

*Revised and Redrafted International Standard on  
Auditing*

---

ISA 200, Overall Objectives of the  
Independent Auditor and the Conduct  
of an Audit in Accordance with  
International Standards on Auditing

*Conforming Amendments*

---

Preface to the International Standards  
on Quality Control, Auditing, Review,  
Other Assurance and Related Services

Other ISAs



International Auditing and Assurance Standards Board  
International Federation of Accountants  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, New York 10017 USA

This International Standard on Auditing (ISA) 200 (Revised and Redrafted), “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing” was prepared by the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting body within the International Federation of Accountants (IFAC). The objective of the IAASB is to serve the public interest by setting high quality auditing and assurance standards and by facilitating the convergence of international and national standards, thereby enhancing the quality and uniformity of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

This publication may be downloaded free of charge from the IFAC website: <http://www.ifac.org>. The approved text is published in the English language.

The mission of IFAC is to serve the public interest, strengthen the worldwide accountancy profession and contribute to the development of strong international economies by establishing and promoting adherence to high quality professional standards, furthering the international convergence of such standards and speaking out on public interest issues where the profession’s expertise is most relevant.

Copyright © October 2008 by the International Federation of Accountants (IFAC). All rights reserved. Permission is granted to make copies of this work provided that such copies are for use in academic classrooms or for personal use and are not sold or disseminated and provided that each copy bears the following credit line: “*Copyright © October 2008 by the International Federation of Accountants (IFAC). All rights reserved. Used with permission of IFAC. Contact [permissions@ifac.org](mailto:permissions@ifac.org) for permission to reproduce, store or transmit this document.*” Otherwise, written permission from IFAC is required to reproduce, store or transmit, or to make other similar uses of, this document, except as permitted by law. Contact [permissions@ifac.org](mailto:permissions@ifac.org).

ISBN: 978-1-934779-53-8

## CONTENTS

---

	Page
International Standard on Auditing (ISA) 200 (Revised and Redrafted), “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing” .....	4
Conforming Amendments	
Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services .....	29
ISA 230 (Redrafted), “Audit Documentation” .....	31
ISA 240 (Redrafted), “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements” .....	32
ISA 260 (Revised and Redrafted), “Communication with Those Charged with Governance” .....	34
All Final Clarified ISAs .....	35

---

**INTERNATIONAL STANDARD ON AUDITING 200\***

**(REVISED AND REDRAFTED)**

**OVERALL OBJECTIVES OF THE INDEPENDENT AUDITOR AND THE CONDUCT  
OF AN AUDIT IN ACCORDANCE WITH INTERNATIONAL STANDARDS ON  
AUDITING**

(Effective for audits of financial statements for periods beginning on or after December 15, 2009)

**CONTENTS**

---

	Paragraph
<b>Introduction</b>	
Scope of this ISA .....	1–2
An Audit of Financial Statements .....	3–9
Effective Date .....	10
<b>Overall Objectives of the Auditor</b> .....	11–12
<b>Definitions</b> .....	13
<b>Requirements</b>	
Ethical Requirements Relating to an Audit of Financial Statements .....	14
Professional Skepticism .....	15
Professional Judgment .....	16
Sufficient Appropriate Audit Evidence and Audit Risk .....	17
Conduct of an Audit in Accordance with ISAs .....	18–24
<b>Application and Other Explanatory Material</b>	
An Audit of Financial Statements .....	A1–A13
Ethical Requirements Relating to an Audit of Financial Statements .....	A14–A17
Professional Skepticism .....	A18–A22
Professional Judgment .....	A23–A27
Sufficient Appropriate Audit Evidence and Audit Risk .....	A28–A52
Conduct of an Audit in Accordance with ISAs .....	A53–A76

---

\* [References in this ISA to other ISAs that have not yet been finalized reflect the working titles of those ISAs. The references are indicated in brackets and will be updated when those ISAs are finalized.]

## **Introduction**

### **Scope of this ISA**

1. This International Standard on Auditing (ISA) establishes the independent auditor's overall responsibilities when conducting an audit of financial statements in accordance with ISAs. Specifically, it sets out the overall objectives of the independent auditor, and explains the nature and scope of an audit designed to enable the independent auditor to meet those objectives. It also explains the scope, authority and structure of the ISAs, and includes requirements establishing the general responsibilities of the independent auditor applicable in all audits, including the obligation to comply with the ISAs. The independent auditor is referred to as "the auditor" hereafter.
2. ISAs are written in the context of an audit of financial statements by an auditor. They are to be adapted as necessary in the circumstances when applied to audits of other historical financial information.

### **An Audit of Financial Statements**

3. The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, that opinion is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework. An audit conducted in accordance with ISAs and relevant ethical requirements enables the auditor to form that opinion. (Ref: Para. A1)
4. The financial statements subject to audit are those of the entity, prepared and presented by management of the entity with oversight from those charged with governance. ISAs do not impose responsibilities on management or those charged with governance and do not override laws and regulations that govern their responsibilities. However, an audit in accordance with ISAs is conducted on the premise that management and, where appropriate, those charged with governance have responsibilities that are fundamental to the conduct of the audit. The audit of the financial statements does not relieve management or those charged with governance of those responsibilities. (Ref: Para. A2-A11)
5. As the basis for the auditor's opinion, ISAs require the auditor 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 is a high level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. However, reasonable assurance is not an absolute level of assurance, because there are inherent limitations of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive. (Ref: Para. A28-A52)
6. The concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected

misstatements, if any, on the financial statements.<sup>1</sup> In general, misstatements, including omissions, are considered to be material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. Judgments about materiality are made in the light of surrounding circumstances, and are affected by the auditor's perception of the financial information needs of users of the financial statements, and by the size or nature of a misstatement, or a combination of both. The auditor's opinion deals with the financial statements as a whole and therefore the auditor is not responsible for the detection of misstatements that are not material to the financial statements as a whole.

7. The ISAs contain objectives, requirements and application and other explanatory material that are designed to support the auditor in obtaining reasonable assurance. The ISAs require that the auditor exercise professional judgment and maintain professional skepticism throughout the planning and performance of the audit and, among other things:
  - Identify and assess risks of material misstatement, whether due to fraud or error, based on an understanding of the entity and its environment, including the entity's internal control.
  - Obtain sufficient appropriate audit evidence about whether material misstatements exist, through designing and implementing appropriate responses to the assessed risks.
  - Form an opinion on the financial statements based on conclusions drawn from the audit evidence obtained.
8. The form of opinion expressed by the auditor will depend upon the applicable financial reporting framework and any applicable laws or regulations. (Ref: Para. A12-A13)
9. The auditor may also have certain other communication and reporting responsibilities to users, management, those charged with governance, or parties outside the entity, in relation to matters arising from the audit. These may be established by the ISAs or by applicable laws or regulations.<sup>2</sup>

### **Effective Date**

10. This ISA is effective for audits of financial statements for periods beginning on or after December 15, 2009.

### **Overall Objectives of the Auditor**

11. In conducting an audit of financial statements, the overall objectives of the auditor are:
  - (a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the

---

<sup>1</sup> ISA 320 (Revised and Redrafted), "Materiality in Planning and Performing an Audit" and ISA 450 (Revised and Redrafted), "Evaluation of Misstatements Identified during the Audit."

<sup>2</sup> See, for example, ISA 260 (Revised and Redrafted), "Communication with Those Charged with Governance;" and paragraph 43 of ISA 240 (Redrafted), "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements."

- auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
- (b) To report on the financial statements, and communicate as required by the ISAs, in accordance with the auditor's findings.
12. In all cases when reasonable assurance cannot be obtained and a qualified opinion in the auditor's report is insufficient in the circumstances for purposes of reporting to the intended users of the financial statements, the ISAs require that the auditor disclaim an opinion or withdraw from the engagement, where withdrawal is legally permitted.

## Definitions

13. For purposes of the ISAs, the following terms have the meanings attributed below:
- (a) **Applicable financial reporting framework** – The financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation and presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

The term “fair presentation framework” is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:

- (i) Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or
- (ii) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

The term “compliance framework” is used to refer to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (i) or (ii) above.

- (b) **Audit evidence** – Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. For purposes of the ISAs:
- (i) **Sufficiency of audit evidence** is the measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor's assessment of the risks of material misstatement and also by the quality of such audit evidence.
- (ii) **Appropriateness of audit evidence** is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.

- (c) Audit risk – The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk.
- (d) Auditor – “Auditor” is used to refer to the person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or, as applicable, the firm. Where an ISA expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term “engagement partner” rather than “auditor” is used. “Engagement partner” and “firm” are to be read as referring to their public sector equivalents where relevant.
- (e) Detection risk – The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.
- (f) Financial statements – A structured representation of historical financial information, including related notes, 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 related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The term “financial statements” ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework, but can also refer to a single financial statement.
- (g) Historical financial information – Information expressed in financial terms in relation to a particular entity, derived primarily from that entity’s accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.
- (h) Management – The person(s) with executive responsibility for the conduct of the entity’s operations. For some entities in some jurisdictions, management includes some or all of those charged with governance, for example, executive members of a governance board, or an owner-manager.
- (i) Misstatement – A difference 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. Misstatements can arise from error or fraud.  

When the auditor expresses an opinion on whether the financial statements are presented fairly, in all material respects, or give a true and fair view, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the auditor’s judgment, are necessary for the financial statements to be presented fairly, in all material respects, or to give a true and fair view.
- (j) Premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit is conducted – That management and, where appropriate, those charged with governance have the following responsibilities that are fundamental to the conduct of an audit in accordance with ISAs. That is, responsibility:



- (i) For the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework; this includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error; and
- (ii) To provide the auditor with:
  - a. All information, such as records and documentation, and other matters that are relevant to the preparation and presentation of the financial statements;
  - b. Any additional information that the auditor may request from management and, where appropriate, those charged with governance; and
  - c. Unrestricted access to those within the entity from whom the auditor determines it necessary to obtain audit evidence.

In the case of a fair presentation framework, the responsibility is for the preparation and *fair* presentation of the financial statements in accordance with the financial reporting framework; or the preparation of financial statements *that give a true and fair view* in accordance with the financial reporting framework. This applies to all references to “preparation and presentation of the financial statements” in the ISAs.

The “premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit is conducted” may also be referred to as the “premise.”

- (k) Professional judgment – The application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.
- (l) Professional skepticism – An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.
- (m) Reasonable assurance – In the context of an audit of financial statements, a high, but not absolute, level of assurance.
- (n) Risk of material misstatement – The risk that the financial statements are materially misstated prior to audit. This consists of two components, described as follows at the assertion level:
  - (i) Inherent risk – The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.
  - (ii) Control risk – The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure 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.

- (o) Those charged with governance – The person(s) or organization(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.

## **Requirements**

### **Ethical Requirements Relating to an Audit of Financial Statements**

- 14. The auditor shall comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. (Ref: Para. A14-A17)

### **Professional Skepticism**

- 15. The auditor shall plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated. (Ref: Para. A18-A22)

### **Professional Judgment**

- 16. The auditor shall exercise professional judgment in planning and performing an audit of financial statements. (Ref: Para. A23-A27)

### **Sufficient Appropriate Audit Evidence and Audit Risk**

- 17. To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion. (Ref: Para. A28-A52)

### **Conduct of an Audit in Accordance with ISAs**

#### *Complying with ISAs Relevant to the Audit*

- 18. The auditor shall comply with all ISAs relevant to the audit. An ISA is relevant to the audit when the ISA is in effect and the circumstances addressed by the ISA exist. (Ref: Para. A53-A57)
- 19. The auditor shall have an understanding of the entire text of an ISA, including its application and other explanatory material, to understand its objectives and to apply its requirements properly. (Ref: Para. A58-A66)
- 20. The auditor shall not represent compliance with ISAs in the auditor's report unless the auditor has complied with the requirements of this ISA and all other ISAs relevant to the audit.

#### *Objectives Stated in Individual ISAs*

- 21. To achieve the overall objectives of the auditor, the auditor shall use the objectives stated in relevant ISAs in planning and performing the audit, having regard to the interrelationships among the ISAs, to: (Ref: Para. A67-A69)

- (a) Determine whether any audit procedures in addition to those required by the ISAs are necessary in pursuance of the objectives stated in the ISAs; and (Ref: Para. A70)
- (b) Evaluate whether sufficient appropriate audit evidence has been obtained. (Ref: Para. A71)

### *Complying with Relevant Requirements*

- 22. Subject to paragraph 23, the auditor shall comply with each requirement of an ISA unless, in the circumstances of the audit:
  - (a) The entire ISA is not relevant; or
  - (b) The requirement is not relevant because it is conditional and the condition does not exist. (Ref: Para. A72-A73)
- 23. In exceptional circumstances, the auditor may judge it necessary to depart from a relevant requirement in an ISA. In such circumstances, the auditor shall perform alternative audit procedures 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 achieving the aim of the requirement. (Ref: Para. A74)

### *Failure to Achieve an Objective*

- 24. If an objective in a relevant ISA cannot be achieved, the auditor shall evaluate whether this prevents the auditor from achieving the overall objectives of the auditor and thereby requires the auditor, in accordance with the ISAs, to modify the auditor's opinion or withdraw from the engagement. Failure to achieve an objective represents a significant matter requiring documentation in accordance with ISA 230 (Redrafted).<sup>3</sup> (Ref: Para. A75-A76)

\*\*\*

## **Application and Other Explanatory Material**

### **An Audit of Financial Statements**

#### *Scope of the Audit* (Ref: Para. 3)

- A1. The auditor's opinion on the financial statements deals with whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Such an opinion is common to all audits of financial statements. The auditor's opinion therefore does not assure, for example, the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity. In some jurisdictions, however, applicable laws and regulations may require auditors to provide opinions on other specific matters, such as the effectiveness of internal control, or the consistency of a separate management report with the financial statements. While the ISAs include requirements and guidance in relation to such matters to the extent that they are

---

<sup>3</sup> ISA 230 (Redrafted), "Audit Documentation," paragraph 8(c).

relevant to forming an opinion on the financial statements, the auditor would be required to undertake further work if the auditor had additional responsibilities to provide such opinions.

*Preparation of the Financial Statements* (Ref: Para. 4)

- A2. An audit in accordance with ISAs is conducted on the premise that management and, where appropriate, those charged with governance have responsibility:
- (a) For the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework; this includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error; and
  - (b) To provide the auditor with:
    - (i) All information, such as records and documentation, and other matters that are relevant to the preparation and presentation of the financial statements;
    - (ii) Any additional information that the auditor may request from management and, where appropriate, those charged with governance; and
    - (iii) Unrestricted access to those within the entity from whom the auditor determines it necessary to obtain audit evidence.
- A3. As part of their responsibility for the preparation and presentation of the financial statements, management and, where appropriate, those charged with governance are responsible for:
- The identification of the applicable financial reporting framework, in the context of any relevant laws or regulations.
  - The preparation and presentation of the financial statements in accordance with that framework.
  - An adequate description of that framework in the financial statements.
- The preparation of the financial statements requires management to exercise judgment in making accounting estimates that are reasonable in the circumstances, as well as to select and apply appropriate accounting policies. These judgments are made in the context of the applicable financial reporting framework.
- A4. The financial statements may be prepared in accordance with a financial reporting framework designed to meet:
- The common financial information needs of a wide range of users (i.e., “general purpose financial statements”); or
  - The financial information needs of specific users (i.e., “special purpose financial statements”).
- A5. The applicable financial reporting framework often encompasses financial reporting standards established by an authorized or recognized standards setting organization, or legislative or regulatory requirements. In some cases, the financial reporting framework may encompass both financial reporting standards established by an authorized or recognized standards setting organization and legislative or regulatory requirements. Other sources may

provide direction on the application of the applicable financial reporting framework. In some cases, the applicable financial reporting framework may encompass such other sources, or may even consist only of such sources. Such other sources may include:

- The legal and ethical environment, including statutes, regulations, court decisions, and professional ethical obligations in relation to accounting matters;
- Published accounting interpretations of varying authority issued by standards setting, professional or regulatory organizations;
- Published views of varying authority on emerging accounting issues issued by standards setting, professional or regulatory organizations;
- General and industry practices widely recognized and prevalent; and
- Accounting literature.

Where conflicts exist between the financial reporting framework and the sources from which direction on its application may be obtained, or among the sources that encompass the financial reporting framework, the source with the highest authority prevails.

- A6. The requirements of the applicable financial reporting framework determine the form and content of the financial statements. Although the framework may not specify how to account for or disclose all transactions or events, it ordinarily embodies sufficient broad principles that can serve as a basis for developing and applying accounting policies that are consistent with the concepts underlying the requirements of the framework.
- A7. Some financial reporting frameworks are fair presentation frameworks, while others are compliance frameworks. Financial reporting frameworks that encompass primarily the financial reporting standards established by an organization that is authorized or recognized to promulgate standards to be used by entities for preparing and presenting general purpose financial statements are often designed to achieve fair presentation, for example, International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB).
- A8. The requirements of the applicable financial reporting framework also determine what constitutes a complete set of financial statements. In the case of many frameworks, financial statements are intended to provide information about the financial position, financial performance and cash flows of an entity. For such frameworks, a complete set of financial statements would include a balance sheet; an income statement; a statement of changes in equity; a cash flow statement; and related notes. For some other financial reporting frameworks, a single financial statement and the related notes might constitute a complete set of financial statements:
- For example, the International Public Sector Accounting Standard (IPSAS), “Financial Reporting Under the Cash Basis of Accounting” issued by the International Public Sector Accounting Standards Board states that the primary financial statement is a statement of cash receipts and payments when a public sector entity prepares and presents its financial statements in accordance with that IPSAS.

- Other examples of a single financial statement, each of which would include related notes, are:
    - Balance sheet.
    - Statement of income or statement of operations.
    - Statement of retained earnings.
    - Statement of cash flows.
    - Statement of assets and liabilities that does not include owner's equity.
    - Statement of changes in owners' equity.
    - Statement of revenue and expenses.
    - Statement of operations by product lines.
- A9. [Proposed] ISA 210 (Redrafted) establishes requirements and provides guidance on determining the acceptability of the applicable financial reporting framework.<sup>4</sup> ISA 800 (Revised and Redrafted) deals with special considerations when financial statements are prepared in accordance with a special purpose framework.<sup>5</sup>
- A10. Because of the significance of the premise to the conduct of an audit, the auditor is required to obtain agreement from management and, where appropriate, those charged with governance that they acknowledge and understand their responsibilities set out in paragraph A2 as a precondition for accepting the audit engagement.<sup>6</sup> The auditor is also required to obtain written representations about whether management and, where appropriate, those charged with governance have fulfilled those responsibilities.<sup>7</sup>

#### Considerations Specific to Audits in the Public Sector

- A11. The mandates for audits of the financial statements of public sector entities may be broader than those of other entities. As a result, the premise, relating to management's responsibilities, on which an audit of the financial statements of a public sector entity is conducted may include additional responsibilities, such as the responsibility for the execution of transactions and events in accordance with legislation or proper authority.

#### *Form of the Auditor's Opinion* (Ref: Para. 8)

- A12. The opinion expressed by the auditor is on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. The form of the auditor's opinion, however, will depend upon the applicable financial reporting framework and any applicable laws or regulations. Most financial reporting frameworks

---

<sup>4</sup> [Proposed] ISA 210 (Redrafted), "Agreeing the Terms of Audit Engagements," paragraph [4(a)].

<sup>5</sup> [ISA 800 (Revised and Redrafted), "Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks," paragraphs [to be inserted].]

<sup>6</sup> [Proposed] ISA 210 (Redrafted), paragraph [4(b)].

<sup>7</sup> ISA 580 (Revised and Redrafted), "Written Representations," paragraphs 10-11.

include requirements relating to the presentation of the financial statements; for such frameworks, *preparation* of the financial statements in accordance with the applicable financial reporting framework includes *presentation*.

- A13. Where the financial reporting framework is a fair presentation framework, as is generally the case for general purpose financial statements, the opinion required by the ISAs is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view. Where the financial reporting framework is a compliance framework, the opinion required is on whether the financial statements are prepared, in all material respects, in accordance with the framework. Unless specifically stated otherwise, references in the ISAs to the auditor's opinion cover both forms of opinion.

### **Ethical Requirements Relating to an Audit of Financial Statements** (Ref: Para. 14)

- A14. The auditor is subject to relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. Relevant ethical requirements ordinarily comprise Parts A and B of the International Federation of Accountants' *Code of Ethics for Professional Accountants* (the IFAC Code) related to an audit of financial statements together with national requirements that are more restrictive.

- A15. Part A of the IFAC Code establishes the fundamental principles of professional ethics relevant to the auditor when conducting an audit of financial statements and provides a conceptual framework for applying those principles. The fundamental principles with which the auditor is required to comply by the IFAC Code are:

- (a) Integrity;
- (b) Objectivity;
- (c) Professional competence and due care;
- (d) Confidentiality; and
- (e) Professional behavior.

Part B of the IFAC Code illustrates how the conceptual framework is to be applied in specific situations.

- A16. In the case of an audit engagement it is in the public interest and, therefore, required by the IFAC Code, that the auditor be independent of the entity subject to the audit. The IFAC Code describes independence as comprising both independence of mind and independence in appearance. The auditor's independence from the entity safeguards the auditor's ability to form an audit opinion without being affected by influences that might compromise that opinion. Independence enhances the auditor's ability to act with integrity, to be objective and to maintain an attitude of professional skepticism.
- A17. International Standard on Quality Control (ISQC) 1 (Redrafted) sets out the responsibilities of the firm for establishing policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements,

including those pertaining to independence.<sup>8</sup> ISA 220 (Redrafted) sets out the engagement partner's responsibilities with respect to relevant ethical requirements. These include evaluating whether members of the engagement team have complied with relevant ethical requirements, determining the appropriate action if matters come to the engagement partner's attention that indicate that members of the engagement team have not complied with relevant ethical requirements, and forming a conclusion on compliance with independence requirements that apply to the audit engagement.<sup>9</sup> ISA 220 (Redrafted) 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, unless information provided by the firm or other parties suggests otherwise.

**Professional Skepticism** (Ref: Para. 15)

A18. Professional skepticism includes being alert to, for example:

- Audit evidence that contradicts other audit evidence obtained.
- Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.
- Conditions that may indicate possible fraud.
- Circumstances that suggest the need for audit procedures in addition to those required by the ISAs.

A19. Maintaining professional skepticism throughout the audit is necessary if the auditor is, for example, to reduce the risks of:

- Overlooking unusual circumstances.
- Over generalizing when drawing conclusions from audit observations.
- Using inappropriate assumptions in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof.

A20. Professional skepticism is necessary to the critical assessment of audit evidence. This includes questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in the light of the circumstances, for example in the case where fraud risk factors exist and a single document, of a nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount.

A21. The auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary. Nevertheless, the auditor is required to consider the reliability of

---

<sup>8</sup> [International Standard on Quality Control (ISQC) 1 (Redrafted), "Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements," paragraphs [to be inserted].]

<sup>9</sup> [ISA 220 (Redrafted), "Quality Control for an Audit of Financial Statements," paragraphs [to be inserted].]



information to be used as audit evidence.<sup>10</sup> In cases of doubt about the reliability of information or indications of possible fraud (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 may have been falsified), the ISAs require that the auditor investigate further and determine what modifications or additions to audit procedures are necessary to resolve the matter.<sup>11</sup>

A22. The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism or allow the auditor to be satisfied with less-than-persuasive audit evidence when obtaining reasonable assurance.

### **Professional Judgment** (Ref: Para. 16)

A23. Professional judgment is essential to the proper conduct of an audit. This is because interpretation of relevant ethical requirements and the ISAs and the informed decisions required throughout the audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances. Professional judgment is necessary in particular regarding decisions about:

- Materiality and audit risk.
- The nature, timing, and extent of audit procedures used to meet the requirements of the ISAs and gather audit evidence.
- Evaluating whether sufficient appropriate audit evidence has been obtained, and whether more needs to be done to achieve the objectives of the ISAs and thereby, the overall objectives of the auditor.
- The evaluation of management's judgments in applying the entity's applicable financial reporting framework.
- The drawing of conclusions based on the audit evidence obtained, for example, assessing the reasonableness of the estimates made by management in preparing the financial statements.

A24. The distinguishing feature of the professional judgment expected of an auditor is that it is exercised by an auditor whose training, knowledge and experience have assisted in developing the necessary competencies to achieve reasonable judgments.

A25. The exercise of professional judgment in any particular case is based on the facts and circumstances that are known by the auditor. Consultation on difficult or contentious matters during the course of the audit, both within the engagement team and between the engagement

---

<sup>10</sup> [ISA 500 (Redrafted), "Audit Evidence," paragraph [to be inserted].]

<sup>11</sup> ISA 240 (Redrafted), paragraph 13; [ISA 500 (Redrafted), paragraph [to be inserted]]; and [ISA 505 (Revised and Redrafted), "External Confirmations," paragraphs [to be inserted].]

team and others at the appropriate level within or outside the firm, such as that required by ISA 220 (Redrafted),<sup>12</sup> assist the auditor in making informed and reasonable judgments.

- A26. Professional judgment can be evaluated based on whether the judgment reached reflects a competent application of auditing and accounting principles and is appropriate in the light of, and consistent with, the facts and circumstances that were known to the auditor up to the date of the auditor's report.
- A27. Professional judgment needs to be exercised throughout the audit. It also needs to be appropriately documented. In this regard, the auditor is required to prepare audit documentation sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the significant professional judgments made in reaching conclusions on significant matters arising during the audit.<sup>13</sup> Professional judgment is not to be used as the justification for decisions that are not otherwise supported by the facts and circumstances of the engagement or sufficient appropriate audit evidence.

### **Sufficient Appropriate Audit Evidence and Audit Risk** (Ref: Para. 5 and 17)

#### *Sufficiency and Appropriateness of Audit Evidence*

- A28. 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 (provided the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit<sup>14</sup>) or a firm's quality control procedures for client acceptance and continuance. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared by an expert employed or engaged by the entity. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In addition, in some cases, the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence.
- A29. The sufficiency and appropriateness of audit evidence are interrelated. Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, 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.

---

<sup>12</sup> [ISA 220 (Redrafted), paragraph [ to be inserted].]

<sup>13</sup> ISA 230 (Redrafted), paragraph 8.

<sup>14</sup> ISA 315 (Redrafted), "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment," paragraph 9.

- A30. Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based. 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.
- A31. Whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion, is a matter of professional judgment. ISA 500 (Redrafted) and other relevant ISAs establish additional requirements and provide further guidance applicable throughout the audit regarding the auditor's considerations in obtaining sufficient appropriate audit evidence.

### *Audit Risk*

- A32. Audit risk is a function of the risks of material misstatement and detection risk. The assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement.
- A33. For purposes of the ISAs, audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not. This risk is ordinarily insignificant. Further, audit risk is a technical term related to the process of auditing; it does not refer to the auditor's business risks such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements.

### Risks of Material Misstatement

- A34. The risks of material misstatement may exist at two levels:
- The overall financial statement level; and
  - The assertion level for classes of transactions, account balances, and disclosures.
- A35. Risks of material misstatement at the overall financial statement level refer to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions.
- A36. Risks of material misstatement at the assertion level are assessed in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk. Auditors use various approaches to accomplish the objective of assessing the risks of material misstatement. For example, 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 acceptable level of detection risk. Some auditors find such a model to be useful when planning audit procedures.
- A37. The risks of material misstatement at the assertion level consist of two components: inherent risk and control risk. Inherent risk and control risk are the entity's risks; they exist independently of the audit of the financial statements.

- A38. Inherent risk is higher 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 accounts consisting of amounts derived from accounting estimates that are subject to significant estimation uncertainty. 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. Factors in the entity and its environment that relate to several or all of the classes of transactions, account balances, or disclosures may also influence the inherent risk related to a specific assertion. Such factors may include, for example, a lack of sufficient working capital to continue operations or a declining industry characterized by a large number of business failures.
- A39. Control risk is a function of the effectiveness of the design, implementation and maintenance of internal control by management to address identified risks that threaten the achievement of the entity's objectives relevant to preparation of the entity's financial statements. However, internal control, no matter how well designed and operated, can only reduce, but not eliminate, risks of material misstatement in the financial statements, because of the inherent limitations of internal control. These include, for example, the possibility of human errors or mistakes, or of controls being circumvented by collusion or inappropriate management override. Accordingly, some control risk will always exist. The ISAs provide the conditions under which the auditor is required to, or may choose to, test the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures to be performed.<sup>15</sup>
- A40. The ISAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement." However, 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 risks 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.
- A41. ISA 315 (Redrafted) establishes requirements and provides guidance on identifying and assessing the risks of material misstatement at the financial statement and assertion levels.

#### Detection Risk

- A42. For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessed risks of material misstatement at the assertion level. For example, the greater the risks of material misstatement the auditor believes exists, the less the detection risk that can be accepted and, accordingly, the more persuasive the audit evidence required by the auditor.
- A43. 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

---

<sup>15</sup> ISA 330 (Redrafted), "The Auditor's Responses to Assessed Risks," paragraphs 7-17.

function of the effectiveness of an audit procedure and of its application by the auditor. Matters such as:

- adequate planning;
- proper assignment of personnel to the engagement team;
- the application of professional scepticism; and
- supervision and review of the audit work performed,

assist to enhance the effectiveness of an audit procedure and of its application and reduce the possibility that an auditor might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results.

A44. ISA 300 (Redrafted)<sup>16</sup> and ISA 330 (Redrafted) establish requirements and provide guidance on planning an audit of financial statements and the auditor's responses to assessed risks. Detection risk, however, can only be reduced, not eliminated, because of the inherent limitations of an audit. Accordingly, some detection risk will always exist.

#### *Inherent Limitations of an Audit*

A45. The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive. The inherent limitations of an audit arise from:

- The nature of financial reporting;
- The nature of audit procedures; and
- The need for the audit to be conducted within a reasonable period of time and at a reasonable cost.

#### The Nature of Financial Reporting

A46. The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made. Consequently, some financial statement items are subject to an inherent level of variability which cannot be eliminated by the application of additional auditing procedures. For example, this is often the case with respect to certain accounting estimates. Nevertheless, the ISAs require the auditor to give specific consideration to whether accounting estimates are reasonable in the context of the applicable financial

---

<sup>16</sup> ISA 300 (Redrafted), "Planning an Audit of Financial Statements."

reporting framework and related disclosures, and to the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.<sup>17</sup>

### The Nature of Audit Procedures

A47. There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example:

- There is the possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation and presentation of the financial statements or that has been requested by the auditor. Accordingly, the auditor cannot be certain of the completeness of information, even though the auditor has performed audit procedures to obtain assurance that all relevant information has been obtained.
- Fraud may involve sophisticated and carefully organized schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the auditor to believe that audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.
- An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.

### Timeliness of Financial Reporting and the Balance between Benefit and Cost

A48. The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive. Appropriate planning assists in making sufficient time and resources available for the conduct of the audit. Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost. This is recognized in certain financial reporting frameworks (see, for example, the IASB's "Framework for the Preparation and Presentation of Financial Statements"). Therefore, there is an expectation by users of financial statements that the auditor will form an opinion on the financial statements within a reasonable period of time and at a reasonable cost, recognizing that it is impracticable 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.

A49. Consequently, it is necessary for the auditor to:

- Plan the audit so that it will be performed in an effective manner;

---

<sup>17</sup> ISA 540 (Revised and Redrafted), "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures," and [ISA 700 (Redrafted), "Forming an Opinion and Reporting on Financial Statements," paragraph [to be inserted].]

- Direct audit effort to areas most expected to contain risks of material misstatement, whether due to fraud or error, with correspondingly less effort directed at other areas; and
- Use testing and other means of examining populations for misstatements.

A50. In light of the approaches described in paragraph A49, the ISAs contain requirements for the planning and performance of the audit and require the auditor, among other things, to:

- Have a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels by performing risk assessment procedures and related activities;<sup>18</sup> and
- Use testing and other means of examining populations in a manner that provides a reasonable basis for the auditor to draw conclusions about the population.<sup>19</sup>

#### Other Matters that Affect the Inherent Limitations of an Audit

A51. In the case of certain assertions or subject matters, the potential effects of the inherent limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

- Fraud, particularly fraud involving senior management or collusion. See ISA 240 (Redrafted) for further discussion.
- The existence and completeness of related party relationships and transactions. See ISA 550 (Revised and Redrafted)<sup>20</sup> for further discussion.
- The occurrence of non-compliance with laws and regulations. See ISA 250 (Redrafted)<sup>21</sup> for further discussion.
- Future events or conditions that may cause an entity to cease to continue as a going concern. See ISA 570 (Redrafted)<sup>22</sup> for further discussion.

Relevant ISAs identify specific audit procedures to assist in mitigating the effect of the inherent limitations.

A52. Because of the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with ISAs. Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with ISAs. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with

---

<sup>18</sup> ISA 315 (Redrafted), paragraphs 5-10.

<sup>19</sup> ISA 330 (Redrafted); [ISA 500 (Redrafted)]; [Proposed] ISA 520 (Redrafted), "Analytical Procedures;" and ISA 530 (Redrafted), "Audit Sampling."

<sup>20</sup> ISA 550 (Revised and Redrafted), "Related Parties."

<sup>21</sup> ISA 250 (Redrafted), "Consideration of Laws and Regulations in an Audit of Financial Statements."

<sup>22</sup> ISA 570 (Redrafted), "Going Concern."

less-than-persuasive audit evidence. 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 in light of the overall objectives of the auditor.

### **Conduct of an Audit in Accordance with ISAs**

#### *Nature of the ISAs* (Ref: Para. 18)

- A53. The ISAs, taken together, provide the standards for the auditor's work in fulfilling the overall objectives of the auditor. 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.
- A54. 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.
- A55. In performing an audit, the auditor may be required to comply with legal or regulatory requirements in addition to the ISAs. The ISAs do not override 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 laws and regulations will not automatically comply with ISAs.
- A56. The auditor may also conduct the audit in accordance with both ISAs and auditing standards of a specific jurisdiction or country. In such cases, in addition to complying with each of the ISAs relevant to the audit, it may be necessary for the auditor to perform additional audit procedures in order to comply with the relevant standards of that jurisdiction or country.

#### Considerations Specific to Audits in the Public Sector

- A57. The ISAs are relevant to engagements in the public sector. The public sector auditor's responsibilities, however, may be affected by the audit mandate, or by obligations on public sector entities arising from legislation, regulation, ministerial directives, government policy requirements, or resolutions of the legislature, which may encompass a broader scope than an audit of financial statements in accordance with the ISAs. These additional responsibilities are not dealt with in the ISAs. They may be dealt with in the pronouncements of the International Organization of Supreme Audit Institutions or national standard setters, or in guidance developed by government audit agencies.

#### *Contents of the ISAs* (Ref: Para. 19)

- A58. In addition to objectives and requirements (requirements are expressed in the ISAs using "shall"), an ISA contains related guidance in the form of application and other explanatory material. It may also contain introductory material that provides context relevant to a proper understanding of the ISA, and definitions. The entire text of an ISA, therefore, is relevant to an understanding of the objectives stated in an ISA and the proper application of the requirements of an ISA.



A59. Where necessary, the application and other explanatory material provides further explanation of the requirements of an ISA and guidance for carrying them out. In particular, it may:

- Explain more precisely what a requirement means or is intended to cover.
- Include examples of procedures that may be appropriate in the circumstances.

While such guidance does not in itself impose a requirement, it is relevant to the proper application of the requirements of an ISA. The application and other explanatory material may also provide background information on matters addressed in an ISA.

A60. Appendices form part of the application and other explanatory material. The purpose and intended use of an appendix are explained in the body of the related ISA or within the title and introduction of the appendix itself.

A61. 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.
- The respective responsibilities of the auditor and others in relation to the subject matter of the ISA.
- The context in which the ISA is set.

A62. 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. Unless otherwise indicated, those terms will carry the same meanings throughout the ISAs. The Glossary of Terms relating to International Standards issued by the International Auditing and Assurance Standards Board in the *Handbook of International Auditing, Assurance, and Ethics Pronouncements* published by IFAC contains a complete listing of terms defined in the ISAs. It also includes descriptions of other terms found in ISAs to assist in common and consistent interpretation and translation.

A63. When appropriate, additional considerations specific to audits of smaller entities and public sector entities are included within the application and other explanatory material of an ISA. These additional considerations assist in the application of the requirements of the ISA in the audit of such entities. They do not, however, limit or reduce the responsibility of the auditor to apply and comply with the requirements of the ISAs.

#### Considerations Specific to Smaller Entities

A64. For purposes of specifying additional considerations to audits of smaller entities, a “smaller entity” refers to an entity which typically possesses qualitative characteristics such as:

- (a) Concentration of ownership and management in a small number of individuals (often a single individual – either a natural person or another enterprise that owns the entity provided the owner exhibits the relevant qualitative characteristics); and
- (b) One or more of the following:

- (i) Straightforward or uncomplicated transactions;
- (ii) Simple record-keeping;
- (iii) Few lines of business and few products within business lines;
- (iv) Few internal controls;
- (v) Few levels of management with responsibility for a broad range of controls; or
- (vi) Few personnel, many having a wide range of duties.

These qualitative characteristics are not exhaustive, they are not exclusive to smaller entities, and smaller entities do not necessarily display all of these characteristics.

A65. The considerations specific to smaller entities included in the ISAs have been developed primarily with unlisted entities in mind. Some of the considerations, however, may be helpful in audits of smaller listed entities.

A66. The ISAs refer to the proprietor of a smaller entity who is involved in running the entity on a day-to-day basis as the “owner-manager.”

*Objectives Stated in Individual ISAs* (Ref: Para. 21)

A67. Each ISA contains one or more objectives which provide a link between the requirements and the overall objectives of the auditor. The objectives in individual ISAs serve to focus the auditor on the desired outcome of the ISA, while being specific enough to assist the auditor in:

- Understanding what needs to be accomplished and, where necessary, the appropriate means of doing so; and
- Deciding whether more needs to be done to achieve them in the particular circumstances of the audit.

A68. Objectives are to be understood in the context of the overall objectives of the auditor stated in paragraph 11 of this ISA. As with the overall objectives of the auditor, the ability to achieve an individual objective is equally subject to the inherent limitations of an audit.

A69. In using the objectives, the auditor is required to have regard to the interrelationships among the ISAs. This is because, as indicated in paragraph A53, the ISAs deal in some cases with general responsibilities and in others with the application of those responsibilities to specific topics. For example, this ISA requires the auditor to adopt an attitude of professional skepticism; this is necessary in all aspects of planning and performing an audit but is not repeated as a requirement of each ISA. At a more detailed level, ISA 315 (Redrafted) and ISA 330 (Redrafted) contain, among other things, objectives and requirements that deal with the auditor’s responsibilities to identify and assess the risks of material misstatement and to design and perform further audit procedures to respond to those assessed risks, respectively; these objectives and requirements apply throughout the audit. An ISA dealing with specific aspects of the audit (for example, ISA 540 (Revised and Redrafted)) may expand on how the objectives and requirements of such ISAs as ISA 315 (Redrafted) and ISA 330 (Redrafted) are to be applied in relation to the subject of the ISA but does not repeat them. Thus, in achieving the objective stated in ISA 540 (Revised and Redrafted), the auditor has regard to the objectives and requirements of other relevant ISAs.

## Use of Objectives to Determine Need for Additional Audit Procedures (Ref: Para. 21(a))

A70. The requirements of the ISAs are designed to enable the auditor to achieve the objectives specified in the ISAs, and thereby the overall objectives of the auditor. The proper application of the requirements of the ISAs by the auditor is therefore expected to provide a sufficient basis for the auditor's achievement of the objectives. However, because the circumstances of audit engagements vary widely and all such circumstances cannot be anticipated in the ISAs, the auditor is responsible for determining the audit procedures necessary to fulfill the requirements of the ISAs and to achieve the objectives. In the circumstances of an engagement, there may be particular matters that require the auditor to perform audit procedures in addition to those required by the ISAs to meet the objectives specified in the ISAs.

## Use of Objectives to Evaluate Whether Sufficient Appropriate Audit Evidence Has Been Obtained (Ref: Para. 21(b))

A71. The auditor is required to use the objectives to evaluate whether sufficient appropriate audit evidence has been obtained in the context of the overall objectives of the auditor. If as a result the auditor concludes that the audit evidence is not sufficient and appropriate, then the auditor may follow one or more of the following approaches to meeting the requirement of paragraph 21(b):

- Evaluate whether further relevant audit evidence has been, or will be, obtained as a result of complying with other ISAs;
- Extend the work performed in applying one or more requirements; or
- Perform other procedures judged by the auditor to be necessary in the circumstances.

Where none of the above is expected to be practical or possible in the circumstances, the auditor will not be able to obtain sufficient appropriate audit evidence and is required by the ISAs to determine the effect on the auditor's report or on the auditor's ability to complete the engagement.

*Complying with Relevant Requirements*

## Relevant Requirements (Ref: Para. 22)

A72. In some cases, an ISA (and therefore all of its requirements) may not be relevant in the circumstances. For example, if an entity does not have an internal audit function, nothing in ISA 610 (Redrafted)<sup>23</sup> is relevant.

A73. Within a relevant ISA, there may be conditional requirements. Such a requirement is relevant when the circumstances envisioned in the requirement apply and the condition exists. In general, the conditionality of a requirement will either be explicit or implicit, for example:

---

<sup>23</sup> ISA 610 (Redrafted), "Using the Work of Internal Auditors."

- The requirement to modify the auditor’s opinion if there is a limitation of scope<sup>24</sup> represents an explicit conditional requirement.
- The requirement to communicate significant deficiencies in internal control identified during the audit to those charged with governance,<sup>25</sup> which depends on the existence of such identified significant deficiencies; and the requirement to obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework,<sup>26</sup> which depends on that framework requiring or permitting such disclosure, represent implicit conditional requirements.

#### Departure from a Requirement (Ref: Para. 23)

A74. ISA 230 (Redrafted) establishes documentation requirements in those exceptional circumstances where the auditor departs from a relevant requirement.<sup>27</sup> The ISAs do not call for compliance with a requirement that is not relevant in the circumstances of the audit.

#### *Failure to Achieve an Objective* (Ref: Para. 24)

A75. Whether an objective has been achieved is a matter for the auditor’s professional judgment. That judgment takes account of the results of audit procedures performed in complying with the requirements of the ISAs, and the auditor’s evaluation of whether sufficient appropriate audit evidence has been obtained and whether more needs to be done in the particular circumstances of the audit to achieve the objectives stated in the ISAs. Accordingly, circumstances that may give rise to a failure to achieve an objective include those that:

- Prevent the auditor from complying with the relevant requirements of an ISA.
- Result in its not being practicable or possible for the auditor to carry out the additional audit procedures or obtain further audit evidence as determined necessary from the use of the objectives in accordance with paragraph 21, for example due to a limitation in the available audit evidence.

A76. Audit documentation that meets the requirements of ISA 230 (Redrafted) and the specific documentation requirements of other relevant ISAs provides evidence of the auditor’s basis for a conclusion about the achievement of the overall objectives of the auditor. While it is unnecessary for the auditor to document separately (as in a checklist, for example) that individual objectives have been achieved, the documentation of a failure to achieve an objective assists the auditor’s evaluation of whether such a failure has prevented the auditor from achieving the overall objectives of the auditor.

---

<sup>24</sup> ISA 705 (Revised and Redrafted), “Modifications to the Opinion in the Independent Auditor’s Report,” paragraph 13.

<sup>25</sup> [Proposed] ISA 265, “Communicating Deficiencies in Internal Control,” paragraph [10].

<sup>26</sup> [Proposed] ISA 501 (Redrafted), “Audit Evidence Regarding Specific Financial Statement Account Balances and Disclosures,” paragraph [14].

<sup>27</sup> ISA 230 (Redrafted), paragraph 12.

**CONFORMING AMENDMENTS AS A RESULT OF ISA 200 (REVISED AND REDRAFTED), OVERALL OBJECTIVES OF THE INDEPENDENT AUDITOR AND THE CONDUCT OF AN AUDIT IN ACCORDANCE WITH INTERNATIONAL STANDARDS ON AUDITING**

**Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services (Preface)**

[There are no changes proposed to paragraphs 1–3. Accordingly, they are not reproduced.]

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

[There are no changes proposed to paragraphs 4–5 and 7–9. Accordingly, they are not reproduced.]

6. International Standards on Assurance Engagements (ISAEs) are to be applied in assurance engagements ~~dealing with subject matters~~ other than audits or reviews of historical financial information.

**International Standards on Auditing<sup>1</sup>**

10. ISAs are written in the context of an audit of financial statements<sup>12</sup> by an independent auditor.<sup>3</sup> They are to be adapted as necessary in the circumstances when applied to audits of other historical financial information. The authority of ISAs is set out in ISA 200 (Revised and Redrafted).<sup>2</sup>
- ~~11. 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. It is undertaken to enhance the degree of confidence of intended users in the financial statements. ISAs, taken together, provide the standards for the auditor's work in fulfilling this objective.~~
- ~~12. In conducting an audit, the overall objective of the auditor 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 on the financial statements in accordance with the auditor's findings. In all cases when this overall objective has not been or cannot be achieved, the ISAs require that the auditor modifies the auditor's opinion accordingly or withdraws from the engagement.~~
- ~~13. The auditor applies each ISA relevant to the audit. An ISA is relevant when the ISA is in effect and the circumstances addressed by the ISA exist.~~
- ~~14. 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. An ISA contains objectives and requirements together with related guidance in the form of application and other explanatory material. It may also contain introductory material that provides context essential to a proper understanding of the ISAs, and definitions. It is, therefore, necessary to consider the entire text of an ISA to understand and apply its requirements.~~

*ISA Objectives*

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

*Requirements*

16. ~~The requirements of each ISA are contained in a separate section and expressed using the word "shall." The auditor applies the requirements in the context of the other material included in the ISA.~~
17. ~~The auditor complies 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 by performing alternative audit procedures 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.~~
18. ~~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*

19. ~~The application and other explanatory material contained in an ISA 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.~~
20. ~~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 explained in the body of the related ISA or within the title and introduction of the appendix itself.~~

*Introductory Material and Definitions*

21. ~~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.~~
22. ~~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. 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 descriptions of other terms found in ISAs to assist in common and consistent interpretation and translation.~~

## International Standards on Quality Control

~~1123.~~ ISQCs are written to apply to firms in respect of all their services falling under the IAASB’s Engagement Standards. The authority of ISQCs is set out in the introduction to the ISQCs.

[There are no changes proposed to paragraphs 24–33, except renumbering. Accordingly, they are not reproduced.]

<sup>1</sup> ~~The terms and concepts in this Preface are explained further in the ISAs, in particular in ISA 200, “Objective and General Principles Governing an Audit of Financial Statements.” (ISA 200 will be revised, inter alia, to incorporate relevant provisions of this Preface that deal with the obligations of the auditor, and the status and authority of objectives, requirements and other material. When ISA 200 is revised and exposed for public comment in 2007, respondents will be invited to comment on the material derived from this Preface in that new context.)~~

<sup>12</sup> Unless otherwise stated, “financial statements” mean financial statements comprising historical financial information.

<sup>2</sup> ISA 200 (Revised and Redrafted), “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing.”

<sup>3</sup> ~~Referred to hereafter as “the auditor.”~~

## ISA 230 (Redrafted), “Audit Documentation”

### *Nature and Purposes of Audit Documentation*

2. Audit documentation that meets the requirements of this ISA and the specific documentation requirements of other relevant ISAs provides:
  - (a) Evidence of the auditor’s basis for a conclusion about the achievement of the overall objectives of the auditor<sup>1</sup>; and
  - (b) Evidence that the audit was planned and performed in accordance with ISAs and applicable legal and regulatory requirements ...

### *Documentation of Significant Matters and Related Significant Professional Judgments* (Ref: Para. 8(c))

- A11. 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. It may also help the auditor to consider whether, in light of the audit procedures performed and conclusions reached, there is any individual relevant ISA objective that the auditor cannot achieve ~~has not met or is unable to meet~~ that would prevent the auditor from achieving the overall objectives of the auditor’s overall objective ...

*Departure from a Relevant Requirement* (Ref: Para. 12)

- A18. ~~The objectives and requirements of the ISAs are designed to enable the auditor to achieve the objectives specified in the ISAs, and thereby support the achievement of the overall objectives of the auditor.~~<sup>6</sup> Accordingly, other than in exceptional circumstances, the ISAs call for compliance with each requirement that is relevant in the circumstances of the audit.
- A19. The documentation requirement applies only to requirements that are relevant in the circumstances. A requirement is not relevant<sup>7</sup> only in the cases where:
- (a) ~~The entire ISA is not relevant (for example, if an entity does not have an internal audit function in a continuing engagement, nothing in [proposed] ISA 610510 (Redrafted)~~<sup>8</sup> is relevant); or
  - (b) ~~The circumstances envisioned do not apply because~~†The requirement is conditional and the condition does not exist (for example, the requirement to modify the auditor’s opinion where there is an inability to obtain sufficient appropriate audit evidence, and there is no such inability)...

<sup>1</sup> ISA 200 (Revised and Redrafted), “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing,” paragraph 11.

<sup>6</sup> ~~[Proposed] ISA 200 (Revised and Redrafted), “Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing,” paragraphs [23–24].~~

<sup>7</sup> ~~[Proposed] ISA 200 (Revised and Redrafted), paragraph 22[27].~~

<sup>8</sup> ~~[Proposed] ISA 610510 (Redrafted), “Using the Work of Internal AuditorsInitial Audit Engagements—Opening Balances.”~~

**ISA 240 (Redrafted), “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements”**

*Responsibilities of the Auditor*

5. An auditor conducting an audit in accordance with ISAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may ~~will~~ not be detected, even though the audit is properly planned and performed in accordance with the ISAs.<sup>3</sup>

<sup>3</sup> ISA 200 (Revised and Redrafted), “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing,” paragraphs A45-A52.

6. As described in ISA 200 (Revised and Redrafted),<sup>4</sup> the potential effects of inherent limitations are particularly significant in the case of misstatement resulting from fraud. The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by



collusion. Collusion may cause the auditor to believe that audit evidence is persuasive when it is, in fact, false. The auditor's ability to detect a fraud depends on factors such as the skillfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved. While the auditor may be able to identify potential opportunities for fraud to be perpetrated, it is difficult for the auditor to determine whether misstatements in judgment areas such as accounting estimates are caused by fraud or error.

7. Furthermore, the risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information or override control procedures designed to prevent similar frauds by other employees.
8. When obtaining reasonable assurance, the auditor is responsible for maintaining ~~an attitude of~~ professional skepticism throughout the audit, considering the potential for management override of controls and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud. The requirements in this ISA are designed to assist the auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement ...

### Professional Skepticism

12. In accordance with ISA 200 (Revised and Redrafted),<sup>5</sup> the auditor shall maintain ~~an attitude of~~ professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance...<sup>4</sup>
- A7. ~~Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence.~~ Maintaining ~~an attitude of~~ professional skepticism requires an ongoing questioning of whether the information and audit evidence obtained suggests that a material misstatement due to fraud may exist. It includes considering the reliability of the information to be used as audit evidence and the controls over its preparation and maintenance where relevant. Due to the characteristics of fraud, the auditor's ~~attitude of~~ professional skepticism is particularly important when considering the risks of material misstatement due to fraud.
- A8. Although the auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance, the auditor's ~~attitude of~~ professional skepticism is particularly important in considering the risks of material misstatement due to fraud because there may have been changes in circumstances...

<sup>4</sup> ISA 200 (Revised and Redrafted), paragraph A51.

<sup>5</sup> ISA 200 (Revised and Redrafted), paragraph 15.

<sup>4</sup> ~~[Proposed] ISA 200 (Revised and Redrafted), paragraph [18].~~

## ISA 260 (Revised and Redrafted), “Communication with Those Charged with Governance”

### Definitions

6. For purposes of the ISAs, the following terms have the meanings attributed below:
- (a) Those charged with governance – The person(s) or organization(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager. ~~In some cases, those charged with governance are responsible for approving<sup>+</sup> the entity’s financial statements (in other cases management has this responsibility).~~ For discussion of the diversity of governance structures, see paragraphs A5-A12.
  - (b) Management – The person(s) with executive responsibility for the conduct of the entity’s operations. For some entities in some jurisdictions, management includes some or all of those charged with governance, for example, executive members of a governance board, or an owner-manager. ~~Management is responsible for the preparation of the financial statements, overseen by those charged with governance, and in some cases management is also responsible for approving<sup>2</sup> the entity’s financial statements (in other cases those charged with governance have this responsibility).~~...

### Those Charged with Governance (Ref: Para. 7)

- A5. Governance structures vary by jurisdiction and by entity, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics. For example:
- In some jurisdictions a supervisory (wholly or mainly non-executive) board exists that is legally separate from an executive (management) board (a “two-tier board” structure). In other jurisdictions, both the supervisory and executive functions are the legal responsibility of a single, or unitary, board (a “one-tier board” structure).
  - In some entities, those charged with governance hold positions that are an integral part of the entity’s legal structure, for example, company directors. In others, for example, some government entities, a body that is not part of the entity is charged with governance.
  - In some cases, some or all of those charged with governance are involved in managing the entity. In others, those charged with governance and management comprise different persons.
  - In some cases, those charged with governance are responsible for approving<sup>3</sup> the entity’s financial statements (in other cases management has this responsibility). ...

<sup>+</sup>—As described at paragraph [A43] of [proposed] ISA 700, (Redrafted), “The Independent Auditor’s Report on General Purpose Financial Statements,” having responsibility for approving in this context means having the authority to

~~conclude that all the statements that comprise the financial statements, including the related notes, have been prepared.~~

<sup>2</sup> ~~See footnote 1.~~

<sup>3</sup> As described at paragraph [to be inserted] of ISA 700, (Redrafted), “Forming an Opinion and Reporting on Financial Statements,” having responsibility for approving in this context means having the authority to conclude that all the statements that comprise the financial statements, including the related notes, have been prepared.

## **All Final Clarified ISAs**

### *Phrases*

~~“attitude of professional skepticism”~~

- ISA 250 (Redrafted), paragraph 8.
- ISA 540 (Revised and Redrafted), paragraph A40.
- ISA 550 (Revised and Redrafted), paragraph A9.

~~“affected by the inherent limitations of inherent to internal control”~~

- ISA 315 (Redrafted), paragraph A42.



**International Federation of Accountants**

545 Fifth Avenue, 14<sup>th</sup> Floor, New York, NY 10017 USA

Tel +1 (212) 286-9344 Fax +1(212) 286-9570 [www.ifac.org](http://www.ifac.org)