

**SEMINAR ON
CLARIFIED INTERNATIONAL STANDARDS
ON AUDITING**

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Part 1

Overview and structural changes

What has happened?

- A new set of International Standards on Auditing (ISAs) will apply to all financial statement audits for periods beginning on or after 15 December 2009.
- All existing ISAs have been changed to varying degrees, with two new standards. In addition, ISQC1 has been redrafted.
- The aim was to clarify an auditor's objectives and obligations, eliminate ambiguity regarding requirements, and make the ISAs more understandable.
- IAASB also undertook a number of significant revisions to core standards.

Why are these changes important?

- Changes were made to improve audit quality, leading to more consistency in the application of the ISAs and their adoption globally.
- Project was considered a pre-requisite to gaining endorsement of the ISAs by regulators and adoption in key jurisdictions (e.g. EU).
- Adopting the ISAs enables us to meet public and regulatory expectations, and manage quality effectively.

Summary of changes

- Each ISA has a new structure. The following sections form the complete ISA:
 - Introductory material
 - Objectives
 - Definitions
 - Requirements
 - Application material
- There are also different terms and language used.

Objectives

- Each standard has one or more objectives that the auditor must use in performing the audit and is expected to achieve.
- The objectives have authority in their own right. As well as evaluating whether sufficient appropriate audit evidence has been obtained, we must consider whether any audit procedures *in addition to those required by the ISAs* are necessary in order to meet the objectives.
- In those rare circumstances where we consider that an objective in a relevant ISA cannot be achieved, it is a significant matter that is required to be documented and we must evaluate the impact on the audit opinion and engagement.

Requirements

- ISA basic principles and essential procedures were previously identified in bold print. Requirements are now included in a separate section of each standard to clearly distinguish them.
- The use of 'should' has been replaced with use of the word 'shall' for all procedures now treated as required (e.g., the auditor 'shall obtain' or the auditor 'shall test').
- About half of the increase in the number of requirements is clarifications to existing guidance and the other half relates to new requirements to improve audit quality - the absolute increase in requirements does not translate directly into changes in audit procedures to be performed.

Application material

- Application and other explanatory material has been included to explain more precisely what a requirement means. It is intended to cover or include examples of procedures that may be appropriate.
- The application material contains considerations for auditors of smaller entities, understanding of which will be important to efficient application of the ISAs.
- The application material will be critical to interpreting and implementing the ISA objectives and requirements.
- We are required to have an understanding of the application material and consider its relevance to our audits.

Terminology

- The clarified ISAs frequently define terms and use language that is different from the existing ISAs.
- Each firm of auditor(s) policies, guidance and tools needs to be updated so that generally we align with the new ISA wording and language conventions.
- For example, 'critical matters' will become 'significant matters', 'planning materiality' will become 'performance materiality', and 'preliminary and final analytics' will become, respectively, 'risk assessment analytics' and 'overall conclusion analytics'.

Part 2

- New
- Revised & Redrafted
- Redrafted

The Clarified Standards

The final set of clarity ISAs comprises of 36 ISAs and the International Standard on Quality Control (ISQC) 1, including:

- Two (2) new standards
- fifteen (15) standards containing new and revised requirements (these have been referred to as "revised and redrafted ISAs"); and
- twenty (20) standards that have been redrafted to apply the new conventions and reflect matters of general clarity only including ISQC 1 (these have been referred to as "redrafted ISAs and the redrafted ISQC 1").

The New ISAs

The two new ISAs are

1. ISA 265 - Communicating Deficiencies in Internal Control to Those Charged with Governance and Management
2. ISA 450 - Evaluation of Misstatements Identified During the Audit

The above have been split from the existing ISA 260 and ISA 320 respectively.

The Revised & Redrafted ISAs

No	Existing title	Revised title
ISA 200	Objective and General Principles Governing an Audit of Financial Statements	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing
ISA 260	Communication of Audit Matters with Those Charged with Governance	Communication with Those Charged with Governance
ISA 320	Audit Materiality	Materiality in Planning and Performing an Audit
ISA 402	Audit Consideration Relating to Entities Using Service Organizations	Audit Considerations Relating to an Entity Using a Third Party Service Organization
ISA 505	External Confirmations	External Confirmations

The Revised & Redrafted ISAs

No	Existing title	Revised title
ISA 540	Audit of Accounting Estimates	Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures
ISA 550	Related Parties	Related Parties
ISA 580	Management Representations	Written Representations
ISA 600	Using the work of Another Auditor	Special Considerations-Audits of Group Financial Statements (Including the work of Component Auditors)
ISA 620	Using the work of Expert	Using the work of an Auditor's Expert

The Revised & Redrafted ISAs

No	Existing title	Revised title
ISA 705	Modifications to the Independent Auditor's Report	Modifications to the Opinion in the Independent Auditor's Report
ISA 706		Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report
ISA 800	The Independent Auditor's report on Special Purpose Audit Engagements	Special considerations - Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks
ISA 805		Special Considerations - Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement
ISA 810		Engagements to Report on Summary Financial Statements

The Redrafted ISAs

No	Existing title
ISQC 1	Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements
ISA 210	Agreeing the Terms of Engagements
ISA 220	Quality Control for an Audit of Financial Statements
ISA 230	Audit Documentation
ISA 240	The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

The Redrafted ISAs

No	Existing title
ISA 250	Consideration of Laws and Regulations in an Audit of Financial Statements
ISA 300	Planning an Audit of Financial Statements
ISA 315	Identifying and Assessing the Risks of Material Misstatements through Understanding the Entity and its Environment
ISA 330	The Auditor's Responses to Assessed Risks
ISA 500	Audit Evidence

The Redrafted ISAs

No	Existing title
ISA 501	Audit Evidence – Specific Considerations for Selected items
ISA 510	Initial Audit Engagements – Opening Balances
ISA 520	Analytical Procedures
ISA 530	Audit Sampling
ISA 560	Subsequent Events

The Redrafted ISAs

No	Existing title
ISA 570	Going Concern
ISA 610	Using the work of Internal Auditors
ISA 700	Forming an Opinion and Reporting on Financial Statements
ISA 710	Comparative Information – Corresponding Figures and Comparative Financial Statements
ISA 720	The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements

Part 3

Key Changes to the Revised & Redrafted ISAs

ISA 210 – Agreeing the terms of Audit Engagements

1. Preconditions for an audit

- Determine whether the financial reporting framework is acceptable.
- Management acknowledges its responsibilities for preparation of the financial statements in accordance with the applicable financial reporting framework and for internal control to enable these to be free from material misstatement.
- Management acknowledges responsibility to provide access to information and personnel.

ISA 260 - Communication with Those Charged with Governance

1. New standard is specific about matters that should be communicated:
 - Auditor's and TCWG's responsibilities in relation to the audit
 - Planned scope and timing of the audit
 - Significant findings from the audit including
 - o Significant qualitative aspects of accounting practices e.g., accounting policies, accounting estimates, and disclosures
 - o Significant difficulties encountered during audit
 - o Significant matters discussed with management
 - o Written representations sought by auditor
 - o Other matters of significance to oversight of financial reporting process
 - Independence matters

ISA 260 – contd...

2. New standard imposes specific obligation on auditor to promote effective two-way communication between auditors and TCWG.
3. Auditor now has specific responsibility to take steps to achieve effective two-way communication, or failing that, to take further appropriate action.
4. Auditor communicates in writing if oral communication would be inadequate. Matters communicated orally have to be documented.

ISA 265 - Communicating Deficiencies in Internal Control to Those Charged with Governance and Management

1. Requires all deficiencies in internal control identified to be communicated to management where they have not been communicated by other parties and if, in the auditor's professional judgment, they are of sufficient importance to merit management's attention.
2. Auditors to determine and communicate in writing "significant deficiencies" to TCWG and management.

ISA 320 - Materiality in Planning and Performing an Audit

1. Provides specific guidance around establishing materiality, and the importance of the nature of an item as well as its size.
2. “Performance materiality” should be established to plan audit procedures.
3. Specific requirements to be observed for documentation of amounts determined and changes to them during the audit.

ISA 402 - Audit Considerations Relating to an Entity Using a Service Organization

1. When teams are obtaining an understanding of controls, and they cannot obtain their understanding from the user, they need to:
 - (a) Obtain a type 1 or type 2 report, if available;
 - (b) Contact the service organization, through the user entity, to obtain specific information;
 - (c) Visit the service organization and perform procedures that will provide the necessary information about the relevant controls at the service organization; or
 - (d) Use another auditor to perform procedures that will provide the necessary information.

ISA 402 – contd...

2. When teams' risk assessment includes an expectation that controls at the service organisation are operating effectively, they need to obtain audit evidence about the operating effectiveness of those controls from one or more of the following procedures:
 - (a) Obtaining a type 2 report, if available;
 - (b) Performing appropriate tests of controls at the service organization; or
 - (c) Using another auditor to perform tests of controls at the service organization on their behalf.

ISA 402 – contd...

3. The ISA requires inquiries of the entity whether the service organization has reported to the entity or whether the entity is aware of any fraud, noncompliance with laws and regulations or uncorrected misstatements affecting the financial statements.

ISA 450 - Evaluation of Misstatements Identified during the Audit

1. Accumulate all misstatements identified other than 'clearly trivial'.
2. Auditor communicates all misstatements accumulated to management and requests that they are corrected.
3. Reassess materiality and determine whether uncorrected misstatements are material, either individually or in aggregate, based on the nature of the misstatements as well as their size, and on the effect of uncorrected misstatements related to prior periods.
4. Uncorrected misstatements are evaluated for their impact on the financial statements and on the opinion in the auditor's report.

ISA 450 - .. Contd..

5. Misstatements that remain uncorrected are communicated to TCWG, with a request that they be corrected.
6. Representation is requested from management that uncorrected misstatements are considered immaterial to the financial statements.

ISA 501 - Audit Evidence-Specific Considerations for Selected Items

1. To identify potential litigation or claims that may give rise to a risk of material misstatement, inquire of management and others, review minutes and correspondence, and legal expense accounts.
2. The Application Material for para 9 c), which is at the risk assessment stage of the revised standard, to review legal expense accounts extends to reviewing source documentation, such as invoices, “depending on the circumstances”.

ISA 505 - External Confirmations

1. Consider new specification around how to carry out confirmation process (relating to maintaining control, obtaining further evidence where doubt arises about reliability of responses, and using negative confirmations).

ISA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosure

1. Obtain an understanding of how management identifies those transactions, events and conditions that may give rise to the need for accounting estimates to be recognized or disclosed in the financial statements. Make inquiries of management about changes in circumstances that may give rise to new, or the need to revise existing, accounting estimates.

ISA 540 – contd..

2. Obtain an understanding of how management makes the accounting estimates, and of the underlying data
 - The method, including the model where applicable, used and changes in the method from the prior period
 - Relevant controls
 - Whether an expert has been used
 - The underlying assumptions
 - Whether and, if so, how management has assessed the effects of estimation uncertainty
3. Review outcome of previous accounting estimates

ISA 540 – contd...

4. Evaluate the degree of “estimation uncertainty”; where there is a high level of uncertainty in an estimate, consider whether this amounts to a significant risk
5. To respond to assessed risks,
 - (a) Whether management has appropriately applied the requirements of the applicable financial reporting framework relevant to the accounting estimate; and
 - (b) Whether the methods for making the accounting estimates are appropriate and have been applied consistently, and whether changes, if any, in accounting estimates or in the method for making them from the prior period are appropriate in the circumstances

ISA 540 - contd...

6. In response to assessed risks, consider whether specialized skills or knowledge in relation to aspects of the accounting estimate are needed
7. Undertake one or more of the following specific procedures:
 - reviewing events occurring up to the date of the auditor's report (i.e. after date payments, etc)
8. Test how management made the accounting estimate and the data on which it is based. In doing so, the auditor shall evaluate whether:
 - (i) The method of measurement used is appropriate in the circumstances; and
 - (ii) The assumptions used by management are reasonable in light of the measurement objectives of the applicable financial reporting framework.

ISA 540 - contd...

9. Test the operating effectiveness of controls over estimates, together with appropriate substantive procedures
10. Develop a point estimate or range to evaluate management's point estimate
11. Carry out substantive procedures in relation to significant risks identified, including:
 - Evaluate how management has considered alternative assumptions or otherwise addressed estimation uncertainty
 - When management has not adequately addressed estimation uncertainty (through considering alternative assumptions etc.), develop a range estimate.

ISA 540 - contd...

12. Evaluate if disclosures related to accounting estimates are reasonable within the requirements of the applicable GAAP and obtain sufficient appropriate audit evidence related to accounting estimates to determine the disclosures are in accordance with the applicable GAAP.
13. Evaluate disclosure of estimation uncertainty for significant risks.
14. Consider whether management's judgments and decisions indicate bias

ISA 540 - contd...

15. Obtain written representations regarding the reasonableness of significant assumptions used in making accounting estimates
16. The following matters are now specifically required to be included in the audit documentation:
 - The basis for the auditor's conclusions about the reasonableness of accounting estimates and their disclosure that give rise to significant risks; and
 - Indicators of possible management bias, if any.

ISA 550 – Related Parties

1. Even where the applicable financial reporting framework establishes minimal or no related party requirements, the auditor nevertheless needs to obtain sufficient understanding of related party relationships and transactions to conclude on (a) of the objectives of the standard. [Objective part (a) Irrespective of whether the applicable financial reporting framework establishes related party requirements, to obtain an understanding of related party relationships and transactions sufficient to be able:
 - (i) To recognize fraud risk factors, if any, arising from related party relationships and transactions that are relevant to the identification and assessment of the risks of material misstatement due to fraud; and

ISA 550 - contd...

- (ii) To conclude, based on the audit evidence obtained, whether the financial statements, insofar as they are affected by those relationships and transactions:
 - a. Achieve fair presentation (for fair presentation frameworks); or
 - b. Are not misleading (for compliance frameworks)

ISA 550 - contd...

2. An understanding of related party relationships and transactions is relevant to the evaluation of fraud risk factors.
3. There is a generally greater emphasis on understanding related party relationships and transactions and on assessing the risks arising from these.
4. The engagement team discussion on risks of fraud or error required by ISA 315 and ISA 240 now needs specifically to consider risks arising from related party relationships and transactions.

ISA 550 – contd...

5. Make specific enquiries into the identity of related parties (and changes from prior year), the nature of the relationship and the type and purpose of any transactions that occurred.
6. Make enquiries to obtain an understanding of the controls around related parties, including authorising and approving significant transactions with related parties and transactions outside the normal course of business.
7. The existing requirement for the auditor to maintain alertness for related party information when reviewing records or documents continues to apply.

ISA 550 – contd...

8. When significant transactions outside the normal course of business are identified as a result of such reviews, auditors shall enquire of management about the nature of the transaction and whether related parties are involved.
9. Determine whether any of the risks (around related parties) are significant risks, and take account of any fraud risk factors identified in the risk assessment required by ISA 240.
10. Identified significant related party transactions outside the normal course of business are considered significant risks.

ISA 550 – contd...

11. Carry out specific procedures where undisclosed related parties or significant related party transactions are identified:

- Promptly discuss within the team.
- Request management to identify all transactions with newly identified parties and inquire why they have not been disclosed.
- Test identified items substantively, to the extent appropriate.
- Re-consider the risks associated with related party transactions including the risk that other unidentified related party transactions may exist.
- If non-disclosure appears intentional reconsider risk of fraud.

ISA 550 – contd...

12. Documentation requirement: such matters need to be communicated to Those Charged With Governance (TCWG) - See #12 below.
13. Specific enquiries are required when significant transactions outside the normal course of business are identified, to consider whether related parties are involved. May require more discussion with the entity, more information from the entity, additional audit work and additional documentation
14. Identified significant related party transactions outside the entity's normal course of business are 'significant risks' and further substantive procedures should be performed, including inspection of contracts and evaluation of business rationale.

ISA 550 – contd...

15. Application material para A38 provides some guidance on considering the business rationale for a transaction outside the normal course of business.
16. Test assertions by management that transactions are on arm's length basis
17. Requires communication with TCWG about significant matters identified during the audit in connection with the entity's related parties
18. Documentation requirement: the names of the identified related parties and the nature of the related party relationships must be included in the audit documentation.

ISA 580, Written Representations

1. The auditor shall request written representations from management that:
 - a) It has provided the auditor with all relevant information and access as agreed in the terms of the audit engagement, and
 - b) All transactions have been recorded and are reflected in the financial statements.

2. Provides requirements for representation process. When management does not provide representations regarding their fulfilment of key responsibilities and completeness of provided information, this results in a disclaimer of opinion (previously a qualification was possible).

ISA 600, Special Considerations-Audits of Group Financial Statements

ISA 600

Division of Responsibility

18. While compliance with the guidance in the preceding paragraphs is considered desirable, the local regulations of some countries permit **a principal auditor to base the audit opinion on the financial statements taken as a whole solely upon the report of another auditor** regarding the audit of one or more components. When the principal auditor does so, the principal auditor's report should state this fact clearly and should indicate the magnitude of the portion of the financial statements audited by the other auditor. When the principal auditor makes such a reference in the auditor's report, audit procedures are ordinarily limited to those described in [paragraphs 7](#) and [9](#).

Clarity ISA 600

Responsibility

11. The group engagement partner is responsible for the direction, supervision and performance of the group audit engagement in compliance with professional standards and regulatory and legal requirements, and whether the auditor's report that is issued is appropriate in the circumstances.³ As a result, **the auditor's report on the group financial statements shall not refer to a component auditor, unless required by law or regulation to include such reference. If such reference is required by law or regulation, the auditor's report shall indicate that the reference does not diminish the group engagement partner's or the group engagement partner's firm's responsibility for the group audit opinion.**

ISA 600, Special Considerations-Audits of Group Financial Statements – contd...

ISA 600	<p>Clarity ISA 600</p> <p>Application guidance</p> <p>A8. Although component auditors may perform work on the financial information of the components for the group audit and as such are responsible for their overall findings, conclusions or opinions, the group engagement partner or the group engagement partner's firm is responsible for the group audit opinion.</p>
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ISA 620, Using the Work of an Auditor's Expert, and ISA 500, Audit Evidence (deals in a consistent way with the work of management's expert)

1. Specifications around planning the work to be performed, including evaluating the competence, capabilities and objectivity of the expert and the adequacy and appropriateness of that expert's work as audit evidence for the relevant assertion.

ISA 620 - contd..

2. In the case of the auditor's expert, the auditor needs to obtain a sufficient understanding of the field of expertise of the expert to determine the nature, scope and objectives of the expert's work and to enable the auditor to evaluate its adequacy. The expert's scope of work is to be documented in writing by the auditor. The auditor's expert's scope of work, roles and responsibilities, the nature, timing and extent of communication and confidentiality issues are to be agreed with the auditor.
3. With the split of ISA 620 and ISA 500, management and auditor's experts are now more clearly distinguished.

ISA 700, Forming an Opinion and Reporting on Financial Statements ISA 705, Modifications to the Opinion in the Independent Auditor's Report ISA 706, Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report

1. Reorganisation of reporting standards, with greater recognition of reporting implications of the different financial reporting frameworks (general purpose and special purpose frameworks, fair presentation and compliance frameworks).
2. Basic form and content of an ISA audit report unchanged other than flexibility introduced in how management's responsibilities can be described.

ISA 700 – contd..

1. Revised standard includes more detailed requirements and guidance on modified opinions (qualifications, adverse opinions, disclaimers).
2. Revised standard includes more structure around appropriate use of Emphasis of Matter paragraphs, and introduction of Other Matters paragraphs.

Areas of particular focus

- Most significantly changed ISAs are:
 - the audit of accounting estimates
 - consideration of related parties
 - group audits
 - using the work of experts.
- Communications with management will also be a particular area of change for some engagements.
- On **larger group audits** the clarified ISAs will need to be applied across all group components and by all component audit teams involved.
- On **smaller, less complex audits** follow the specific 'smaller entity application guidance' to avoid compliance with the letter of the requirements becoming a disproportionate burden.

The End