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Dear Mr. Sylph

**Proposed Amendments to the Preface to the International Standards on Quality Control, Auditing, Assurance and Related Services and the four proposed redrafted ISAs (The Clarity project)**

The Committee of European Banking Supervisors welcomes the opportunity to comment on the IAASB Clarity project.

Through their opinions on annual accounts and annual reports, external auditors constitute an integral part of the public oversight model. As banking supervisors we therefore have an interest in ensuring that auditing standards, which are the basis for audit work, are of a high quality and are clear and capable of consistent application.

We support the Clarity project and its approach of setting an objective for each standard, separating the requirements from the application materials and improving the overall readability of the standards. However, based on our review of the four ISAs which had been redrafted under the Clarity project, and our understanding of the proposed changes to the preface, we believe that there are various aspects the Board should review in order to achieve the objectives of making the standards clearer and more robust.

In the attached note, we set out our answers to the questions raised in the explanatory memorandum.

Our comments were coordinated by our Expert Group on Accounting and Auditing (EGAA), and especially by its Sub-Working Group on Auditing, which is under the direction of Pat Sucher from the FSA, UK.

If you have any questions regarding our comments, please feel free to contact the chairman of EGAA, Prof Arnold Schilder (+31.20.524.3360), the deputy chairman of EGAA, Arnoud Vossen (+31.20.524.3903) or Miss Pat Sucher (+44.20.7066.5644).

Yours sincerely



Danièle Nouy  
Chair

## **Detailed comments**

### **Questions in the Exposure Draft (ED)**

#### **1. In light of the separation of requirement and application guidance, as presented in the four EDs, do you believe there is a need to repeat the requirements at relevant points within the application material to enhance context and reference?**

We do not support the repetition of the requirements in the application material as the repetition may convey the wrong message concerning the content of the ISAs. It would undermine the objectives based nature of the ISAs, which is a key, overriding strength of the ISAs. In addition, it may also confuse matters again regarding what is a requirement and what is application material.

Our arguments are strengthened by the obligation for professional accountants to consider the entire standard regulated in the paragraphs 18 and 22 in the revised preface. In paragraph 18 it is stated that. '*The professional accountant is required to consider the entire text of a Standard in carrying out work on an engagement.*' and in paragraph 22 the same obligation for the professional accountants is emphasized "*While the professional accountant has a responsibility to consider the whole<sup>1</sup> 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.*"

#### **2. Are the objectives to be achieved by the auditor stated at the beginning of the proposed ISAs appropriate?**

The objectives are a key strength of the ISA as, 'the professional accountant must achieve the objective stated at the beginning of each Standard that is relevant in the circumstances of the engagement', (paragraph 19 of the preface). Objectives, if properly phrased, can represent the overall principle of what the auditor is trying to achieve and therefore can cope with all the different situations that an auditor might face. Requirements should cover most situations, but it is necessary also to have a principle to guide the auditor in other situations that might arise.

It was not always clear what criteria the IAASB had used in developing the objectives. We would anticipate that objectives would be outcomes based – presenting the overall outcome that the auditor needs to achieve for that ISA. This would then fit with paragraph 19, which is a key paragraph in emphasising the objectives based nature of the ISAs. However, the objective laid out for ISA 300, for example, does not seem to reflect an outcome from planning the audit, but a process and it is unclear to us how the suggested objective could work with paragraph 19. We suggest that the objectives should reflect the need to use judgement over and above what is included in the requirements; otherwise they are effectively the same as requirements.

As an example, the objective 3 (a) in ISA 330 mainly reflects the requirement in paragraph 5 of that ISA. In other words it does not seem to reflect an overall objective, but rather a summary of requirements.

Without a complete review of all the objectives for all the ISAs it is difficult to ascertain whether the individual objective provided for the specific ISA is appropriate. For example, to what extent is there a need to refer to the overall objective of the audit in a particular ISA's objective? It is also clear that there are probably different levels of objectives for different ISAs depending on the focus of the ISA. For example, ISA 200 should provide the overall objective of the audit. Then there are the ISAs, which reflect the overall audit risk approach (ISA 315/320 & 330). Then there are those ISAs which relate to the audit process itself (e.g. ISA 300, 500), those that relate to specific parts of the audit (e.g. ISA 210; 550; 600). Finally, there is the audit reporting ISA.

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<sup>1</sup> To be consistent and to follow the rewording of the preface the word whole should be replaced by the word entire.

We appreciate that the IAASB will be reviewing all the redrafted ISAs to ensure that they are consistent, complete and free of overlap (Explanatory Memorandum: page 9). However, we believe it is necessary to ensure that the IAASB review, at an early stage, the objectives of all the ISAs together to make sure they constitute a coherent whole.

**3. Have the guidelines identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements are at a level, which promotes consistency in performance and the use of professional judgement by auditors?**

In general, there has been a reasonable application of the guidelines; however, we have identified some areas where we do not believe the guidelines have been applied consistently.

The use of explanatory material in the requirements section causes unnecessary ambiguity. Explanatory material is provided in two ways in the requirements section. There is provision of background material in individual paragraphs which contain no requirements e.g. paragraphs 5, 11 and 16 of ISA 315. Then there is provision of background material in paragraphs, which also include a requirement e.g. paragraph 15 of ISA 240 and paragraph 18 of ISA 330.

The inclusion of such material in the requirements section can be confusing as its status is unclear. For example, is such material implicitly also a requirement?

We would suggest that the IAASB should evaluate carefully whether it is necessary to include *any* explanatory material in the requirements section. If it is considered necessary, the criteria for including *any* explanatory material in the requirements section should be clearly presented and it should be clearly noted separately from any paragraphs containing requirements.

As a separate point, we note that the revised ISAs have five parts: Introduction, objective, definitions, requirements and application material. However, the inclusion of material in the different sections does not always seem to have been carried out in a consistent manner. We would suggest that a consistent approach is taken to the use of the introduction section. For example in ISA 240 there is a very long introduction covering material that could more usefully be included in the application material.

In addition, where there is a definitions section, to aid understanding, it would seem appropriate to include it before the introduction section as the introduction sometimes refers to definitions e.g. in ISA 240. It is also necessary to ensure that the definitions provided in these sections are the same as those provided in the glossary.

**4. Has the application material been edited in a way that makes it clearer?**

In general, the application material has been edited in a way that increases the clarity of the individual ISAs. However, we have noted an inconsistent approach in some cases to what is or is not included in the application material or requirements. For example, in ISA 330, paragraph 5 states that the auditor 'shall determine and implement overall responses....' And the detail of what those responses might be is now included in the application material. This may seem appropriate as the responses might change for different circumstances. However, in Para 21 & 22 of ISA 240 there is more detail in the requirements section regarding the nature of the overall responses.

We suggest that the IAASB should review the balance between the requirements and application materials sections to ensure there is a consistent approach.

**5. Has an appropriate balance been achieved between eliminating duplicative material and retaining some repetition in the proposed ISAs to help users understand a particular ISA or how the ISAs interrelate?**

Generally, repetition of one ISA in another seems to be unnecessary, as the ISAs should be read as a whole. If it is considered appropriate to remind professional accountants of the contents of another ISA, then a cross reference should suffice. However in some circumstances it may be helpful to repeat some paragraphs in the requirements section where two or more ISAs are intimately linked to each other e.g. paragraphs 13 & 19 of the revised ISA 240, which are also covered in ISA 200 and ISA 315 respectively.

**6. Do you support the manner in which special considerations in the audits of SMEs and public sector entities have been included in the application material?**

No comment

**7. Do respondents from developing nations foresee difficulties arising from the changes in the proposed ISAs in a developing nation's environment?**

No comment

**8. Do you foresee any potential translation issues?**

See answer to Q 10 about 'shall consider'.

**9. Do you agree with the proposed implementation approach (including priorities and timetable)?**

(a) Priorities

The Clarity project represents an important reorganisation of the ISAs, which should improve the quality of the ISAs. Therefore we would prefer the timetable was shortened and more resources were devoted to the Clarity project. Secondly, we would suggest that some of the ISAs included in Appendix 1, table IV should have a higher priority in the Clarity project.

Given developments in financial reporting and the increased number of companies following IFRS, it would seem remiss not to include ISA 545, Auditing Fair Value Measurements and Disclosures as a revised and then clarified ISA. In addition, ISA 570, Going Concern and ISA 250, Consideration of Laws and Regulations in an Audit of Financial Statements, should be prioritised, as they are ISAs, which are more fundamental to the work of an auditor of credit institutions. ISA 505, External confirmations is also a concern to us.

Furthermore, it is not clearly stated what will happen with the practice statements under the Clarity project. We would be prepared to work with you on IAPS 1006 to ensure that it can be updated and then revised in the clarity format.

(b) Process for sorting the ISAs in transition.

With the recently revised and updated ISAs, it is not clear that these will be re-exposed. Given they will be in the new format, we would suggest they are re-exposed. In addition, it would be helpful to have mapping documents for other clarified standards.

**10. Do you have any comments on the necessary changes to the Preface to reflect new drafting conventions?**

We do have several concerns about aspects of the Preface.

### *Placement of the Preface*

As the Preface includes key interpretations of how the ISAs should be applied, it is important that its contents are included directly in the ISAs, e.g. through inclusion in ISA 200.

### *Where relevant*

Paragraph 21 states; '*The requirements of a Standard are to be applied in all cases where they are relevant in the circumstances of the engagement.*' We are unclear whether the 'where relevant' issue for ISAs and requirements in ISAs have been addressed correctly in this paragraph. Paragraph 21 seems to imply that the 'where relevant' aspect applies to individual requirements. For a high quality audit of the credit institutions we supervise, we believe it is necessary that the 'where relevant' should apply to the ISA itself. We have the same concern about paragraph 17.

If it is considered that a requirement may not be relevant in a particular audit assignment, there should be clear, reasonable, documentation requirements to justify the reason it is not relevant. However, we are unclear what examples could be provided here given the IAASB guideline of only including requirements in the ISAs when they are expected to be applicable in virtually all engagements.

Alternatively, if the 'not relevant' should only apply to an ISA, not the requirement, paragraphs 17 & 21 need rewording.

### *Shall consider*

It is stated in the preface, paragraph 20, that 'shall consider' = the consideration is required not the action. We are not clear whether this will provide clarity to auditors. It seems to us that the phrase 'shall consider' is used in different ways in the text of the ISAs and this may cause confusion about the necessary documentation requirements.

In some circumstances, 'shall consider' means judging when there are alternative courses of action e.g. the practitioner needs to reflect on what (or what not) to do – and this reflection should be documented so it is clear why the auditor has or has not done something. Here the result is an action or not. E.g. ISA 240 paragraph 26.

In other circumstances, as used in an ISA, it means 'determine whether' or 'assess' and there would be audit results from the consideration itself. E.g. in ISA 315 para 12c, '*The auditor shall consider whether the entity's accounting policies are appropriate for its business and consistent with the applicable accounting framework and accounting policies used in the industry.*' The action here is the 'shall consider' or rather 'assess'; there is not a choice of actions.

This confusion of definition of 'shall consider' will then feed through into the documentation requirements. The mixture of the two uses of 'shall consider' continues to add ambiguity to the ISAs. Assuming the IAASB continues with the use of 'shall consider' then it should seek to ensure that it is only used in one manner, not both.

In addition, the phrase 'shall consider', as it is used in different ways, may cause problems on translation.

### *Transitional approach*

In paragraph 17, which deals with the situation with 'unclarified ISAs', it is stated that auditors are allowed to depart from a principle or essential procedure if they can achieve the purpose of that (principle or essential procedure) in some other way. However, is it always clear what the purpose is under the old ISAs e.g. the requirements of ISA 720?