

ANNUAL REPORT 2007

INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD



CLARITY and BEYOND

CHARTING THE COURSE FOR THE FUTURE



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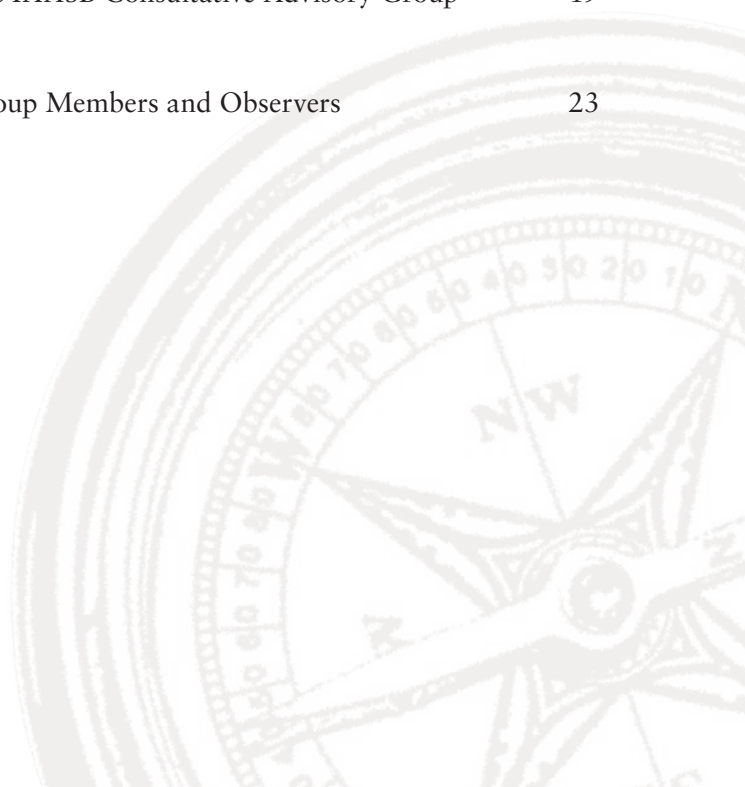
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THE INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD

The International Auditing and Assurance Standards Board (IAASB) is a standard-setting body designated by, and operating under the auspices of, the International Federation of Accountants (IFAC). The IAASB is subject to the oversight of the Public Interest Oversight Board (PIOB). The objective of the IAASB is to serve the public interest by setting, independently and under its own authority, high quality standards dealing with auditing, review, other assurance, quality control, and related services, and by facilitating the convergence of national and international standards. This objective contributes to enhanced quality and uniformity of practice in these areas throughout the world, and strengthened public confidence in financial reporting.

The IAASB consists of a full-time chairman and 17 volunteer members from around the world. It comprises members in public practice with significant experience in the field of auditing and other assurance services, as well as individuals who are not in public practice (“non-practitioners”). Members are

appointed by the IFAC Board based on recommendations from the IFAC Nominating Committee. Member appointments are subject to the approval of the PIOB. At present, the IAASB meets four to five times a year.

The IAASB is supported financially by IFAC, which itself is funded by membership dues from 158 members and associates in 123 countries, and by contributions from the Forum of Firms. The Forum of Firms is an organization of public accounting firms that share the objective of promoting consistently high standards of financial reporting and auditing worldwide in the interests of the public and users of the profession’s services. Funding includes staff costs, the costs of the chairman, the travel costs of the public members of the IAASB, and a contribution towards the travel costs of the other members. The IAASB is a component of the overall IFAC reporting entity and, accordingly, its financial results are included within IFAC’s audited financial statements. These financial statements are published as part of IFAC’s Annual Report, which is available on www.ifac.org.



Back row (left to right): *Phil Cowperthwaite, Marcel Pheijffer, Kjell Larsson, Will Rainey, Gérard Trémolière, and Professor William Kinney.* Middle row (left to right): *John Fogarty, M. Abdullah Yusuf, Makoto Shinohara, John Kellas (Chairman), Ian McPhee, and Roberto Tizzano.* Front row (left to right): *Denise Esdon (Deputy Chair), Jan Bo Hansen, Diana Hillier, Susan Jones, Craig Crawford, and David Swanney.*

REPORT OF THE CHAIRMAN OF THE IAASB



John Kellas
Chairman

I am pleased to present the annual report of the IAASB for 2007. I am particularly delighted to be able to report that we have reached a significant milestone in our efforts to improve the clarity of our International Standards on Auditing (ISAs) through our Clarity project.¹ We have now approved all the exposure drafts of the standards to be clarified under this project – a total of 21 in 2007. I am therefore confident that we shall complete the Clarity project as planned in 2008.

As a result of this progress, and of the significant improvements we have made to some of our more important standards, we shall have a complete set of strong, consistently presented standards that will come into effect for audits of financial statements for periods beginning on or after December 15, 2009.

Full details of this and our other achievements are given in the review of the year from the Executive Director, Professional Standards.

STRATEGY AND FUTURE DIRECTION

Over the last few years, the priority of the IAASB has been the development of high quality ISAs that are accepted globally and that facilitate convergence, primarily through the significant amount of time and resources dedicated to the Clarity project. This year has been no exception, but we are keenly aware of the need to plan for the future. Accordingly, to prepare for the period after 2008, the IAASB embarked on an extensive consultation program to obtain the widest possible input into determining its future priorities.² This process led to the release of a consultation paper in October that included the IAASB's draft strategy for the period 2009-2011.

¹ The aim of the Clarity project is to improve the clarity of IAASB standards, so as to make them more readable and to avoid any possible ambiguity as to what they require and what is guidance, thereby improving the consistency with which they are implemented by auditors.

² See the Executive Director's review of the year for details of the strategy consultation process.

International Standards on Auditing

During the early stages of the consultation process, it was clear that there is considerable concern about standards overload. Related to this is a need for auditors and others to have ample time to digest the clarified ISAs and to ensure that their implementation is effective.

The IAASB therefore proposed in the consultation paper that, unless there is an urgent need to respond to unforeseen circumstances, any new ISAs issued after the end of the Clarity project will not be made effective for audits of financial statements for periods beginning before December 15, 2011. The IAASB believes that this will allow the users of the ISAs time to implement the revisions introduced by the Clarity project. Initial analysis of the responses to the consultation paper suggests that this proposal has been well received.

This does not mean that we attach any less importance to auditing standards, which remain our most important single product. Indeed, we indicated in our consultation document that we intended to proceed with the development or revision of some auditing standards, and we are looking to the responses to guide us as to where such development efforts should be directed.

The IAASB is also exploring how to assess the effectiveness of the implementation of new standards. This is not to suggest that we are proposing to extend our activities to monitor implementation of standards – this is the role of the regulatory and professional monitoring agencies. Rather, it would be aimed at allowing the IAASB to determine whether there is any necessity for further refinement to achieve the intended effect of new standards. The experience of the oversight bodies that monitor audit quality ought to provide an important source of information to the IAASB about how standards are being implemented in practice. I hope, therefore, that we shall be able to enlist their assistance in this process, as well as that of auditors themselves.

Implementation Guidance

To date, the IAASB has concentrated its efforts on setting clear standards and providing adequate time for

their implementation.

The IAASB has not seen its role as one of developing implementation guidance. The initial consultations, however, clearly indicated a desire by practicing accountants for assistance with the implementation of

ISAs, and these views

were confirmed by responses to the consultation paper. We anticipate healthy discussion amongst our Board members and with national standard setters as we try to find appropriate solutions to this question.

One area where such guidance may be needed is in the audit of fair value information in financial statements. The recent disruptions in the global credit markets have highlighted the difficulty of estimating fair values when markets have become less liquid or where a move from market valuations to valuations based on unobservable inputs is necessary. The revision of ISA 540 (Revised and Redrafted), *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, allowed us to bring relevant auditing standards up to date. We recognize, however, that there are limits to the specific guidance that can be included in a general auditing standard. As a result, in response to suggestions made during the exposure of our proposals for that standard and comments received in response to our strategy consultation, the IAASB has established a group to consider what further guidance, if any, can be given to auditors faced with specific fair value auditing problems.

Other Assurance Services

The strategy consultation document recognized that there is a public interest in the quality of the opinions that accountants are often required to give for the purposes of prospectuses (or investment circulars). Other than in respect of accountants' reports on prospective financial information, there is nothing within our assurance standards that is specifically directed at such opinions. National standard setters have generally provided relevant guidance. However, with increasing cross-border investment activity and in some cases the legal recognition of prospectuses

THE SMP COMMITTEE
ALSO PROVIDES THE
IAASB WITH IMPORTANT
ASSISTANCE BY ENSURING
WE ARE AWARE OF THE
CONCERNS OF THIS
IMPORTANT USER GROUP.

issued in other jurisdictions, the IAASB has received requests to issue further standards that will be relevant to accountants' reports included in prospectuses. I expect that we shall take this matter forward.

In December 2007, we approved a project to develop a standard for assurance on carbon emissions information. Many accountants practice in the field of assurance on sustainability and similar reports, and for a number of years they have been asking us to consider developing standards specifically designed for such work. This project will allow us to do so in a limited area that seems to have a particular need, particularly in the context of carbon trading schemes.

The Needs of Small- and Medium-sized Entities

I know from talking to practitioners in smaller firms or their representative bodies that the application of ISAs to smaller audits in an efficient way remains a matter of concern to them. While there is general agreement that there should be one set of standards for audits of all sizes, there are widely divergent views about how the IAASB should respond to the needs of small- and medium-sized entities (SMEs) and small and medium practices (SMPs). A feature of the Clarity project was to introduce specific guidance relevant to SMEs within the ISAs. This has been generally welcomed.

One significant event in 2007 that should be beneficial to auditors of SMEs was the publication of the *Guide to Using International Standards on Auditing in the Audit of Small- and Medium-sized Entities* by IFAC's Small and Medium Practices (SMP) Committee.³ While this is not an IAASB publication, I hope that this guide will assist auditors of SMEs in applying the ISAs. The SMP Committee also provides the IAASB with important assistance by ensuring that we are aware of the concerns of this important user group in drafting our standards.

Beyond efforts to assist auditors of smaller entities, we have considered input as part of the strategy consultations about whether it is appropriate for the IAASB to explore, in consultation with other interested parties, the concept of an alternative assurance service for SMEs. At the very least, it seems likely that revisions to our standards on review and compilation engagements could assist practitioners in this field.

³ See the Executive Director's review of the year for further discussion of the SMP Guide.

GLOBAL ACCEPTANCE OF ISAs

- The World Federation of Exchanges has endorsed the IAASB's processes for standard setting and recognizes the importance of ISAs.
- The Financial Stability Forum has identified ISAs as one of the 12 key standards for sound financial systems and deserving of propriety implementation depending on country circumstances.
- The World Bank uses ISAs as the benchmark for its ROSCs (Reports on the Observance of Standards and Codes) for assessing the quality of national auditing standards.

ISAs are becoming more widely accepted throughout the world. Many national standard setters have recognized the benefits of consistent auditing standards and have adopted our standards, or are working to do so. In this regard, I was pleased to note the statement from the International Organization of Securities Commissions (IOSCO) in November confirming their support for robust international auditing standards and that they are evaluating under what conditions they could endorse ISAs for cross-border use in the securities markets and the form of any such endorsement.

European Commission

One of the most significant adoption programs is that of the European Commission (EC), under the European Union's 8th Company Law Directive. The IAASB is committed to assisting the EC towards successful adoption. I recognize, however, that the EC must follow its own due process and that as a result the timetable for possible adoption has not yet been announced. For our part, we need to ensure the satisfactory completion of the Clarity project and to maintain close contact with the EC and its advisory bodies.

The main groups currently advising the EC are the Audit Regulatory Committee (AuRC) and the European Group of Audit Oversight Bodies (EGAOB). Neither group involves the auditing profession, though EGAOB has a sub-group to advise it on matters relevant to ISAs, and the profession is represented there. I consider it extremely important that these groups should have some direct contact with the IAASB, so that they can have a good understanding of our

activities and the opportunity to raise directly with us any matters that are unclear to them. I was therefore pleased to be able to meet both groups during the year and have made clear my desire to do so again.

As part of its work towards the adoption of ISAs, the EC has commissioned two independent studies into the possible effects of the adoption of ISAs. These will look at the costs and benefits of ISA adoption, for auditors and companies generally, as well as in the special cases of those companies that are also subject to the auditing standards of the U.S. Public Company Accounting Oversight Board (PCAOB) as a result of the registration of their securities with the U.S. Securities and Exchange Commission. We stand ready to assist the appointed researchers in any way that we can.

Translation is a critical part of effective implementation for all jurisdictions, but it presents particular challenges for the European Union (EU). With such technical material, we strongly believe that the involvement of competent audit professionals in the translation process is essential. We have encouraged the EC to indicate as soon as possible to the European profession and standard setters what process will be used for translation of ISAs. In the meantime we are encouraging the national standard setters in the EU to proceed to translate the latest versions of the ISAs so that they may be made available to the EC and to the auditors who will have to implement them in practice.

Finally, I am aware that the European Parliament and its committees have an important role in the adoption process. It is likely that in 2008 we shall be seeking some contact with the parliamentary processes.

I hope that our engagement in the process will contribute to a smooth adoption by the EC of ISAs.

OVERSIGHT

We continue to have a constructive relationship with the Public Interest Oversight Board (PIOB). The quality of the PIOB's membership means that their questions to us are always challenging, especially on matters of due process. The PIOB observers to our meetings are able to provide us with their thoughts on our discussions. We value these as they help us to ensure that our work is conducted to the highest international standards in the public interest. We also look forward to the PIOB's consideration of our strategy

and work program for 2009-2011. While we are confident that our careful consultations will ensure that our work program is appropriate, the PIOB has the authority to propose that items be added to it in the public interest. Accordingly, we shall not finalize our strategy and work program until it has been considered by the PIOB.

OTHER INITIATIVES AND DEVELOPMENTS

IAASB's Working Procedures

In accordance with the PIOB's recommendations, the IFAC Nominating Committee has been moving the composition of the IAASB towards equal numbers of practitioners and non-practitioners. The nominations for 2008 have achieved this. We have therefore set up a small task force of IAASB members and technical advisors to consider and make recommendations on how, if at all, the IAASB's working procedures should be amended in light of the changed composition of the IAASB. The Task Force will take into account:

- The need for significant input to standard setting from those with current experience of auditing;
- The efficient use of the combined skills of the IAASB members and technical advisors;
- The effective use of non-practitioners both in the IAASB's discussions and detailed work at the task force level; and
- The financial considerations of any recommended changes.

The Task Force will present its recommendations to the IAASB early in 2008.

CONCLUDING REMARKS

The next year will present more challenges to us as we strive to complete the Clarity project. We have set the course to achieve this goal and while that is our primary focus for 2008, we must also agree on our future actions and priorities. It is our goal to set standards, and to act in the public interest; our future work program must be such as to make this assertion the reality we know it to be.

ACKNOWLEDGEMENTS

I would like to thank my fellow members on the IAASB and their technical advisors for their dedication and hard work in advancing our work over the past year. Without their collective efforts, all of which have been voluntary, the successes we have achieved would

not have been possible. I should like, in particular, to recognize the contribution of the four retiring IAASB members: Jan Bo Hansen, Will Rainey, Makoto Shinohara, and Roberto Tizzano.

I would like to thank the national standard setters who have so generously offered to assist us in redrafting some of our standards under the Clarity project, national standard setters who have worked with us on other projects, and the external experts (including International Organization of Supreme Audit Institutions (INTOSAI) nominees and representatives of the firms) who have participated in a number of our project task forces. I would also like to extend my thanks to the three official observers to the IAASB – the EC, the Japanese Financial Services Agency and the U.S. PCAOB – for their contributions to our deliberations. I should particularly mention Dr. Yamaura who has represented the Financial Services Agency of Japan since it took up its observership of our meetings. Dr. Yamaura is standing down following his appointment to the Board of Audit of Japan. I have appreciated his patient efforts to ensure that I and other members of IAASB understand the Japanese audit environment. On behalf of the IAASB, I wish him well in his new role and look forward to welcoming his successor.

Our continuing success in setting international standards that are globally recognized and accepted would also not be possible without the appreciable support, encouragement, challenge and advice we receive from the PIOB, the IAASB Consultative Advisory Group (CAG) and its chairman, the IFAC Board and the IFAC Transnational Auditors Committee, regulators, and others, for which I am especially grateful.

Finally, I must pay tribute to our staff. We have a dedicated team, working under the direction of the Executive Director, Professional Standards, and they have all made a significant contribution to our continuing success. I know that the IAASB can continue to count on their support in the coming years.

I hope you will find this annual report informative and helpful to you in understanding our work. As always, I welcome your comments.



John Kellas
Chairman

REVIEW OF THE EXECUTIVE DIRECTOR, PROFESSIONAL STANDARDS

As expected, during 2007, the IAASB made significant progress towards its commitment to complete the Clarity project by the end of 2008. In some ways, the IAASB is at the peak of its efforts towards this goal – following its December 2007 meeting, all of the planned exposure drafts of the proposed redrafted ISAs had been issued.

The IAASB appreciates the considerable workload its efforts have placed on its stakeholders. Given the large number of exposure drafts issued, the IAASB agreed to stagger the deadlines for comment where appropriate to allow respondents time to give each exposure draft due consideration. In 2008, the IAASB expects to finalize all of the redrafted or revised and redrafted standards, taking into account the responses received from stakeholders, which will no doubt involve robust discussions among the IAASB and the IAASB CAG.

In 2007, the IAASB approved seven final ISAs and 21 exposure drafts of ISAs drafted in accordance with the new conventions. I expect that the IAASB will complete all 35 ISAs as final standards by the end of 2008.

DEVELOPMENT OF STANDARDS

The IAASB made substantial progress on its work program and agenda in 2007:

- Four revised and redrafted standards approved under the Clarity project in particularly challenging areas: group audits, written representations, audits of accounting estimates (including fair values), and communication with those charged with governance.
- Three more redrafted standards approved under the Clarity project.
- 21 redrafted or revised standards issued as exposure drafts under the Clarity drafting conventions.
- A proposed new standard dealing with communicating deficiencies in internal control issued as an exposure draft.
- A proposed new assurance standard on reporting on controls at a service organization issued as an exposure draft.
- Significant consultation and effort on developing the IAASB's future strategy and work program.

This substantial level of activity is testament to the tremendous dedication, perseverance and hard work put in by the volunteer members of the IAASB, their technical advisors, national standard setters, and others who serve on its task forces, to help the IAASB meet its goals.



James M. Sylph
*Executive Director,
Professional Standards*

EFFECTIVE DATES FOR CLARIFIED ISAs

When I reported last year, the IAASB had provisionally planned to make all revised and redrafted ISAs effective for audits of financial statements for periods beginning on or after December 15, 2008. The IAASB had made it clear that this would be amended to a later date if that proved necessary.

At its July 2007 meeting, the IAASB considered the minimum period necessary for effective adoption and implementation of the clarified ISAs. It announced

in early October that the definitive effective date for the set of clarified ISAs would be for audits of financial statements for periods beginning on or after December 15, 2009, thereby making the implementation period for the redrafted ISAs longer than provisionally proposed.

In determining this date, the IAASB took account of the fact that many participants in the IAASB strategy consultations during 2007 urged the IAASB to consider delaying the effective date. This input reflected the concern that more time for implementation would be needed because a significant number of the ISAs (including some that have been substantively revised) would be finalized in the latter half of 2008 and all would be effective at the same time.

The IAASB believes that this effective date strikes an appropriate balance

**FIVE IAASB
MEETINGS AND
APPROXIMATELY 115
TASK FORCE MEETINGS
WERE HELD IN 2007.**

between (a) the desire to obtain the benefit of the revised and redrafted ISAs as soon as practicable, and (b) the need to provide individual jurisdictions with the time they need to translate and adopt the ISAs,

and for practitioners to implement them effectively. The IAASB believes that it is in the public interest to give the more than 100 jurisdictions around the world that use ISAs, or that base their national standards on them, appropriate time to enable them to fully comply with the newly drafted ISAs by their effective date.

There is strong reason for making the approved documents available as early as possible to assist in their translation, adoption and implementation. Accordingly, the IAASB agreed to release redrafted ISAs as they are approved. The final ISAs redrafted under the Clarity conventions can be found on the IAASB website at www.ifac.org/IAASB/Resources.php.

FINAL STANDARDS

ISA 260 (Revised and Redrafted), *Communication with Those Charged with Governance*

This ISA sets out a framework for communicating with those charged with governance. It also identifies specific matters to be communicated by the auditor, including a requirement to communicate in writing about auditor independence. The ISA also acknowledges that law or regulation, or an agreement with the entity, may require communication of other matters. The ISA contains new requirements and guidance for the communication process, including a specific requirement for the auditor to evaluate the adequacy of the two-way communication between the auditor and those charged with governance.

ISA 540 (Revised and Redrafted), *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

This ISA, which reflects the combination of extant ISA 540, *Auditing Accounting Estimates and Related Disclosures (Other Than Those Involving Fair Value Measurements and Disclosures)*, as revised by the IAASB in 2006, and ISA 545, *Auditing Fair Value*

Measurements and Disclosures, was approved by the IAASB in December. In addition to applying the Clarity conventions to the combined standard, the IAASB also tailored the application and other explanatory material to include more guidance relevant to fair value accounting estimates. The IAASB believes that combining the standards not only allowed it to update the standard with regard to fair value measurements, but also to align the similar principles underlying the audits of fair value accounting estimates with those of routine estimates.

However, there may be more work that could be done in this area, as I indicate in my discussion of our strategy consultations below.

ISA 580 (Revised and Redrafted), *Written Representations*

The revision of extant ISA 580 was a challenging task for the IAASB, in part due to the jurisdictional nuances surrounding written representation letters. In the course of revising the standard, the IAASB has introduced changes aimed at promoting consistency in practice.

The description of the fundamental premise, relating to management's responsibilities, on which an audit is conducted, has been revised. In doing so, the IAASB recognized that changes were necessary to the matters set forth in proposed ISA 210 (Redrafted), *Agreeing the Terms of Audit Engagements*, and proposed ISA 700 (Redrafted), *The Independent Auditor's Report on General Purpose Financial Statements*.

Other matters addressed during the IAASB's discussions include (a) whether written representations can suffice as audit evidence, (b) the date of the written representations, and (c) cases of unreliable written representations or the refusal of management to provide them.

ISA 600 (Revised and Redrafted), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

One of the most significant new standards is ISA 600 (Revised and Redrafted). I am particularly pleased that we have successfully completed this project. The ISA was developed over a period of five years and was influenced by the responses to three exposure drafts. The new ISA takes account of (a) regulatory and

standard-setting developments around the world, (b) the interests of small entities, and (c) the expectations of various stakeholders, including those represented on the IAASB CAG. The project has not been an easy one but I am confident that the new standard will enhance current practice and promote consistency on group audits worldwide.

FINAL REDRAFTED ISAs

The IAASB also approved three standards redrafted under the Clarity conventions. A full listing of the standards approved in 2007 is provided in the IAASB Standards section of the Appendix. Further details, including copies of IAASB pronouncements and exposure drafts, can be accessed on the IAASB website.

EXPOSURE DRAFTS ISSUED IN 2007

In addition to the redrafting projects, the IAASB is also making significant progress on a number of other ISA projects under its current work program. Key aspects of these projects are highlighted below.

Proposed ISA 200 (Revised and Redrafted), Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing

The IAASB's *Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services* (Preface) was reissued in January 2007 to reflect the effect of the new Clarity drafting conventions. The Preface contains important statements about the authority of ISAs and the

obligations of auditors who follow those standards. The IAASB decided that these statements should be incorporated within the ISAs themselves. Accordingly, proposed ISA 200 (Revised and Redrafted) incorporates the provisions of the amended Preface that are relevant to ISAs.

The proposed ISA also describes the nature of an audit of financial statements and related concepts that provide the basis for a proper understanding of (a) the conduct of an audit, (b) the auditor's overall objective, and (c) the objectives and requirements of the ISAs. These explanations should be helpful to auditors, regulators and others with an interest in audits and auditing standards.

Incorporating the relevant provisions of the Preface into this ISA gives them greater prominence, and ensures that the standards themselves directly impose on auditors using ISAs the obligation to follow all their requirements. This is particularly important for any regulators adopting the ISAs, but not planning to enshrine the Preface in legislation.

Proposed ISA 402 (Revised and Redrafted), Audit Considerations Relating to an Entity Using a Third Party Service Organization

Many entities outsource aspects of their business to organizations that provide services that range from (a) performing a specific task under the entity's direction to (b) replacing one or more of the entity's business units or functions. Frequently, services provided by such organizations are integral to the entity's information system relevant to financial reporting.

Following a risk-based approach, the proposed standard deals with the auditor's responsibilities to obtain audit evidence when an entity uses one or more service organizations. This may include obtaining reports on controls prepared by the auditors of those organizations.

Proposed ISA 505 (Revised and Redrafted), External Confirmations

Recent experience has indicated that external confirmations are not always as reliable as expected. This has led to requests for more rigorous requirements governing the auditor's use of external confirmations. The auditor's



**ALL CLARIFIED ISAs
ARE PLANNED FOR
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DECEMBER 15, 2009.**

the effective performance of external confirmation procedures when the auditor determines that such procedures appropriately respond to an assessed risk of material misstatement.

**Proposed ISA 620 (Revised and Redrafted),
*Using the Work of an Auditor's Expert***

This revised standard deals with the auditor's use of the work of a person or organization possessing expertise in a field other than accounting or auditing, who is employed or engaged by the auditor to assist the auditor to obtain sufficient appropriate audit evidence. It places particular emphasis on the need for the auditor to evaluate the expert's objectivity, and to jointly establish a proper understanding of that expert's responsibilities for the purposes of the audit.

**Re-Exposure of Proposed ISA 550
(Revised and Redrafted), *Related Parties***

The overall aim of the project is to enhance the auditor's consideration of related parties and related party transactions in an audit of financial statements, establishing an approach that requires the auditor to assess the risks of misstatement and direct audit work accordingly. The exposure draft includes a new definition of a related party for the purposes of the audit. It also better differentiates the auditor's procedures to identify relevant risks of material misstatement from the auditor's responses to the assessed risks. Different accounting frameworks define and address related parties in varied ways. The proposed standard emphasizes the need for the auditor to be aware of related parties and the extent to which they affect the financial statements, even where the financial reporting framework applied

decision whether to use external confirmation procedures is based on the identification and assessment of risks of material misstatement in accordance with other ISAs, as well as the relative value of different sources of audit evidence. Proposed ISA 505 (Revised and Redrafted) is directed at

in preparing the financial statements does not establish requirements for related parties (or does so inadequately).

NEW EXPOSURE DRAFTS OF REDRAFTED ISAs

In fulfilling its commitment to complete the Clarity project by the end of 2008, the IAASB issued 16 exposure drafts of redrafted ISAs in 2007, seeking comments only on the application of the Clarity drafting conventions. A full listing of the exposure drafts approved in 2007 is provided in the IAASB Standards section of the Appendix. The exposure drafts, which had comment periods ranging from 90 to 150 days, can be downloaded from the IAASB website at www.iaasb.org.

NEW ISA UNDER DEVELOPMENT

**Proposed ISA 265, *Communicating
Deficiencies in Internal Control***

The IAASB commenced this project in October 2005 in response to regulatory and standard-setting developments around the world regarding internal control-related matters, including, in particular:

- The EU's Statutory Audit Directive that requires auditors to report identified material weaknesses in internal control to audit committees; and
- The PCAOB's issue of an auditing standard addressing audits of internal control over financial reporting.

The proposed ISA deals with the auditor's responsibility to communicate to management and those charged with governance deficiencies in internal control the auditor has identified. It distinguishes between significant and other deficiencies in order to establish requirements to communicate to the appropriate levels within the entity. It also requires written communication of significant deficiencies to those charged with governance.

This new proposed standard is intended to enhance the effectiveness of the auditor's communication of deficiencies in internal control. It does this by requiring a clearer focus on what is important to those taking ultimate responsibility for control over financial reporting. The proposed standard will require written communication of these matters on a timely basis, so that those charged with governance can take steps to strengthen internal control.

THE IAASB'S TIMETABLE

The 16 exposure drafts of redrafted ISAs, plus the new ISA under development, are all planned for completion in 2008, and intended to become effective for periods beginning on or after December 15, 2009. The IAASB's latest project timetable through 2008 is available on its website at www.ifac.org/IAASB/downloads/Current_IAASB_Project_Timetable.doc. Subject to any unforeseen difficulties that may arise in redrafting or revising individual ISAs, I am confident the IAASB will meet this timetable.

NEW ASSURANCE STANDARD UNDER DEVELOPMENT

Reports on Controls at a Third Party Service Organization

Proposed International Standard on Assurance Engagements (ISAE) 3402, *Assurance Reports on Controls at a Third Party Service Organization*, is the first subject-matter specific standard developed under the IAASB's *International Framework for Assurance Engagements*. It complements proposed ISA 402 (Revised and Redrafted) in that reports prepared in accordance with proposed ISAE 3402 will be capable of providing appropriate audit evidence under the proposed ISA. It will help make reporting on controls at service organizations more consistent, thereby assisting such organizations to meet the needs of their clients (user entities) and their auditors, especially for reports issued in one country to meet the requirements of auditors of user entities in other countries.

GUIDE TO USING INTERNATIONAL STANDARDS ON AUDITING IN THE AUDIT OF SMALL- AND MEDIUM-SIZED ENTITIES

I would like to take this opportunity to provide more background on the *Guide to Using International Standards on Auditing in the Audit of Small- and Medium-sized Entities* issued by IFAC's SMP Committee. This guide, issued in December and available for free download on the IFAC website, provides non-authoritative guidance on applying ISAs that were effective as of December 31, 2006. It is intended to help practitioners understand and consistently implement the IAASB's standards on SME audits. More than 4,600 downloads in the first two months are testament to the global interest in this type of guidance.

The Guide provides a detailed analysis of the ISAs and their requirements in the context of an SME audit. It addresses, among other things: the key concepts underlying risk assessment; planning and performing risk assessment procedures; understanding the entity being audited; responding to risks; evaluating audit evidence; and reporting. In addition, the Guide offers some useful practice aids and an in-depth illustrative case study based on a typical SME audit.

CONSULTATION AND DUE PROCESS

Consultation

Consultation is an important part of the IAASB's due process.⁴ There is often informal consultation with others during the development of a project, and the IAASB involves its CAG at all significant stages of a project. When developing proposed international pronouncements, including ISAs, the IAASB formally consults with its stakeholders by issuing exposure drafts for public comment.

In some cases, the IAASB's consultations may be more extensive, as was the case this year in the development of the IAASB's future strategy and work program. In early 2007, the IAASB began this consultation process with a strategy review survey. The survey was sent directly to key stakeholders, including those who had responded to IAASB exposure drafts in the past. It was also made publicly available on the IAASB website. 138 responses were received from a wide group of stakeholders that included IFAC member bodies, regional professional accountancy organizations, national standard setters, organizations representing preparers of financial statements, audit firms, public sector audit organizations, public authorities and international regulators.

The IAASB also held two public forums. The first, in Sydney, Australia, set the stage for the process and allowed the opportunity of directly obtaining stakeholder views through formal presentations and informal question and answer sessions. The IAASB continued its consultation at a second forum held in Brussels, Belgium, which was well-attended by its CAG and European stakeholders.

⁴ The due process document can be accessed at www.ifac.org/IAASB/downloads/IAASB_Due_Process_and_Working_Procedures.pdf.

In total, over 120 people attended these two forums and I cannot thank the participants enough for providing their valuable input into the IAASB's process, highlighting projects of particular importance and confirming that the IAASB's strategic initiatives remain appropriate.

The IAASB consulted with not only its CAG, which has wide representation of those with an interest in auditing and assurance services, including preparers of financial statements and other information, investors, regulators and other users, and the auditing profession but also other interested parties including national standard setters around the world.

The results of these consultations formed the basis for the Consultation Paper, *Proposed Strategy for 2009-2011*, issued in October 2007, which also included possible implementation actions. This, amended in light of comments received, will form the basis for the IAASB's work program for 2009-2011, which will be discussed by the IAASB at its March 2008 meeting.

IAASB CAG

The IAASB CAG met in April, June and September 2007. The IAASB continues to benefit from the advice it receives from the members of the advisory group. At the June CAG meeting, the representatives reappointed David Damant as its Chairman for a further three-year term. His reappointment was confirmed by the PIOB in September 2007.

In addition to discussing the various IAASB projects in progress, the CAG played an active role in the IAASB's consultations to develop its future strategy and work program. Further details on the activities of the CAG during the year are set out in the report of the CAG Chairman, David Damant, on pages 19 to 22.

The CAG Chairman is entitled to attend IAASB meetings as an observer with the privilege of the floor. I am pleased that Mr. Damant has been able to attend the IAASB meetings on a regular basis.

Due Process

The IAASB continues to benefit from its strong working relationship with the PIOB. The PIOB gave input to the IAASB's plans for its strategy consultation. At its June meeting, the PIOB discussed its process for

approving the IAASB's strategic plan. The IAASB will be submitting its work program to the PIOB for approval after it is finalized in March 2008.

The PIOB is also continuing to monitor the IAASB's due process as it works to finalize the redrafted ISAs over the course of the next year. Considering the volume of ISAs the IAASB plans to finalize, it is essential for the IAASB to work closely with the PIOB to ensure that their oversight procedures can be carried out as expeditiously as possible. This will allow due process to be confirmed and the final ISAs to be made public in a timely manner following IAASB approval.

The PIOB has expressed satisfaction that the IAASB has met due process in all matters it has reviewed to date. The PIOB has also encouraged the IAASB to consider improvements in its Basis for Conclusion documents that accompany its final standards to better discuss the significant issues raised by respondents and the basis for the IAASB's conclusions. As a result, the IAASB has increased the depth and detail of these documents and will continue to assess whether additional improvements can be made.

INCREASED FOCUS ON AUDIT REGULATION AND AUDIT QUALITY

The IAASB considers regulators to be among its most important group of stakeholders. These bodies are tasked with ensuring that the standards accepted in their jurisdiction are applied as they were intended, and this responsibility is one of the foremost ones in protecting the public interest and promoting high quality audits.

Because of this, the IAASB maintains significant ongoing relationships with regulators through their responsibilities as representatives on the IAASB CAG, and also informally through the IAASB's attendance and participation in their meetings and conferences.

Although much reform has taken place since the time of Enron and other financial scandals, an expectations gap between an auditor's responsibilities under the ISAs and the public's perception of these responsibilities still exists; as a result, the Committee of European Securities Regulators has published a study highlighting (a) issues within the marketplace regarding the clarity of the independent auditor's report, and (b) how auditors' communications could be enriched.

I acknowledge that questions have been raised and am aware that the IAASB should consider its role in this area. This matter was referenced in the IAASB's strategy consultation paper and it is anticipated the IAASB will consider it in due course.

In addition, the IAASB welcomes the ongoing discussions between the EC and the PCAOB regarding steps to enhance cooperation in the oversight of audit firms. As PCAOB Chairman Mark Olson notes, the ability of regulatory authorities to cooperate is not only critical from a financial stability perspective due to the global nature of firms, but also due to the importance of regulators avoiding unnecessary duplication.

The International Forum of International Audit Regulators (IFIAR), which was formed in 2006, aims to share knowledge of the audit market environment and practical experience of independent audit regulatory activity. Carrying out this aim will promote collaboration in regulatory activity and provide a focus for contacts with other international organizations interested in audit quality. The Chairman and I wrote to IFIAR in 2007 to encourage its input into our standard-setting activities, and I am pleased to report that we will be meeting with their group in the spring.

ISAs, either as written or locally adapted, or national standards that are compared with ISAs to eliminate differences. This year, the Canadian Auditing and Assurance Standards Board affirmed its decision to adopt the ISAs, in part due to the IAASB's ability to meet its planned timetable for the Clarity project.

Others, such as the Australian Auditing and Assurance Standards Board and the United States Auditing Standards Board, have announced plans to revise and reissue their national standards based on the Clarity format. These important developments clearly signal to me that the IAASB's initiatives are the right ones, and that the IAASB is meeting its goal of producing high quality auditing standards.

COORDINATION WITH OTHERS TOWARDS THE GOAL OF CONVERGENCE

The IAASB continues to work with others to facilitate convergence.

IOSCO

IOSCO continues to observe the IAASB meetings regularly, demonstrating its commitment to keeping abreast of developments in the IAASB's standard-setting activities. They also provide detailed and thoughtful comments and recommendations on our exposure drafts.

The possibility of an IOSCO endorsement of IAASB's standards is still under consideration. I am optimistic that the public statement issued by IOSCO in November 2007 discussing their interaction with the IAASB represents progress towards this endorsement. The Chairman and I will continue to liaise with them on this matter, and look forward to our continued working relationship.

Basel Committee on Banking Supervision

The Chairman met members of the Basel Committee's Accounting Task Force (ATF) in April 2007 in Sydney concurrent with the IAASB meeting there, and updated them on the IAASB's strategy and work program. The ATF takes a close and welcomed interest in the IAASB's work, including, in particular, the fair value aspects within the ISA on auditing accounting estimates and the newly formed group exploring the possibility of guidance on auditing fair value accounting estimates.



DEVELOPMENTS ON THE COURSE TO CONVERGENCE

There have been a number of important developments relating to the acceptance of ISAs in other parts of the world. We know ISAs are widely accepted; more than 100 countries use auditing standards that are

National Standard Setters

The IAASB hosted its seventh meeting of the most active national standard setters in March 2007, with standard setters from 12 countries in attendance. Topics discussed included the Clarity project, audit quality, national agendas and convergence-related issues, IAASB strategy review, audit documentation for audits of SMEs, alternative assurance services, financial reporting frameworks described by reference to International Financial Reporting Standards (IFRSs), assurance reports on a service organization's controls, and the matter of the effective dates of ISAs.

Participants also discussed the topic of implementation guidance and training for practitioners. They agreed that both of these factors play important roles in enhancing audit quality, and that the need for support in these areas was being keenly felt at the smaller end of the market. This is consistent with what was heard during the IAASB's strategy consultations. I anticipate further discussion on this subject at the 2008 meeting.

European National Standard Setters

IAASB representatives participated in the regular European Auditing Standard Setters meeting hosted by the Fédération des Experts Comptables Européens in Brussels. The focus of discussions was the program for the Clarity project, EU endorsement of the ISAs and issues around translation of the redrafted ISAs.

U. S. Public Company Accounting Oversight Board

The IAASB's observer status at the Standing Advisory Group (SAG) meetings allows us to keep in touch with PCAOB developments, and to provide the PCAOB with an international view on a number of its auditing standards projects. The SAG meets three times a year, and the Chairman or I represent the IAASB. This activity complements the PCAOB's observer membership in the IAASB and its CAG.

INTOSAI

I met the Chair of the Professional Standards Committee (PSC) of the INTOSAI in May 2007. The meeting allowed me to share with him the findings of the IAASB's strategy review survey relevant to the public sector. I indicated that respondents to the strategy survey had recommended continued dialogue with INTOSAI.

The meeting also enabled the Chair of the INTOSAI PSC to share with me the findings of a recent survey it had conducted and which included a question on the appropriateness of using ISAs as the basis for developing the Financial Audit Guidelines that support the implementation of the INTOSAI Fundamental Auditing Principles. Those findings indicated that ISAs are used by many Supreme Audit Institutions (SAIs), and that national standards used by SAIs may also be based on ISAs. The majority of respondents to the INTOSAI PSC survey supported the "dual approach" to standard setting by INTOSAI, that is, INTOSAI Fundamental Auditing Principles supported by more detailed Financial Audit Guidelines that draw on ISAs.

In this regard, I am pleased to report that the first nine Financial Audit Guidelines were endorsed by the International Congress of Supreme Audit Institutions at its 19th meeting held in Mexico City during 2007.



IAASB MEETINGS

Five IAASB meetings totaling 24 days of full Board deliberation were held over the past year. This significantly higher level of Board activity became necessary because of the substantial workload driven by the priorities of the Clarity project. Additionally, approximately 115 task force meetings (in person and through conference calls) were held during the year.

Although physical meetings are often essential, we endeavor to maximize the use of technology for our task force and other meetings. During 2007, we also began using video conferencing technology, and anticipate using this valuable means of communication more frequently in 2008 to reduce not only our volunteers' time and travel costs, but also our carbon footprint.

COMMUNICATIONS

Part of the IAASB's strategy is to raise public awareness of its work, thereby promoting greater understanding of its activities and outputs.

To this end, IAASB members and staff delivered a variety of presentations and speeches throughout the year, or were otherwise involved in meetings with stakeholders, all aimed at informing the audiences about the IAASB's objectives and work. A list of events or forums in which IAASB representatives participated is provided in the Appendix under the heading Communicating with Stakeholders.

The extent of this communication effort reflects the IAASB's belief that (a) openly and transparently sharing information with its stakeholders about its objectives, strategic priorities, initiatives and outputs, and (b) being receptive to their input and feedback, are critical factors in gaining wide recognition and acceptance of IAASB standards.

TRANSLATION

A major challenge for the successful implementation of the ISAs is translation. To facilitate translation and reproduction of its pronouncements, IFAC has recently released the following two updated policy statements:⁵

- *Policy for Reproducing, or Translating and Reproducing, Publications Issued by the*

- *International Federation of Accountants; and*
- *Permission to State that the International Federation of Accountants has Considered a Translating Body's Process for Translating Standards and Guidance.*

In addition, to increase the accessibility of its guidance worldwide, IFAC has developed a database that enables professional accountants to locate third-party translations of its pronouncements in more than 30 languages. The database features information on the languages available, publication titles, date of translation, names of translating organizations and (where available) lists of translated key terms.

The IAASB recognizes that the translation of ISAs is not an easy task, and that it will be one that becomes even more important in the next two years as the effective date of the clarified ISAs approaches. The IAASB encourages all those working to translate the ISAs (a) to leverage the work that is being done by member bodies and national standard setters and, perhaps most importantly (b) to involve the profession in the process since ISAs are technical documents, written for professional auditors.

In addition, in its exposure process, the IAASB has sought feedback on matters where translation could be a challenge, in particular in the specification of the requirements of the ISAs and believes it has reflected the comments received in the final ISAs to the extent possible.

PUBLICATIONS AND DISTRIBUTION

During 2007, the IAASB website attracted 158,300 visitors. More than 95,000 copies of final IAASB publications, including standards, and nearly 87,000 copies of exposure drafts were downloaded. Approximately 5,300 print copies of the 2007 *IFAC Handbook of International Auditing, Assurance, and Ethics Pronouncements* were distributed.

To achieve the widest use and recognition of IAASB standards, the IAASB makes its pronouncements available on its website free of charge. IFAC and the IAASB jointly released the 2007 edition of the *Handbook of International Auditing, Assurance, and Ethics Pronouncements*, containing all pro-

⁵ The revised policies and the database can be found at www.ifac.org/translations.

nouncements issued as of December 31, 2006. A free PDF downloadable version of the Handbook was also released with the printed edition. Individual publications continue to be available for download free of charge from the website.

IFAC member bodies are encouraged to promote IAASB standards and guidance to their members, and to that end can link their websites to the IAASB website.

IAASB MEMBERSHIP

The IAASB bid farewell to four members of the Board who completed their appointed terms at the end of 2007: Jan Bo Hansen, Will Rainey, Makoto Shinohara, and Roberto Tizzano. I join the Chairman in expressing my gratitude to them for their positive contributions to the IAASB during their respective terms, and, in particular, over the past year.

The IAASB welcomes the following new appointments and re-appointments to the board from January 1, 2008 for terms of three years:

Nominated by IFAC Member Bodies

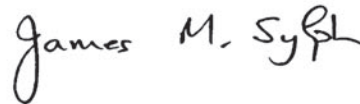
- Josef Ferlings, *Germany*;
- Jianhua Tang, *China*; and
- Jon Grant, *United Kingdom*.

Nominated by the IFAC Transnational Auditors Committee

- Craig Crawford, *KPMG* (re-appointed); and
- Caithlin McCabe, *Deloitte*.

ACKNOWLEDGEMENTS

I would like to thank the Chairman for his outstanding leadership of the IAASB over the past year, and wish to extend my appreciation to the Board members and all those who have contributed to the work of the IAASB. I am also grateful to my team of staff members who work tirelessly behind the scenes to ensure that the IAASB is able to meet its work schedule and deliver on its commitments.



James M. Sylph
Executive Director, Professional Standards



IAASB Technical Staff (left to right): Ken Siong, Dorothy Ofori, James M. Sylph (Executive Director, Professional Standards), James L. Gunn, Alta Prinsloo, Kathleen Kerrigan, Daria Koukhar, and Michael Nugent.

IAASB MEMBERS, TECHNICAL ADVISORS, OBSERVERS, AND TECHNICAL STAFF

Throughout 2007

BOARD MEMBERS

TERM ENDING

TECHNICAL ADVISORS

Nominated by IFAC Member Bodies

John Kellas (Chairman), <i>United Kingdom</i>	2008	
Phil Cowperthwaite, <i>Canada</i>	2008	Greg Shields
John Fogarty, <i>United States</i>	2009	Sharon Walker
William Kinney, <i>United States</i>	2009	Josef Ferlings
Marcel Pheijffer, <i>The Netherlands</i>	2008	Hans Verkruijsse
Will Rainey, <i>United Kingdom</i>	2007	Jon Grant
Makoto Shinohara, <i>Japan</i>	2007	Yuichi Yamamoto / Sachiko Kai
Roberto Tizzano, <i>Italy</i>	2007	Michele Casó
Gérard Trémolière, <i>France</i>	2008	Cédric Gélard
M. Abdullah Yusuf, <i>Pakistan</i>	2009	Shahid Hussain

Nominated by the IFAC Transnational Auditors Committee

Denise Esdon (Deputy Chair), <i>Ernst & Young</i>	2008	George Tucker / Dan Montgomery
Craig Crawford, <i>KPMG</i>	2007	Sylvia Smith
Jan Bo Hansen, <i>Deloitte Touche Tohmatsu</i>	2007	Jennifer Haskell
Diana Hillier, <i>PricewaterhouseCoopers</i>	2008	Philip Ashton
Susan Jones, <i>Grant Thornton</i>	2009	Maria Manasses / Debra Hahn

Public Members

Kjell Larsson, <i>Sweden</i>	2009	Kelly Ånerud
Ian McPhee, <i>Australia</i>	2008	Richard Mifsud
David Swanney, <i>United Kingdom</i>	2008	

OBSERVERS

David Damant (IAASB CAG Chair, *United Kingdom*)
 Jennifer Rand (Public Company Accounting Oversight Board, *United States*)
 Jürgen Tiedje/Jean-Philippe Rabine (European Commission, *European Union*)
 Dr. Hisashi Yamaura (Financial Services Agency, *Japan*)

IAASB Technical Staff

Executive Director, Professional Standards:	James M. Sylph
Deputy Directors:	James L. Gunn Alta Prinsloo
Senior Technical Manager:	Ken Siong
Technical Managers:	Kathleen Kerrigan Daria Koukhar Michael Nugent
Executive Assistant:	Dorothy Ofori
Administrative Assistant:	Irina Kaminsky

IAASB STANDARDS

The following standards were issued or are under development by the IAASB. Additional information on these projects can be found on the IAASB website at www.iaasb.org.

2007 ACHIEVEMENTS

Final Documents Approved

	<i>Date</i>
International Standard on Auditing (ISA) 230 (Redrafted), <i>Audit Documentation</i>	September
ISA 260 (Revised and Redrafted), <i>Communication with Those Charged with Governance</i>	September
ISA 540 (Revised and Redrafted), <i>Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures</i>	December
ISA 560 (Redrafted), <i>Subsequent Events</i>	December
ISA 580 (Revised and Redrafted), <i>Written Representations</i>	December
ISA 600 (Revised and Redrafted), <i>Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)</i>	July
ISA 720 (Redrafted), <i>The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements</i>	September

Approved for Public Exposure as Redrafted Standards under the Clarity Project

International Standard on Quality Control (ISQC) 1 (Redrafted), <i>Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements</i>	July
ISA 210 (Redrafted), <i>Agreeing the Terms of Audit Engagements</i>	December
ISA 220 (Redrafted), <i>Quality Control for an Audit of Financial Statements</i>	July
ISA 250 (Redrafted), <i>The Auditor's Responsibilities Relating to Laws and Regulations in an Audit of Financial Statements</i>	April
ISA 500 (Redrafted), <i>Considering the Relevance and Reliability of Audit Evidence</i>	April
ISA 501 (Redrafted), <i>Audit Evidence Regarding Specific Financial Statement Account Balances and Disclosures</i>	December
ISA 510 (Redrafted), <i>Initial Audit Engagements—Opening Balances</i>	July
ISA 520 (Redrafted), <i>Analytical Procedures</i>	December
ISA 530 (Redrafted), <i>Audit Sampling</i>	July
ISA 570 (Redrafted), <i>Going Concern</i>	February
ISA 700 (Redrafted), <i>The Independent Auditor's Report on General Purpose Financial Statements</i>	July
ISA 705 (Revised and Redrafted), <i>Modifications to the Opinion in the Independent Auditor's Report</i>	July
ISA 706 (Revised and Redrafted), <i>Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor's Report</i>	July
ISA 710 (Redrafted), <i>Comparative Information—Corresponding Figures and Comparative Financial Statements</i>	December
ISA 800 (Revised and Redrafted), <i>Special Considerations—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement</i>	July
ISA 805 (Revised and Redrafted), <i>Engagements to Report on Summary Financial Statements</i>	July

Approved for Public Exposure as Revised and Redrafted Standards

ISA 200 (Revised and Redrafted), <i>Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing</i>	April
ISA 402 (Revised and Redrafted), <i>Audit Considerations Relating to an Entity Using a Third Party Service Organization</i>	December
ISA 505 (Revised and Redrafted), <i>External Confirmations</i>	September
ISA 550 (Revised and Redrafted), <i>Related Parties</i>	February
ISA 620 (Revised and Redrafted), <i>Using the Work of an Auditor's Expert</i>	September

Approved for Public Exposure as New Standards

ISA 265, <i>Communicating Deficiencies in Internal Control</i>	December
International Standard on Assurance Engagements (ISAE) 3402, <i>Assurance Reports on Controls at a Third Party Service Organization</i>	December

COMMUNICATING WITH STAKEHOLDERS

The following lists the most significant events IAASB members or staff attended, or organizations they met during the year.

- 19th Meeting of the International Congress of Supreme Audit Institutions, Mexico City, Mexico
- 24th Session of Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting, Geneva, Switzerland
- The Association of Chartered Certified Accountants' Sustainability Assurance Reporting Forum, London, United Kingdom
- American Accounting Association Meetings, Charleston and Chicago, United States
- Basel Committee on Banking Supervision's Accounting Task Force Meeting, Sydney, Australia
- Canadian Public Accountability Board Meeting, Toronto, Canada
- Central American Joint Celebration of IFAC's 30th Anniversary, San Salvador, El Salvador
- Costa Rica VII Public Accounting Congress, San Jose, Costa Rica
- CPA Associates International's 50th Annual Meeting, New York, United States
- Danish National Audit Office, Copenhagen, Denmark
- Deakin University School of Accounting, Economics and Finance Research Seminar, Melbourne, Australia
- European Group of Audit Oversight Bodies Meeting, Brussels, Belgium
- Fédération des Experts Comptables Méditerranéens' Annual Conference, Athens, Greece
- FEE Third European Congress for SME and SMP Accountants, Scheveningen, Netherlands
- Financial Stability Institute, Basel, Switzerland
- Fourth European Audit Research Network Symposium, Aarhus, Denmark
- Global Reporting Initiative's Technical Advisory Committee Meetings, Amsterdam, Netherlands
- IFAC Small and Medium Practices' Forum, St. Julians, Malta
- Institute of Chartered Accountants in India's Auditing and Assurance Standards Board, New Delhi, India
- Institute of Internal Auditors' International Conference, Amsterdam, Netherlands
- Interamerican Accounting Association, Executive Council Meeting, Asunción, Paraguay
- International Organization of Supreme Audit Institutions' Financial Audit Guidelines Subcommittee Meeting, Stockholm, Sweden
- International Organization of Securities Commissions' Standing Committee 1 Auditing Subcommittee, London, United Kingdom
- Malta Institute of Accountants' Symposium, Differential Assurance, St. Julians, Malta
- New York State Society of CPAs' Annual Auditing Conference, New York, United States
- Norwegian Institute of Public Accountants' Seminar on The Profession's Future, Oslo, Norway
- Pace University Lubin School of Business' Conference, New York, United States
- Russian Audit Council – 5th Anniversary Conference and 20th Anniversary of the Establishment of the First Audit Firm, Moscow, Russia
- Salvador Institute of CPAs – International Conference of Accounting and Auditing Standards, San Salvador, El Salvador
- Universidad Externado de Colombia Faculty Event, Bogota, Colombia
- World Bank Conference for Latin America and the Caribbean, Mexico City, Mexico

REPORT OF THE CHAIRMAN OF THE IAASB CONSULTATIVE ADVISORY GROUP

The Consultative Advisory Group (CAG) of the International Auditing and Assurance Standards Board (IAASB) provides the forum in which the representatives of the various organizations and professions, and the different geographical areas, can provide input to the drafts of International Standards on Auditing (ISAs) and other documents developed by the IAASB, and to the IAASB's strategy. The overall aim is to bring forward to the IAASB the views of IAASB CAG members which, although in most cases not auditors, have an interest in the development of auditing standards and in their technical content. It is my task as chairman of the CAG to facilitate this interface.

The membership of the CAG as at December 31, 2007 is shown in the Appendix. In accordance with the Terms of Reference, the membership of the CAG was due for renewal in 2007. All members of the CAG expressed the view that they wished to have their membership renewed and the Public Interest Oversight Board (PIOB) confirmed the membership. In addition, the CAG proposed that my chairmanship should be renewed for a further three years and this also was confirmed by the PIOB.

It should be noted that membership is, in the large majority of cases, by organization. Representatives of the organizations attend the meetings of the CAG but the significance of the views of the CAG is increased by the fact that on substantial questions it is the opinions of the organizations which can be brought to bear on the evolution of the ISAs. In addition, one of the strengths of the CAG is the representation by a number of regulatory organizations, and I am pleased to report that the Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB) has joined the CAG. The SLAASMB is a member of the International Federation of Independent Audit Regulators (IFIAR), which brings together the leading audit regulators as they have emerged throughout the world.

In my view the CAG membership now represents a very adequate coverage of those organizations internationally or within geographical areas that represent those interested in auditing without being auditors or bodies representing auditors. I shall continue to work

to include others in the membership of the CAG should any gaps appear in this regard.

THE CAG'S INPUT TO THE IAASB

The Terms of Reference of the CAG state that the objective of the CAG is to provide input to and assist the IAASB in three areas:

- Advice on the IAASB's agenda and project timetable (work program), including project priorities;
- Technical advice on projects; and
- Advice on other matters of relevance to the activities of the IAASB.

These three areas are discussed below.

ADVICE ON THE IAASB'S AGENDA AND PROJECT TIMETABLE

During 2007, the CAG spent time in discussing the IAASB's strategy for the work to be done after the completion of the Clarity project, that is the plan for the work of the IAASB from 2009 - 2011. The CAG as a whole attended the IAASB Strategy Review Forum held on June 28 and held an additional meeting of the CAG the following day to discuss strategic matters. There was a general agreement with the outlines set out by the IAASB in the Strategy Review, and two subjects may be mentioned which were especially emphasized by the CAG.

First, there was considerable support for a project to inquire as to whether, in the case of small- and medium-sized entities (SMEs), a level of assurance could be provided which was not at the level of a full audit. On many occasions, the CAG has agreed with the IAASB and other commentators that an audit is an audit, which should not in any way be diluted, to whatever companies it is applied, whether small or large. But on a cost and benefit analysis it may be desirable for the IAASB to prepare a standard or guidance for a lower level of assurance, which could be applied to SMEs, which would be satisfactory in the jurisdictions in which an SMEs operates, and to



David Damant
Chairman

the users of SME financial statements. Some procedures of this kind are already in place, for example in the case of a review, or in certain countries a compilation, but the matter is worthy of serious enquiry and initiatives in this direction by the IAASB are supported by the CAG.

Secondly, and in response to a number of concerns around the world, the CAG very strongly supported the idea of an IAASB task force to look into the questions which arise when auditing financial statements containing remeasurements of financial instruments, particularly complex financial instruments. Representatives of various organizations that are members of the CAG put forward the view that this matter should be addressed as a matter of urgency (that is, without waiting for the end of the Clarity project) and a number of members of the CAG volunteered to work on the planning group which the IAASB intends to set up, to decide upon the make-up of the task force and its Terms of Reference.

In a limited number of areas, in particular the two very important areas mentioned above, the CAG has taken a proactive role in its interface with the IAASB. I would expect this proactive stance to continue in the future, although it remains true that the main activity of the CAG is to respond to initiatives arising in the IAASB.

In looking at its own future strategy, the CAG during 2007 completed the Self-Assessment project,

THE BROAD NATURE OF THE CAG MEMBERSHIP CONTINUES TO BE A SIGNIFICANT ASSET.

of the CAG but the present arrangements which had been implemented over the previous three years were in general approved.

TECHNICAL ADVICE ON PROJECTS

One aspect of the Self-Assessment project which was discussed within the CAG concerned the extent to which the technical details of the draft ISAs and other documents should be discussed in the CAG, as opposed to broader matters of principle. It was decided that the present level of technical discussion was essential, since otherwise the CAG would hardly fulfill its Terms of Reference, or the expectation of outside parties. Nevertheless, it was considered that some further time in meetings could be spent on questions of principle. The way in which this can be done, within the relevant time constraints, will be a matter of experiment in 2008.

The work of the CAG on technical matters involves a number of small working groups, usually of not more than four members, that study the IAASB documents in order to bring forward points for discussion at CAG meetings. It is not necessary for the members of a working group to agree one with another on any particular point, nor to produce papers unless that is the decision of the working group. During 2007, the working groups were expanded in their number and membership, and a Rapporteur was appointed to each working group to coordinate the work of that group. Some of the working groups may of course, should they wish, bring forward new topics for discussion within the area concerned, which might lead to a more proactive role by the CAG in





that area. In general however the thrust of the working groups is to study the proposals of the IAASB.

In the context of the technical advice provided to the IAASB by the CAG, I should like to state that, as Chairman, I have been able to observe the interface between the CAG and the

IAASB over more than three years, partly by attending the meetings of the IAASB (with the right of the floor) and partly by studying the flow of documents between the two bodies, and chairing the CAG meetings themselves. My observation leads to the conclusion that the IAASB and its task forces take serious note of the work of the CAG, in the development of the draft ISAs in their various stages.

One important example of the CAG's contribution is the development of the ISA on written representations which went through very considerable revisions as a result of CAG discussions. The CAG also carried out detailed discussions on the development of an ISA on related parties where in the case of auditing standards, as well as accounting standards, different economic and cultural backgrounds around the world require careful attention. In addition, the CAG was especially concerned with the wording and authority of proposed ISA 200 (Revised and Redrafted), *Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing*, which is the overall governing standard, and again important changes have resulted. In these three areas, as well as others, the CAG's views have been strongly expressed.

In 2008 a considerable number of ISAs will need to be approved, in order to complete the Clarity project, and I am taking particular care to ensure that all the final drafts are reviewed by the CAG. This will in nearly all cases be at the two CAG meetings, but in the very few cases where this may be impossible for timing reasons the drafts will be dealt with by correspondence. In this way the CAG will have complete input to the final stage of the Clarity project. Nevertheless, it should of course be borne in mind, in this and other contexts, that the


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responsibility for ISAs rests with the IAASB as an independent body.

ADVICE ON OTHER MATTERS OF RELEVANCE TO THE ACTIVITIES OF THE IAASB

The CAG has continued to monitor the questions that arise for audit reports concerning financial statements that are prepared in accordance with financial reporting frameworks described by reference to International Financial Reporting Standards (IFRSs) but where the framework is not completely in line with IFRSs. This is a matter of very considerable importance and on this topic there has been the appropriate liaison with the International Accounting Standards Board (IASB). The CAG has also continued to watch the development of XBRL in the auditing context.

We have received presentations on certain other matters concerning the implementation of ISAs, including an explanation as to how an audit firm will accommodate a new ISA in its internal processes. It is my intention to continue activities of this kind so that an understanding between organizations with different standpoints can be deepened.

DUE PROCESS AND TRANSPARENCY

The Terms of Reference of the CAG have been revised by the CAG and the IAASB staff, and approved by the PIOB. They appear on the IAASB website at www.ifac.org/IAASB/About.php#ConsultativeAdvisoryGroup.

In addition the CAG and the IAASB staff have developed rules for the re-appointment of the members of the CAG, and the appointment or re-appointment of the Chair. These rules were approved by the PIOB and essentially applied during the CAG re-appointments of 2007.

CONCLUSION

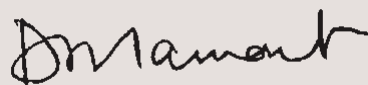
I continue to be of the view that one of the overall aims of the work of the IAASB, and of the CAG, is to develop the process of the setting of auditing standards to the point at which, both from the technical point of view, and from the point of due process, international confidence can be maintained even in the event of future auditing crises. Crises in the field of auditing are certain to arise in one context or another, but such events should not, if we do our work correctly, reflect upon the general content of the

auditing standards, but rather only failings of performance at a particular point. It is important to bear this dimension of our activities in mind since there is always a risk that reactions to a crisis, particularly political reactions, could lead to over-regulation, or inappropriate regulation. The difficulty is that the failures, should they occur, are very visible; whereas the burden of over-regulation is invisible. The efficient working of the capital markets, by ensuring through transparency of information that investors are correctly informed, can lead to large increases in wealth for society as a whole, even for the poorest sections of society. Without regulation, the transparency of information cannot be assured. With inappropriate regulation, the efficiency of markets is impaired and scarce resources are wasted. But through a high level of technical achievement, and the correct due process, we can build up public confidence so that the discussion of regulation is conducted within appropriate parameters.

Towards this end, many inputs are required in the development of ISAs and the work generally of the IAASB. As regards these input, in the case of the

public perception of the technical discussions and of due process, the broad nature of the CAG membership continues to be a significant asset.

I must again thank the staff at the IAASB for their contribution. Their professionalism and dedication is highly commendable. I would also like to thank the members of the IAASB and in particular the chairs of the IAASB task forces for the efficient way in which the various drafts are presented to the CAG. This is an area of activity which is added to the already considerable burdens involved in membership of the IAASB itself. I will continue to give particular attention to these interfaces, in liaison with the Chairman of the IAASB. My thanks are due to him and to the Deputy Chair, and I look forward to developing our cooperation further as the Clarity project comes to an end and a new phase of the work of the IAASB begins.



David Damant
Chairman



CONSULTATIVE ADVISORY GROUP MEMBERS AND OBSERVERS

As at December 31, 2007

MEMBER ORGANIZATIONS

- Asian Financial Executives' Institutes
- Basel Committee on Banking Supervision
- BusinessEurope
- CFA Institute
- Chairman of the Standards Advisory Council of the International Accounting Standards Board
- Dean of the Graduate School of Financial Management, Moscow
- Eastern Central and Southern African Federation of Accountants
- European Commission
- European Federation of Accountants and Auditors for SMEs
- European Financial Executives' Institutes
- Fédération des Experts Comptables Européens
- Information Systems Audit and Control Association
- Institute of Internal Auditors
- Institute of International Finance
- Instituto Brasileiro de Governanca Corporativa
- International Accounting Standards Board
- International Actuarial Association
- International Bar Association
- International Corporate Governance Network
- International Organization of Securities Commissions
- International Organization of Supreme Audit Institutions
- Islamic Financial Services Board
- Japan Securities Dealers Association
- North American Financial Executives' Institutes
- Sri Lanka Accounting and Auditing Standards Monitoring Board
- United Nations Conference on Trade & Development
- World Bank
- World Federation of Exchanges

OBSERVERS

- Financial Services Agency, Japan
- U.S. Public Company Accounting Oversight Board

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