

Consultation Paper

**CONSULTATION ON WHETHER UK AND IRISH AUDITING
STANDARDS SHOULD BE UPDATED FOR THE NEW
INTERNATIONAL AUDITING STANDARDS**

October 2008

**— The Auditing Practices
Board**

THE AUDITING PRACTICES BOARD

The Auditing Practices Board (APB), which is part of the Financial Reporting Council (FRC), prepares for use within the United Kingdom and the Republic of Ireland:

- Standards and guidance for auditing;
- Standards and guidance for reviews of interim financial information performed by the auditor of the entity;
- Standards and guidance for the work of reporting accountants in connection with investment circulars; and
- Standards and guidance for auditors' and reporting accountant's integrity, objectivity and independence

with the objective of enhancing public confidence in the audit process and the quality and relevance of audit services in the public interest.

The APB comprises individuals who are not eligible for appointment as company auditors, as well as those who are so eligible. Those who are eligible for appointment as company auditors may not exceed 40% of the APB by number.

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INVITATION TO COMMENT

The APB is seeking views on when and how to update the ISAs (UK & Ireland) for the new 'Clarity ISAs'.

The International Auditing and Assurance Standards Board (IAASB) is soon to complete an important project to update and reformat the International Standards on Auditing (ISAs). This, so called, 'Clarity Project' was undertaken with international regulatory support in order to improve the understandability of the ISAs and make them more compatible with regulatory frameworks, including the EC's Statutory Audit Directive.

The decision and timetable for an endorsement of the 'Clarity ISAs' within the EU has not yet been established. The APB anticipates that such endorsement, if any, would be at a later date than the effective date established by IAASB.

In 2004 APB made the strategic decision to base UK and Irish auditing standards on ISAs. One of the reasons for this was to benefit efficiently from future improvements in the ISAs. Since then, in parallel with the Clarity Project, ISAs on important topics such as auditing groups, estimates (including fair values) and related party transactions have been improved to reflect the latest developments and thinking.

As the improvements that have been made are designed to improve audit quality and the Clarity Project has been undertaken primarily to improve the understandability of the ISAs, APB believes that there is merit in introducing these new standards in the UK and Ireland as soon as is practicable. The APB would greatly appreciate hearing the views of investors (who have a particular interest in obtaining high quality audits), companies (who pay audit fees), accountancy bodies (who will need to provide training and implementation support) and audit firms (who will have to apply the new standards) on any matter referred to in this Consultation Paper and specifically:

- 1. Do you agree that ISAs (UK and Ireland) should be updated to reflect improvements in the underlying international auditing standards? If not, please explain your reasons.**
- 2. If you agree that the ISAs (UK & Ireland) should be updated for improvements in the underlying international auditing standards, do you believe that this should be done by adopting the Clarity ISAs:**
 - (a) as soon as practicable, or**
 - (b) if and when they are endorsed by the EC?**
- 3. If you believe the Clarity ISAs should be adopted as soon as practicable, do you believe it will be practicable to require the resulting new ISAs (UK & Ireland) to apply to audits of UK and Irish entities with accounting periods commencing on or after 15 December 2009?**
- 4. Do you support APB's view that the same standards should apply to audits of entities of all sizes? If not, please explain your reasons.**

The APB would prefer to receive letters of comment in an electronic form that facilitates 'cut and paste': these may be sent by e-mail to k.billing@frc-apb.org.uk. If this is not possible, please send letters of comment to:

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Letters of comment should be sent so as to be received no later than ***16 January 2009***
All comments will be regarded as being on the public record, unless otherwise requested and will be posted to the APB's website soon after receipt.

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1. INTRODUCTION

Current relationship between UK and Irish auditing standards and the ISAs

- 1.1 This consultation paper is issued at a time when there is increasing momentum towards international convergence in standards for accounting and auditing. The US Securities and Exchange Commission has recently confirmed its commitment to the adoption of IFRS and the European Commission has passed enabling legislation for the harmonisation of auditing standards throughout the EU. It is generally recognised that adoption of the International Standards on Auditing (ISAs) issued by the International Audit and Assurance Standards Board (IAASB) is the most likely way in which the EC's objective will be achieved.
- 1.2 In principle, APB supports these moves towards harmonisation of auditing standards internationally and has committed significant effort and resources over a number of years to assisting IAASB improve the quality of the ISAs.
- 1.3 In 2004, APB took the strategic decision to issue ISAs (UK and Ireland) which comprised the ISAs, as then issued by the IAASB¹, supplemented with 'pluses' where necessary to maintain the requirements and clarity of the existing UK and Irish auditing standards. Factors taken into account in reaching that decision included:
- the IAASB had recently introduced new ISAs which strengthened auditing standards in the critical areas of audit risk, fraud and quality control,
 - work was underway to update and improve a number of the other ISAs on important topics such as auditing groups, accounting estimates (including fair values), and related party transactions. APB wanted to benefit efficiently from these improvements, and
 - the expectation that the European Union (EU) would adopt the ISAs in the foreseeable future.
- 1.4 Since 2004 the APB has made very few changes to ISAs (UK and Ireland). Instead it has channelled its energies into supporting IAASB's efforts to improve ISAs, with the expectation that these improvements would be implemented by the APB in due course.
- 1.5 The IAASB is close to completing its major project to clarify and improve the ISAs. APB believes that there are significant improvements in these standards that should be implemented in the UK and Ireland as soon as is practicable. Furthermore, the APB understands that a number of other countries are planning to implement the Clarity ISAs for accounting periods commencing on or after 15 December 2009. This consultation seeks views on whether respondents agree with this approach and, if so, on timing.

¹ Since 2004 the APB has considered the two ISAs subsequently updated by the IAASB and evaluated whether they should be introduced in the UK and Ireland. ISA 230 (Revised), which addresses audit documentation, has been adopted; ISA 700 (Revised), which addresses the form of the auditor's report, has not been adopted.

IAASB's Clarity Project

- 1.6 The IAASB's Clarity Project was commenced in late 2005. It largely relates to the way that the standards are presented, including:
- Describing an objective for each ISA,
 - Separating the requirements in each ISA from the application material,
 - Clarifying the obligations imposed on auditors by the requirements of the ISAs, including eliminating ambiguity about the requirements an auditor needs to fulfil arising from the use of the present tense in the guidance to the current ISAs, and
 - Improving the overall readability and understandability of the ISAs through structural and drafting improvements.
 - Reducing the complexity of the existing ISAs – this was seen as being especially important to smaller audit firms with limited technical resources.
- 1.7 In addition to 'clarifying' all of the ISAs, 13 of the ISAs have also been revised and a new ISA, (ISA 265 which addresses communicating deficiencies in internal control) is being introduced. Some of the revised ISAs increase the rigour of auditing standards in key areas such as accounting estimates (including fair values), related parties and group audits involving more than one audit team.
- 1.8 The IAASB is also planning to issue three ISAs that address special reporting frameworks. The APB is not intending to promulgate these three ISAs² as they are not relevant to statutory audits in the UK and Ireland and the APB is alert to a danger that there may be confusion as to how these standards interrelate with the APB's Standards for Investment Reporting (SIRs).
- 1.9 The intention of the IAASB is that all the ISAs redrafted in the Clarity format, including those that have been revised, should come into effect internationally on the same date – for audits of financial statements for periods beginning on or after 15 December 2009.
- 1.10 It is likely that the larger UK audit firms will implement the new standards from this date, irrespective of any action taken by APB, because of their commitments to IFAC³.
- 1.11 The IAASB is aiming to complete its work on the Clarity Project by the end of 2008. The new ISAs are published in final form on the IFAC website when the Public Interest Oversight Board⁴ has confirmed that due process was followed in

² ISA 800 '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' and ISA 810 'Engagements to report on summary financial statements'.

³ The larger UK audit firms are members of IFAC's Forum of Firms. Members of the Forum of Firms are required to have policies and methodologies for the conduct of audits that are based, to the extent practical, on ISAs and to promote the consistent application of high quality audit practices worldwide.

⁴ The PIOB is an independent body responsible for approval of appointments and ongoing oversight of IFAC public interest activities.

their development. Many of the clarified ISAs are already available and it is planned that all the finalised ISAs will have been published by IFAC by the end of March 2009.

APB involvement in the Clarity Project

- 1.12 APB and its SME Audit sub-committee⁵ have discussed each of the Clarity ISAs and responded to all 30 exposure drafts issued by IAASB. The APB is generally satisfied with how responsive IAASB has been to its comments – especially those from the SME Audit sub-committee which have challenged the applicability of some of the suggested requirements on smaller audits and offered additional guidance intended to ease the burden of implementing the standards when undertaking smaller audits.
- 1.13 Although the Clarity Project is not yet complete⁶ APB does not anticipate having major concerns regarding the appropriateness of the clarified ISAs to UK and Irish audits other than with respect to:
- The format of auditor reports required by ISA 700 ‘The Independent Auditor’s Report on General Purpose Financial Statements’, and
 - The likely need to perpetuate some of the ‘pluses’ in the existing ISAs (UK and Ireland), for example to provide guidance on specific UK and Irish legal requirements and possibly to maintain the relatively small number of current supplementary requirements that have not been addressed in the clarified ISAs (see paragraph 3.12).
- 1.14 In September 2008 APB issued an exposure draft of ISA (UK and Ireland) 700 (Revised). As described more fully in that paper it is APB’s intention to reduce the amount of ‘boiler plate’ language in UK and Irish auditor reports. As the Clarity version of ISA 700 would perpetuate, indeed exacerbate, the use of ‘boiler plate’ language in auditor reports APB believes that it is preferable to issue a national auditing standard at this stage. IAASB has announced its intention to consider recent research and developments with regard to the auditor’s report in 2009 and, in the light of this, determine what action should be taken in relation to ISA 700. The APB will be actively participating in this project.
- 1.15 In developing its proposed changes to ISA (UK and Ireland) 700, APB has sought to ensure that compliance with it would not preclude auditors in the UK and Ireland from asserting that the ISAs have been complied with.

Implementation of the EC Statutory Audit Directive

- 1.16 Article 26 of the Statutory Audit Directive provides the platform for the adoption of international auditing standards in the EU for all statutory audits. While the European Commission (EC) is in active dialogue with Member States regarding this issue, the ISA adoption process can not formally commence until the Clarity Project has been finalized. Although in APB’s view it is likely that the ISAs will

⁵ The APB SME Audit Sub-committee comprises representatives of smaller audit firms and sole practitioners who assist the APB in considering audit developments from an SME perspective.

⁶ 3 ISAs remain to be finalised at the IAASB’s meetings scheduled for December 2008.

be adopted for use in the EU, the timing and manner of such adoption has yet to be determined.

- 1.17 The APB's current view is that it will be unlikely that the EU will have adopted the Clarity ISAs in time to mandate them for audits of financial periods beginning on or after 15 December 2009 (i.e. adoption by the EU will be later than the effective date established by the IAASB)⁷.
- 1.18 While APB would hope that EU adoption would relate to the ISAs in their entirety, there is a possibility that, as the EU adoption process develops, a need may be seen for the EC to change the ISAs as issued by IAASB. If this were to happen, and APB had already promulgated the Clarity ISAs, APB would need to consider whether it was then necessary to make further changes to UK and Irish auditing standards in order to comply with EU legislation. EC changes could involve additions, 'carve-outs' or both.

2. DIFFERENCES BETWEEN ISAs (UK & IRELAND) AND THE CLARITY ISAs AND THE IMPACT OF THIS ON AUDITS IN THE UK AND IRELAND

Differences in Clarified ISAs

- 2.1 Many of the changes to the ISAs relate to the manner in which the information is structured and the way that the requirements are identified (for example the Clarity ISAs cluster all of the requirements in a single section and use the word 'shall' to signify an imperative whereas the existing ISAs use a 'bold text' convention using the word 'should').
- 2.2 As described in paragraph 1.6, one of the objectives of the Clarity Project was to clarify the obligations imposed on auditors by eliminating ambiguity about the requirements an auditor needs to fulfil arising from the use of the present tense in the current ISAs. This has resulted in some of the material that was previously included as 'present tense guidance' now being included as requirements in the Clarity ISAs. Addressing the 'present tense guidance' in this way results in an increase in the number of requirements within the ISAs.
- 2.3 Overall there is an increase of about a third in the number of requirements in the ISAs that apply to the performance of an audit of a single entity – about a half relates to 'clarification' of existing guidance and about a half of this increase relates to new requirements designed to improve audit quality. There is also an increase in the number of requirements that apply to group audits.
- 2.4 This absolute increase in the number of requirements in the ISAs does not however translate directly into changes in audit procedures to be performed and consequently future work effort as:

⁷ In a speech in December 2007, the European Commissioner for Internal Market and Services made it clear that before making a decision regarding the endorsement of ISAs, the EC will wish to assess the outcome of the Clarity Project and the results of two studies that the EC has commissioned to look at the costs and benefits of introducing ISAs in Europe and the potential differences between ISAs and US auditing standards.

- some audit firms have taken the view that the current ISA guidance reflects the proper application of the existing standards, and have accordingly already incorporated it in their audit methodologies,
- some audit teams will already be undertaking procedures that correspond to the new requirements added as ‘improvements’ to the existing ISAs, and
- many of the additional requirements are conditional and will not apply to all audits, others relate to the contents of written communications such as auditor reports, letters of engagement and representation letters.

2.5 The following ISAs have been revised as well as clarified:

ISA	
200	Objective and General Principles Governing an Audit of Financial Statements
260	Communication of Audit Matters With Those Charged With Governance
320	Materiality in Planning and Performing an Audit
402	Audit Considerations Relating to Entities Using Service Organizations
450	Evaluation of Misstatements Identified During the Audit
505	External Confirmations
540/545	Auditing Accounting Estimates, Including Fair Value Accounting Estimates, And Related Disclosures.
550	Related Parties
580	Management Representations
600	The Audit of Group Financial Statements
620	Using the Work of an Expert
705 ⁸	Modifications to the Opinion in the Independent Auditor’s Report
706	Emphasis of Matter Paragraphs and Other Matters Paragraphs in the Independent Auditor’s Report

2.6 The revisions are intended to enhance audit quality by increasing the rigour of auditing standards in key areas. Appendix 1 summarises the main changes in the revised ISAs that the APB believes are most likely to affect audit work effort, compared to existing ISAs (UK and Ireland).

2.7 As explained above the APB has made very few changes to UK and Irish auditing standards in recent years. Instead it has channelled its energies into supporting IAASB’s efforts to improve ISAs. This has involved:

- Using the APB’s work on the auditing implications of aggressive earnings management to improve the auditing standards on materiality and accounting estimates with APB members chairing the IAASB working parties on these subjects,

⁸ ISAs 705 and 706 will supersede ISA 701 ‘ Modifications to the Independent Auditor’s Report’.

- Undertaking research studies such as on how to improve auditing of related parties⁹,
- Promoting strengths of particular APB standards including those relating to quality control and communications with those charged with governance, and
- Responding to all IAASB exposure drafts.

2.8 The introduction of the Clarity ISAs will therefore result in improvements to the UK and Irish auditing standards that reflect the latest developments and thinking. Many of these changes would have been made by APB notwithstanding IAASB's work had the APB not decided to channel its energies in the way it has. By working internationally the APB has ensured that there is broad support for its views and that the final standards are in a form that is likely to lead to widespread international adoption.

Impact of differences between ISAs (UK & Ireland) and the Clarity ISAs

2.9 APB staff have undertaken an assessment of the possible impact on the cost of individual audit engagements of applying the Clarity ISAs. This work is described in Appendix 2.

2.10 This assessment confirmed that relatively little additional cost is expected to arise from the clarification of the existing ISAs (see the discussion in Appendix 2, pages 26 and 27, of the main causes of the impacts). However, revision of some of the ISAs designed to increase audit quality has a more substantial impact. Overall the work performed suggests that the impact on audit cost will be as follows:

	Audits of small and mid-sized entities	Audits of listed and large private companies
Sample size	14 companies / charities	13 companies
Average increase in recurring cost of the audit of an individual entity	9.6%	1.9%
Average impact of ISA 600 on group audits	0.5%	3.0%
Total recurring costs for group audits	10.1%	4.9%
Average increase in 'year one' non-recurring costs	3.8%	0.1%
Total year one cost	13.9%	5.0%

⁹ APB published a paper 'Improving the auditing of entities subject to common control' in October 2003 with the specific objective of assisting IAASB revise ISA 550.

- 2.11 Whether such increases in costs will be passed on to preparers in the form of increased audit fees will be subject to market forces.
- 2.12 The cost analysis demonstrates that the cost increase in percentage terms is likely to be greater for smaller audits than larger audits. This is unsurprising as the base hours impacted are low (the mean audit time spent on these audits was 145 hours) and therefore a small number of additional hours has a significant impact in percentage terms.
- 2.13 It is important to note that the range of results, especially for smaller audits, is fairly wide (for example the range for the increase in recurring costs of small and mid-sized entities was between less than 1% and 17%) - see Appendix 2 for more details). Factors that will impact the actual cost impact include:
- The characteristics of the audit (for example for some audits the impact of ISA 540 on the audit of accounting estimates will be especially important; for other audits the impact of ISA 550 on related parties may be the prime driver of cost increases); and
 - The extent to which the audit firm's current methodology and practices already incorporates the requirements of the Clarity ISAs. The audit firms with the more sophisticated methodologies and practices are likely to have the lowest cost increases as they already address many of the 'advances' in the Clarity ISAs.
- 2.14 Non-recurring costs include matters such as the time spent explaining changes in the audit approach to the client and changes to the audit engagement letter. Non-recurring costs do not include added costs associated with the 'learning curve'. A number of audit firms commented that on the first few audits under the new standards there would be inefficiencies as auditors familiarise themselves with the new requirements in the revised ISAs and determine how best to apply them in practice. Some of the smaller audit firms quantified this learning curve to be of a similar magnitude to year one 'non-recurring costs'. The cost of the 'learning curve' has not been included in the summary cost impact as:
- The learning curve will only apply on the first few audits under the new standards not to all audits conducted in the first year after adoption of the Clarity ISAs, and
 - There is likely to be an inverse relationship between the size of the 'learning curve' on individual audits and investment in training (both by individuals by way of Continual Professional Development and by audit firms in more structured training exercises).
- 2.15 Other 'year-one' costs are likely to be incurred by audit firms, including preparing/updating manuals and training staff. Estimates of the possible effect of these other non-recurring costs have not been included in the figures above.

3. POSSIBLE ADOPTION STRATEGIES

Options

- 3.1 An important factor to be considered is that the new requirements are designed to increase audit quality in areas that are central to the effectiveness of the audit, especially in the current reporting environment (for example the auditing of fair value estimates). The APB believes that the auditing standards it promulgates should reflect these improvements in order to maintain the position that UK and Irish auditing standards are the best available.
- 3.2 The APB has considered a number of possible adoption strategies and concluded that there are two primary choices:

Option	
1	To update the ISAs (UK & Ireland) for the new ‘Clarity ISAs’ and for the new standards to apply to UK and Irish audits as soon as practicable.
2	Leaving the existing ISAs (UK and Ireland) in issue until the EC has adopted the new ISAs.

- 3.3 The possible advantages and disadvantages of each approach are set out below.

Option 1. To update the ISAs (UK & Ireland) for the new ‘Clarity ISAs’ and for the new standards to apply to all UK and Irish audits as soon as practicable.

As mentioned above, the intention of the IAASB is that all the ISAs redrafted in the Clarity format, including those that have been revised, should come into effect internationally on the same date – for audits of financial statements for periods beginning on or after 15 December 2009. The APB anticipates that this will be a practicable date for implementation in the UK and Ireland on the assumption that the IAASB meets its timetable for finalisation of the Clarity ISAs, with publication of them by the end of March 2009 (see paragraphs 3.12 – 3.15 below).

The advantages of this approach are:

- The most rigorous auditing standards would be applied in the UK and Ireland at the earliest possible opportunity on audits of all sizes, thus reinforcing the UK’s commitment to adopting the most robust auditing standards available. A number of other countries¹⁰ are planning to implement the Clarity ISAs for accounting periods commencing on or after 15 December 2009.
- The new ‘clarified ISAs’ will be easier for all auditors (especially those in the smaller firms) to understand and apply. Some audit firms and training providers consider the existing standards to be overly complex.

¹⁰ Current indications are that Australia, Brazil, Canada, The Netherlands and South Africa will implement the Clarity ISAs broadly in line with IAASB’s timetable and New Zealand and India will soon follow. Other countries such as Japan and China are still finalising their plans).

- It would avoid uncertainty as to which standards should be applied in the UK and Ireland and allow audit firms and training organisations to plan their implementation strategies.
- Alternative approaches could lead to ‘two sets’ of auditing standards. This could result in confusion for companies, investors and auditors in understanding what an audit comprises and other disadvantages (see below).
- Adoption of the Clarity ISAs in the UK and Ireland as early as possible would help the adoption process within the EU.
- It reflects the APB’s support for moves towards harmonisation of auditing standards internationally, not just in Europe.

The possible disadvantages of this approach are:

- The increased rigour of the revised Clarity ISAs designed to improve the quality of auditing will add to audit cost (especially on audits of smaller entities). The effect of waiting until EU adoption takes place would only be to defer these additional costs.
- There is a danger that the added cost (and the reluctance of smaller entities to pay additional audit fees) could result in a number of existing smaller audit firms withdrawing from being Registered Auditors. This could result in changes in market conditions for smaller entities (including the availability of and competition between, audit firms) and charities and solicitors finding it more difficult to obtain certain assurance services (and perhaps more costly).¹¹
- There is a risk, but perhaps a relatively small risk, that the EU may change the Clarity ISAs as a result of the adoption process. In order to comply with EU legislation this could cause APB to have to change the auditing standards, perhaps relatively soon after the Clarity ISAs have been promulgated.
- Firms, accountancy bodies and training providers may not be ready to implement the Clarity ISAs for accounting periods commencing on or after 15 December 2009. While there has already been dialogue with accountancy bodies and training providers, hasty implementation could lead to inefficiency and additional costs for the audit firms and perhaps audited entities.

Option 2. Leaving the existing ISAs (UK and Ireland) in issue until the EC has adopted the new ISAs.

The main advantage of such an approach would be to minimise the risk of there being differences between APB auditing standards and those adopted, in due course, by the EC. This benefit may however be outweighed by the disadvantages of:

- Failure to implement improvements in auditing standards designed to increase audit quality,
- The consequent risk that an audit failure could occur which could have been avoided if the Clarity ISAs been adopted,
- The UK and Ireland not being able to demonstrate internationally their commitment to applying the best auditing standards available, and

¹¹ Independent Examinations of certain charities and compliance reports for the Law Society currently have to be performed by Registered Auditors.

- Uncertainty regarding when the EC will adopt the Clarity ISAs.

- Q1 Do you agree that ISAs (UK and Ireland) should be updated to reflect improvements in the underlying international auditing standards? If not, please explain your reasons.**
- Q2 If you agree that the ISAs (UK & Ireland) should be updated for improvements in the underlying international auditing standards, do you believe that this should be done by adopting the Clarity ISAs:**
- (a) as soon as practicable, or
- (b) if and when they are endorsed by the EC?
- Q3 If you believe the Clarity ISAs should be adopted as soon as practicable, do you believe it will be practicable to require the resulting new ISAs (UK & Ireland) to apply to audits of UK and Irish entities with accounting periods commencing on or after 15 December 2009?**

Other options considered

3.4 Other options that were considered by the APB included:

Updating the existing ISAs (UK and Ireland) individually for some of the improvements embedded in the Clarity ISAs.

3.5 The main advantage of such an approach would be to deliver some of the improvements in the Clarity ISAs on a timely basis. However, the APB rejected this option as it considered that:

- The new ISAs in the ‘Clarity’ format will not ‘fit’ with existing ISAs (UK and Ireland) and this approach is likely to be considered confusing.
- Updating the existing UK standards would be extremely resource intensive for both the FRC (who would do the work) and the audit profession (firms and accountancy bodies who would need to respond to a large number of exposure drafts), and
- The value of such work is likely to be short lived because of, and indeed might well be overtaken by, the EU adoption process.

Adopting the Clarity ISAs for audits only of listed companies - Establishing two sets of auditing standards

3.6 As illustrated by the table in Appendix 2, the UK audit market involves companies (both listed and unlisted), charities and pension schemes. These entities are of varying size and public interest. While the audit of about 4,500 listed entities account for about 40% of the total audit cost, there are perhaps 147,500 other entities (pension schemes, large charities and unlisted companies above the statutory threshold) that are required to have an audit and perhaps another 120,000 that have an audit performed on a voluntary basis.

- 3.7 In light of this, one possibility that the APB has discussed is adopting the new Clarity ISAs for the audits of listed companies and allow the auditors of other entities the option of choosing whether to apply the existing ISAs (UK and Ireland) or the Clarity version of the ISAs (UK and Ireland). Such an approach would:
- focus changes on the largest companies where the public interest in robust auditing is probably greatest, and
 - defer the cost impact for smaller entities until adoption of the Clarity ISAs is required by the EU.
- 3.8 While superficially attractive, implications of such an approach include:
- It would mean that two sets of auditing standards – the existing ISAs (UK and Ireland) and the Clarity versions of the ISAs (UK and Ireland) – would be in existence. As explained earlier in this paper the APB considers that application of the Clarity ISAs will result in improved audit quality.
 - The auditor is required to express the same conclusion on all statutory audits i.e. their view as to whether the financial statements present a true and fair view. The existence of two sets of auditing standards with differing levels of requirements in some areas, both supporting the same conclusion, is likely to be confusing to companies, investors and auditors in understanding what an audit comprises.
 - Company management would probably be involved in the decision as to which auditing standards should be applied. Management’s views is likely to be strongly influenced by cost; as shareholders, not management, are the ultimate beneficiaries of an audit it does not seem appropriate to APB that management should be able to elect for less robust audit, and allowing such a debate would jeopardise auditor independence.
 - The existence of two sets of auditing standards is likely to distract accountancy bodies and audit firms from implementing the Clarity versions of the ISAs (UK and Ireland) in a cost effective manner,
 - Some audit firms would need to perform audits under both sets of standards and auditors would therefore need to understand both sets of auditing standards,
 - It is likely to be impractical for both sets of standards to be taught for the purpose of the examinations for trainee accountants/auditors; if one set is covered this will give rise to difficulties for trainees who have to apply the other set “on the job”, and
 - An impression might be created that smaller audits are ‘second class’.
- 3.9 Since its inception, the APB has taken the view that the same set of auditing standards should apply to audits of entities of all sizes. This view is supported by:
- IAASB who, during the development of the Clarity ISAs, has involved auditors of smaller entities and specifically considered issues relating to smaller audits, and

- APB’s SME audit sub-committee who have reviewed all of the Clarity ISA exposure drafts and, through APB’s responses, been effective in achieving important changes in the final standards.
- 3.10 The existence of an audit exemption threshold within UK and Irish company law allows shareholders of smaller companies to decide whether an audit need be undertaken. In so doing shareholders will balance the likely costs and benefits. Once legislators (for companies above the threshold) and shareholders (for companies below the threshold) have decided that an audit should be performed, APB believes that its role is to establish standards that determine the quality of that audit and that the same standards should apply to audits of entities of all sizes.
- 3.11 APB’s view that the same sets of standards should apply to all audits does not preclude alternative forms of engagements being provided for entities that are not required to have their financial statements audited. For example compilation engagements are frequently performed for smaller entities, independent examinations are undertaken on smaller charities and some firms of accountants provide other review services.

Q4 Do you support APB’s view that the same standards should apply to audits of entities of all sizes? If not, please explain your reasons for taking a different view.

Adequacy of time for implementation

- 3.12 Following this consultation APB will announce in March 2009 which course it intends to take. If Option 1 is to be pursued the APB will very shortly thereafter issue exposure drafts of a complete set of Clarity ISAs (UK and Ireland). These ISAs will be the Clarity ISAs as issued by IAASB possibly supplemented by a small number of ‘pluses’. The Clarity ISAs (UK and Ireland) are also likely to contain a small amount of additional application material to provide guidance on legal and regulatory matters specific to the UK and Ireland. APB has not yet debated the need for specific ‘pluses’ in detail – when it does it will focus on whether current pluses need to be maintained (e.g. because they have not been addressed in the clarified ISAs and are considered important to maintain the quality of UK and Ireland audits), APB is not anticipating a need to add “new” pluses. The pluses will be the subject of the future consultation and views on them are not being sought at this time.
- 3.13 APB is conscious that if new standards are to improve the quality of audits in a cost effective manner, sufficient time must be allowed for accountancy bodies and audit firms to understand the changes, update methodologies and train staff. In this context the APB hopes that any problems arising from the fact that the final Clarity ISAs are unlikely to be published by IFAC before March 2009 will have been alleviated by the following steps:
- IAASB commenced the Clarity Project in 2005 and, since then, has achieved a high degree of transparency in the way that it has communicated progress made.
 - The majority of the Clarity ISAs have already been finalised and are published on the IFAC and IAASB websites, and

- Over the last two years APB has also published information about the Clarity Project on its website to alert auditors and others with an interest in auditing standards to the changes being proposed and the possible impact of these on current practice in the UK and Ireland. Meetings have also been held with third party methodology, software and training providers to brief them on developments.
- 3.14 Although 15 December 2009 is not far away, it should be noted that, with the possible exception of a few ‘short’ accounting periods, the standards would be first applied to audits of accounting periods ending on 31 December 2010. None of those audits will be completed before 2011 and, in the case of smaller audits, virtually all the audit work will be undertaken in 2011.
- 3.15 APB welcomes views on the practical implications of applying the Clarity ISAs for audits of financial statements commencing on or after 15 December 2009.

Summary of revisions to the ISAs most likely to impact the auditor's work effort in the UK and Ireland

This appendix summarises the main changes to the procedures required to be performed by auditors in the UK and Ireland if the Clarity ISAs were to be adopted. The summary has been prepared for illustrative purposes because, at the current date, not all of the ISAs have been finalised by the IAASB. In relation to ISAs 265 and 402 it is based on the exposure drafts issued by the IAASB which may change in the finalisation process. The summary also excludes:

- changes to the ISAs relating to the auditor's report (ISAs 700, 705 and 706), and
- changes to the ISAs relating to agreeing the terms of engagement and obtaining and confirming management's representations (ISAs 210 and 580)

as these may result in relatively minor changes to existing practice in the UK and Ireland and are not likely to impact the auditor; work effort.

ISA	Main changes expected in the clarified standards ¹²
<p>260 Communication With Those Charged With Governance</p>	<p><i>It is important to be aware that in the process of finalising the 'Clarity ISAs' there may be some changes to the points below. This includes to 'finalised' ISAs as they may be updated by conforming changes for other ISAs,</i></p> <p>The revision of ISA 260 has brought it closer to the current ISA (UK and Ireland) 260 and implementation should not cause a significant change in approach or increase in work effort. However, there are several additional requirements that are currently covered in substance by guidance text in the ISA (UK and Ireland), including:</p> <ul style="list-style-type: none"> • Where applicable, explaining why accounting practices are not considered appropriate. • Documenting matters communicated orally. <p>In addition there are new explicit communication requirements for the auditor, including:</p> <ul style="list-style-type: none"> • Significant difficulties, if any, encountered during the audit. • Significant matters, if any, arising from the audit that were discussed, or subject to correspondence with management (unless all those charged with governance are involved in managing the entity).
<p>265 Communicating Deficiencies in Internal Control</p>	<p>This is a proposed new ISA which is intended to enhance the quality of the auditor's communication of deficiencies in internal control identified by the auditor. It includes requirements for the auditor to:</p> <ul style="list-style-type: none"> • Determine, on the basis of the audit work performed, whether, individually or in combination, identified deficiencies in internal control constitute 'significant deficiencies'. • Communicate all identified deficiencies, other than those that are clearly trivial, to management; and

¹² This table identifies some of the significant new requirements set out in the revised ISAs. It does not identify all the requirements. For a full understanding of the requirements and changes from current standards reference should be made to the draft and finalised standards published by the IAASB on its website (www.ifac.org/iaasb).

ISA	Main changes expected in the clarified standards¹² <i>It is important to be aware that in the process of finalising the ‘Clarity ISAs’ there may be some changes to the points below. This includes to ‘finalised’ ISAs as they may be updated by conforming changes for other ISAs,</i>
	<ul style="list-style-type: none"> • To communicate in writing all ‘significant’ deficiencies to those charged with governance, including a description of the deficiencies and an explanation of their potential effects.
320 Materiality in Planning and Performing an Audit	<p>During the revision process it was decided that evaluation of identified misstatements should be addressed in a separate, new, ISA (450 – see below). The revision has introduced more requirements relating to the determination of materiality and related amounts, but does <u>not</u> specify a methodology (e.g. percentages) that should be applied.</p> <p>The definition of materiality is replaced by a description of the common characteristics of materiality covered in financial reporting frameworks. It is made clearer that materiality depends on the nature of an item as well as its size.</p> <p>The new requirements include:</p> <ul style="list-style-type: none"> • Determining whether an amount or amounts lower than the materiality level for the financial statements as a whole are applicable to particular classes of transactions, account balances or disclosures. • Determining a lower amount, ‘performance materiality,’ for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures. • Revising materiality in the event of becoming aware of information that would have caused the auditor to determine a different amount initially. • Specific documentation requirements for the amounts determined and any changes made during the audit.
402 Audit Considerations Relating to Entities Using Service Organizations	<p>The revision aligns the standard with the risk assessment standards. It also increases the focus on, and expands the requirements in respect of, the use of reports from service organisation auditors when they are needed as audit evidence (in particular ‘Type B’ reports, which cover the operating effectiveness of controls at a service organization). Requirements include:</p> <ul style="list-style-type: none"> • When the user auditor’s risk assessment includes an expectation that controls at the service organization are operating effectively for certain assertions for which controls are applied only at the service organization, specifying procedures the user auditor performs to obtain audit evidence about the operating effectiveness of those controls. • Specifying procedures to be performed if the user auditor plans to use a Type B report as audit evidence.
450 Evaluation of Misstatements Identified During the Audit (currently covered in ISA 320)	<p>There are a number of new requirements, although for most audits these are not expected to give rise to significant changes in current practice. These include:</p> <ul style="list-style-type: none"> • Accumulating all misstatements identified other than those that are clearly trivial. • Determining whether uncorrected misstatements are material, with consideration given to the nature of the misstatements as well as their size and to the effect of uncorrected misstatements related to prior periods. <p>Requirements relating to the overall evaluation of misstatements have been included in ISA 700.</p>
505 External Confirmations	<p>The proposed revised ISA relates to the ‘how’ of confirmations, not the ‘when’. The new requirements are unlikely to result in significant changes of substance</p>

ISA	<p>Main changes expected in the clarified standards¹²</p> <p><i>It is important to be aware that in the process of finalising the ‘Clarity ISAs’ there may be some changes to the points below. This includes to ‘finalised’ ISAs as they may be updated by conforming changes for other ISAs,</i></p>
	<p>to current practice. Compared to the current ISA there is more specification, in particular in relation to:</p> <ul style="list-style-type: none"> • Maintaining control over the confirmation requests. • Obtaining further evidence to resolve any doubts about the reliability of responses. • Specifying when negative confirmations may be used as audit evidence. <p>A conforming change has been made to ISA 330 to require that auditors consider whether external confirmation procedures are to be performed as substantive procedures, but, in substance, this is no change from the requirement in the current ISA 505.</p>
<p>540 Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures</p>	<p>This revision introduces a substantial increase in the number of requirements. The scope of the ISA is extended to cover fair value accounting estimates (current ISA 545 will be withdrawn). New requirements include:</p> <ul style="list-style-type: none"> • More specification regarding matters the auditor obtains an understanding of for the purpose assessing risks. • Reviewing the outcome of accounting estimates included in prior period financial statements. • Evaluating estimation uncertainty and determining whether estimates with high levels of uncertainty give rise to significant risks. • More specification of the procedures the auditor undertakes in response to assessed risks, including developing a point estimate or a range to evaluate management’s point estimate. • Further substantive procedures to respond to significant risks, including: <ul style="list-style-type: none"> ○ Evaluating how management has considered alternative assumptions or outcomes, or how it has otherwise addressed estimation uncertainty. ○ Obtaining sufficient appropriate audit evidence about whether management’s decisions to recognise, or not recognise, the estimates in the financial statements, and the selected measurement basis, are in accordance with the applicable financial reporting framework. ○ Evaluating the adequacy of the disclosure of estimation uncertainty in the context of the applicable financial reporting framework. • Reviewing management’s judgments and decisions to identify whether there are indicators of possible management bias.
<p>550 Related Parties</p>	<p>The revised ISA places greater emphasis on a risk based approach to the consideration of related parties. It also seeks to improve auditor performance with the difficult task of identifying related party relationships and transactions not disclosed to them by management.</p> <p>New requirements include:</p> <ul style="list-style-type: none"> • Specifying that the audit team discussion required by ISA 315 shall include consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity’s related party relationships and transactions. • Obtaining an understanding of the controls, if any, that management has established, including to:

ISA	<p>Main changes expected in the clarified standards¹²</p> <p><i>It is important to be aware that in the process of finalising the ‘Clarity ISAs’ there may be some changes to the points below. This includes to ‘finalised’ ISAs as they may be updated by conforming changes for other ISAs,</i></p>
	<ul style="list-style-type: none"> ○ Identify, account for, and disclose related party relationships and transactions in accordance with the applicable financial reporting framework; ○ Authorize and approve significant transactions and arrangements outside the normal course of business. ● Treating identified significant related party transactions outside the entity’s normal course of business as giving rise to ‘significant risks.’ ● Specifying procedures to be performed if the auditor identifies related parties or significant related party transactions that management has not previously disclosed to the auditor. ● Specifying procedures to be performed for identified significant related party transactions outside the entity’s normal course of business, including: <ul style="list-style-type: none"> ○ Evaluating the business rationale of the transactions ○ Inspecting the underlying contracts or agreements, if any, and evaluating whether the terms of the transactions are consistent with management’s explanations; and whether they have been appropriately accounted for ○ Obtaining audit evidence that the transactions have been appropriately authorised and approved. ● When management has made an assertion in the financial statements to the effect that a related party transaction was conducted on terms equivalent to those prevailing in an arm’s length transaction, the auditor shall obtain sufficient appropriate audit evidence about the assertion. ● Communicating with those charged with governance about significant matters identified during the audit regarding related party relationships and transactions. ● Documenting the names of identified related parties and the nature of related party relationships.
<p>600 Special Considerations - Audits of Group Financial Statements (Including the Work of Component Auditors)</p>	<p>The revised ISA introduces a change in focus and a significant increase in the number of requirements. These strengthen the direction of the audit by the group auditor and the group auditor’s involvement in the work of component auditors. Matters covered by the requirements include:</p> <ul style="list-style-type: none"> ● Acceptance and continuance as group auditor (including, where component auditors will be involved, consideration of whether the group engagement team will be able to be involved in the work of the component auditor to the extent necessary to obtain sufficient appropriate audit evidence). ● Overall audit strategy and audit plan. ● Obtaining an understanding of the group, its components, and their environments, and assessing the risks of material misstatement of the group financial statements. ● Obtaining an understanding of component auditors ● Materiality (for group audit purposes to be determined by the group auditor, including for components). ● Responding to assessed risks, including determining: <ul style="list-style-type: none"> ○ the work to be performed on the financial information of components

ISA	Main changes expected in the clarified standards¹² <i>It is important to be aware that in the process of finalising the ‘Clarity ISAs’ there may be some changes to the points below. This includes to ‘finalised’ ISAs as they may be updated by conforming changes for other ISAs,</i>
	<p>(distinguishing between those that are significant and those that, individually, are not)</p> <ul style="list-style-type: none"> ○ the level of involvement in the work performed by component auditors. ● Consolidation process. ● Subsequent events. ● Communication with component auditors (including details of matters to be covered). ● Evaluating the sufficiency and appropriateness of audit evidence obtained. ● Communication with group management and those charged with governance of the group. ● Documentation.
620 Using the Work of an Auditor’s Expert	<p>The scope of the proposed revised ISA is restricted to consideration of the auditor’s use of the work of an expert, employed or engaged by the auditor, possessing expertise in a field other than accounting or auditing.</p> <p>Conforming amendments have been made to ISA 500 so that it addresses management’s experts.</p> <p>Compared to the current ISA there is more specification, in particular regarding the agreement of work to be performed and evaluating the reasonableness of the expert’s findings.</p>

Evaluation of the cost impact of adopting the Clarity ISAs

UK audit costs

In March 2008 the FRC published a paper¹³ which, in an appendix, contained an estimate of UK audit costs as follows:

Size of entity	Number of entities	Cost £m	Cost £m
Companies			
FTSE 100	100	400	
FTSE 250	250	150	
Other main market	2,000	300	
AIM	2,000	100	
Total listed			950
Large private	12,500		625
Mid-sized	25,000		250
Below statutory audit threshold ¹⁴	1,300,000		60
Charities			
Large	10,000		300
Small ¹⁵	150,000		-
Pension schemes	100,000		100
Estimated total cost of UK audit			2285

Background

To assist APB and interested parties in making a decision as to whether the Clarity ISAs should be adopted ahead of their adoption by the EC, APB staff undertook an assessment of the possible impact of applying the Clarity ISAs adoption on audit costs. 11 audit firms assisted with the exercise being each of the largest 6 UK audit firms and 5 small audit firms (volunteers from the APB's SME Audit Sub-committee).

¹³ Cost-effectiveness of FRC Regulation – Discussion Paper

¹⁴ Only around 120,000 of these companies have an audit. In these cases, auditors are usually involved in preparing the financial statements, and the additional cost of audit (around £500) is, therefore, small.

¹⁵ Exempt from audit (cost of independent examinations excluded)

Each firm was asked to evaluate for a small sample of clients the impact of those new and revised Clarity ISAs that had been identified by APB staff as most likely to have an impact on audit work effort¹⁶ Firms were asked to:

- estimate the recurring additional time and cost, if any, that the requirements of these Clarity ISAs would give rise to on the audit of individual entities (see below for the consideration of the impact on group audits).
- consider whether other changes to the Clarity ISAs would give rise to increased work effort and costs (firms were presented with a summary of the expected main other changes to the Clarity ISAs).
- identify non-recurring costs that might arise in the first year of implementation, both at the level of the audit engagement (e.g. time to be spent explaining changes to the client, changing engagement letters etc) and at the level of the audit firm (e.g. time spent on revising methodologies, providing training etc).

The firms were asked to consider actual audits so that the impact of the Clarity ISAs could be assessed in relation to their current audit methods and practices, not just in relation to the requirements of the current ISAs (UK and Ireland).

Data was obtained for a total of 27 audits, covering a variety of size of audit and different industry sectors as follows:

	Number of audits	Number of audit firms
Audits of small and mid-sized entities	14	7
Audits of listed and large private companies	13	5

Group Audits

In 2006 APB staff undertook an estimate of the cost effect of implementing the proposed ISA 600 (Revised and Redrafted) on larger audits based on a sample of 9 specific group audits. It was decided to utilise this information rather than repeating the evaluation as part of the current exercise as the changes to the requirements in the finalised ISA 600 will not affect significantly the 2006 estimates of its cost effect. However, for those smaller audits which were group audits (only 3 out of the 14), the auditors were asked to quantify the cost of applying ISA 600 (Revised and Redrafted).

The findings in relation to ISA 600 (Revised and Redrafted) are as follows:

Larger audits. The 2006 exercise indicated cost increases mostly in the range of 1% to 5% of group audit costs and an average of 3%.

Smaller audits. On the 3 relevant audits the cost increase averaged 0.5%. The impact is small because smaller firms tend to audit relatively simple groups and, for those groups, the same engagement team often audits all group components (a significant element of the impact of ISA 600 relates to relationships between the group auditor and component auditors).

¹⁶ ISAs 265 (communication of significant deficiencies in internal control), 540 (estimates), 550 (related parties) and 620 (experts).

Overall Impact

The overall impact average of implementing the Clarity ISAs on the recurring costs of smaller audits (small and mid-sized entities) of individual entities was found to be in the region of **9.5%** and, for larger audits (listed and large private companies), in the region of **2%**. For audits of large groups, involving more than one engagement team, the cost is likely to be increased, on average, by a further **3%**.

These are average¹⁷ figures. It is important to bear in mind that the impact of the Clarity ISAs is likely to vary significantly from one audit to another depending on a number of factors, including:

- The characteristics of the audit (for example for some audits the impact ISA 540 on the audit of accounting estimates will be especially important; for other audits the impact of ISA 550 on related parties may be the prime driver of cost increases); and
- The extent to which the audit firm's current methodology already incorporates the requirements of the Clarity ISAs. The audit firms with the more sophisticated methodologies are likely to have the lowest cost increases as they already address many of the 'advances' in the Clarity ISAs.

In addition, for smaller audits an additional 'year one' cost of nearly **4%** was identified (see below).

Summary cost impact:

	Audits of small and mid-sized entities	Audits of listed and large private companies
Average increase in recurring costs	9.6% (90% in the range 0.6 – 17.2)	1.9% (90% in the range 0 – 5.3)
Average increase in non-recurring costs	3.8% (90% in the range 0.3 – 8.2)	0.1% (90% in the range 0 - 0.6)
Average increase in year 1 costs	13.4% (90% in the range 1.9 – 21.2)	2.0% (90% in the range 0 – 5.3)
Average impact of ISA 600 on group audits¹⁸	0.5%	3.0% (90% in the range 0.1 – 8.0)
Total year 1	13.9%	5.0%

¹⁷ The average is the mean of the sample results.

¹⁸ The general estimated impact of ISA 600 on group audits undertaken by smaller firms was found to be relatively low (three such audits were included in the sample of smaller firms, with impacts of 0%, 0.6% and 0.9% on recurring costs).

Ranges of Impact

The range of cost increases is wide as is demonstrated in the following analysis.

Recurring Costs

Estimated increase in recurring costs (%)	Number of audits with current hours less than 100	Number of audits with current hours between 100 and 500	Number of audits with current hours between 501 and 1000	Numbers of audits with current hours of more than 1000
0 - 5	1	4	2	9
5.1 – 10	-	2	1	1
10.1 – 15	2	2	-	-
15.1 +	2	1	-	-

Non-recurring Costs

Estimated increase in non-recurring costs (%)	Number of audits with current hours less than 100	Number of audits with current hours between 100 and 500	Number of audits with current hours between 501 and 1000	Numbers of audits with current hours of more than 1000
0 - 1	-	1	3	10
1.1 – 5	4	7	-	-
5.1 – 10	-	1	-	-
10.1 +	1	-	-	-

Non-recurring costs include, for example, the time spent explaining changes in the audit approach and procedures to the client and changes to the audit engagement letter. The impact of this in percentage terms reflects the fixed cost of change. A few additional hours involved in, for example, changing the engagement letter can be significant in percentage terms when the total audit time is only 100 hours but is immaterial on an audit involving thousands of audit hours.

The non-recurring costs above do not include inefficiency in applying the new standards in year one. A number of audit firms commented that on the first few audits under the new standards there would be a 'learning curve'. Some of the smaller audit firms quantified the learning curve to be of a similar magnitude to year one 'non-recurring costs'. The cost of the 'learning curve' has not been included in the summary cost impact as:

- The learning curve will only apply on the first few audits under the new standards not to all audits conducted in the first year after adoption of the Clarity ISAs, and
- There is likely to be an inverse relationship between the size of the ‘learning curve’ on individual audits and investment in training (both by individuals by way of Continual Professional Development and by audit firms in more structured training exercises).

Other ‘year-one’ costs are likely to be incurred by audit firms, including preparing/updating manuals and training staff. Estimates of the possible effect of these other non-recurring costs have not been included in the figures above – they may vary significantly between firms and it is generally difficult, for the purpose of this exercise, to apportion costs incurred at a firm level to individual audits.

Main Causes of the Impacts

The table below summarises the estimated effect of each ISA on the audit work effort¹⁹ (i.e. the time of partners, managers and other staff). The results confirmed the expectation that the impact on work effort (and consequently cost) derive substantially from the ISAs that have been revised rather those that had been clarified only.

Estimated average % increase in work effort caused by Clarity ISAs

	265	540	550	600	620	Other	Total
Audits of small and mid-sized entities	0.9	2.5	3.5	0.3	0.5	1.7	9.4
Audits of listed and large private companies	0.1	0.5	0.4	3.0	0.3	-	4.3

ISA 265

ISA 265 is a proposed new ISA that addresses communication of deficiencies in internal control. The requirement within ISA 265 that mandates communication of significant deficiencies that have come to the auditor’s attention to those charged with governance is broadly similar to the current requirement to communicate material weaknesses to those charged with governance.

¹⁹ The total reflects the effect on audit hours. This differs from the effect on cost as new work required (e.g. on accounting estimates) will generally involve the more experienced (and costly) members of the engagement team.

However, ISA 265 will also require auditors to communicate deficiencies that have come to their attention, other than those that are clearly trivial, to management. Although the communication to management may be made orally it was generally believed that the underlying approach may need to be more rigorous and more documentation would be needed to demonstrate that this had been done – especially on smaller audits.

ISAs 540 and 550

The Clarity ISAs with the greatest impacts on auditor work effort were 540 (which addresses estimates and fair values), and 550 (which addresses related parties). Both cover important topics, especially in the context of current economic conditions. In particular ISA 540 emphasises the need for auditors to consider estimation uncertainty and management bias when auditing accounting estimates.

Both revised ISA 540 and 550 have an increased focus on management's processes (e.g. for making estimates and for identifying related party relationships and transactions) and stipulate audit procedures that are not in the current ISAs (e.g. the requirement in ISA 540 to review the outcome of prior year estimates). Some audit firms already perform these procedures but, even in these cases, it was typically believed that more audit documentation would be needed.

ISA 600

The revised ISA 600 clarifies how the risk model underpinning the current ISAs (UK and Ireland) 315 and 330 applies in a group context. In particular, there are significant new requirements relating to the relationships between the 'group engagement team' and 'component auditors' and communications between them. Consequently the impact is expected to be most significant on audits where group components are audited by different teams, particularly for large transnational group audits. Because of this the impact on small group audits is likely to be small as the same engagement team often audits all group components.

ISA 620

ISA 620 addresses the use of experts²⁰ by auditors to help obtain audit evidence, and is therefore only relevant where experts (other than experts in accounting or auditing) are used. It was generally felt that the Clarity ISA would drive more rigour and formality, and consequently documentation, with respect to the relationships with experts and evaluating the results of an expert's work.

Other ISAs

For the other ISAs, the impacts were generally much less significant. However, some firms believe that to satisfy the requirements of external audit inspectors they may need to incorporate more mandated procedures in to their methodologies and may need to produce more audit documentation to demonstrate compliance with the increased numbers of mandatory requirements.

²⁰ "Experts" for the purpose of this ISA exclude persons with 'specialist' audit and accounting knowledge. Such specialists are addressed in ISA 220.