of the Clarity Project, there should be a significant enhancement in the quality and consistency of audit practice worldwide. The adoption of the clarified ISAs around the world should help global auditing firms in particular, and will aid international harmonisation of auditing practice. The next few years will see a change in auditing practice, to an approach which encourages uniformity and reduces the scope for deliberate under-auditing. Audit firms should be beginning to plan for their convergence to these new standards.

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