

IAASB CAG PAPER



International Federation of Accountants

545 Fifth Avenue, 14th Floor, New York, NY 10017 USA
Tel +1 (212) 286-9344 Fax +1 (212) 286-9570 www.ifac.org

Agenda Item

B

Committee: IAASB Consultative Advisory Group

Meeting Location: Brussels

Meeting Date: June 29, 2007

**Draft Minutes of the Public Session of the Meeting of the
INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD
CONSULTATIVE ADVISORY GROUP (CAG)**

**Held on April 2-3, 2007
New York, USA**

PRESENT

Members

David Damant	Chair
Conchita Manabat	Asian Financial Executives Institutes
Ju Xinhua	Asian Financial Executives Institutes
Marc Pickeur	Basel Committee on Banking Supervision
Rebecca Todd McEnally	CFA Institute
Linda de Beer	Eastern Central and Southern African Federation of Accountants
Jean-Philippe Rabine	European Commission
Federico Diomeda	European Federation of Accountants and Auditors for SMEs
Jean-Luc Peyret	European Financial Executives Institutes
Hilde Blomme	Fédération des Experts Comptables Européens
Philip Johnson	Fédération des Experts Comptables Européens
Robert Roussey	Information Systems Audit and Control Association
Bengt Hallqvist	Instituto Brasileiro de Governanca Corporativa
Wayne Upton	International Accounting Standards Board (April 2 only)
Claude Lamoureux	International Corporate Governance Network (April 2 only)
Susan Koski-Grafer	International Organization of Securities Commissions (April 2 only)
Len Jui	International Organization of Securities Commissions (April 3 only)
Tomokazu Sekiguchi	International Organization of Securities Commissions
Pat Sucher	International Organization of Securities Commissions
Filip Cassel	International Organization of Supreme Audit Institutions
Brenda Lovell	Institute of Internal Auditors
Mohini Singh	Institute of International Finance
Rifaat Karim	Islamic Financial Services Board
Hayanari Uchino	Japan Securities Dealers Association
David Morris	North American Financial Executives Institute
Thomas Krantz	World Federation of Exchanges

Observers

Jennifer Rand U.S. Public Company Accounting Oversight Board

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By Invitation

Harold Monk

IFAC Small and Medium Practices Committee

IAASB

John Kellas

Chairman

Denise Esdon

Deputy Chair

Philip Ashton

Member (April 3 only)

Craig Crawford

Member (Afternoon of April 3 only)

Josef Ferlings

Member (April 2 only)

Jan Bo Hansen

Member (April 3 only)

G rard Tr moli re

Member (Via telephone from 9:00-10:00 on April 2 only)

Public Interest Oversight Board

David Brown (April 2 only)

Aulana Peters (April 3 only)

IFAC Staff

Jim Sylph

Executive Director, Professional Standards

Alta Prinsloo

IAASB Deputy Director

Kathleen Kerrigan

IAASB Manager

APOLOGIES

Members

Gerald Edwards

Basel Committee on Banking Supervision

Nelson Carvalho

Chairman of the Standards Advisory Council of the International Accounting Standards Board

Elena Lobanova

Dean of the Graduate School of Financial Management, Russia

Sam Gutterman

International Actuarial Association

George White

International Bar Association

Kristian Koktvedgaard

Union of Industrial and Employers' Confederations of Europe

Yoseph Asmelash

United Nations Conference on Trade and Development

John Hegarty

World Bank

Observers

Hisashi Yamaura

Japanese Financial Services Agency

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APRIL 2, 2007

Introduction (Agenda Item A)

Mr. Damant opened the meeting and welcomed the Representatives, IAASB members, Mr. Monk (representing the IFAC Small and Medium Practices (SMP) Committee), and public observers. He noted that BUSINESSEUROPE (previously UNICE) is a new Member Organization, but that its representative was unable to attend this meeting.

Mr. Damant noted that he had received documents from a group that is considering the interface between XBRL and the auditing profession. These documents will be distributed to the IAASB CAG after the meeting. He encouraged Representatives from Member Organizations that have not yet considered XBRL to discuss the matter with their organizations.

Mr. Damant confirmed that the minutes of the previous meeting reflected the comments received from the Representatives. The minutes were approved.

Mr. Damant emphasized the importance of the minutes. He explained that they are provided to the IAASB and its task forces as a record of the Representatives' recommendations, and form the basis of the IAASB reports to the IAASB CAG of its consideration of those recommendations. The minutes and the meeting material, including the report back documents, are available from the IFAC website and provide a transparent record of the IAASB CAG discussions and interface with the IAASB. This process was reviewed and approved by the Public Interest Oversight Board (PIOB).

IAASB CAG Working Groups (Agenda Item A)

Mr. Damant referred to his memorandum of March 12, 2007, which contained the proposed *Membership and Operations of Working Groups*.

Ms. Koski-Grafer and Messrs. Roussey and Sekiguchi complimented Mr. Damant on clarifying the operations of the working groups. Ms. Koski-Grafer emphasized the importance of point 6, which notes that the discussions in the IAASB CAG should not replace or duplicate detailed comments which may be made by various Member Organizations responding to an IAASB Exposure Draft.

Mr. Roussey suggested that IAASB staff alert the working group rapporteur, and provide him or her with the relevant papers, when a project is to be discussed at an IAASB CAG meeting. Mr. Damant agreed to alert the working group rapporteur, and to interact with IAASB staff with regard to the distribution of the relevant papers. He also agreed to amend the operating procedures to take account of this.

Mr. Sekiguchi asked whether the document was discussed with the PIOB. Mr. Damant responded that original documentation to the PIOB dealt with working groups and that he had alerted the PIOB that he was reviewing the matter. When finalized, a copy of the paper will be sent to the PIOB for its records.

Mr. Damant suggested that a working group be established for the Clarity project. Although the Clarity project is of importance and interest to all the Representatives, it could be helpful to have a working group to provide leadership. He suggested that the working group responsible for

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considering the list of clarity objectives become the working group responsible for the Clarity project. The members of the working group are Messrs. Hegarty and Johnson and Ms. Koski-Grafer.

Mr. Damant asked that Representatives who wish to join any of the working groups indicate their interest to him or IAASB staff. He also asked that Representatives indicate whether they want to act as rapporteur of a working group.

Mr. Karim indicated that he wanted to be a member of the working group responsible for corporate governance and investor matters. Mr. Damant noted that this working group will focus on those matters as they relate to an audit of financial statements.

Related Parties (Agenda Item B)

To NOTE matters that may affect the Member Organizations' comments on the exposure draft of proposed ISA 550 (Redrafted and Revised) issued in February 2007.

Mr. Damant introduced the topic, drawing the attention of the Representatives to a particular matter relating to the proposed revised definition of a “related party” set out in the re-exposure draft of ISA 550, “Related Parties.” Specifically, he noted that the revised definition adopted for audit purposes in cases where there is no, or no adequate, definition in the applicable financial reporting framework departed from the definition based on International Accounting Standard (IAS) 24 set out in the previous exposure draft. He was of the view that the revised definition (in contrast to the previous IAS 24-based definition) did not appear to capture related party transactions that are quantitatively immaterial but might be qualitatively material, such as those in which the directors of the entity may be financially interested.

Mr. Trémolière noted that the auditor’s focus is only on material items. He indicated that the use of the related party definition in IAS 24 for audit purposes could be problematic if the applicable financial reporting framework established no, or only limited, related party requirements. In particular, the entities themselves might not have implemented the information systems necessary to record, process and summarize related party transactions as defined under IAS 24, as many respondents to the previous exposure draft had pointed out. In addition, it was important for the ISA to be framework-neutral. Accordingly, the Task Force proposed a more principles-based definition in the re-exposure draft. Mr. Trémolière was of the view that, where the applicable financial reporting framework does not deal with related parties, or does so inadequately, the provisions set out in the re-exposure draft would capture related party transactions that are material.

Mr. Hallqvist was of the view that the auditors are working primarily for the entity’s owners and, accordingly, should report to the owners circumstances where the entity’s directors appear to be benefiting from related party transactions at the expense of the entity. Ms. Todd McEnally agreed. She was of the view that related party transactions pose the greatest risk of material misstatement of the financial statements, yet do not appear to receive the attention they deserve in the accounting literature. She noted that a fraud committed by management or those charged with governance through a related party transaction remains a fraud even if the transaction is insignificant in the context of the entity’s financial statements. Mr. Peyret was of the view that the focus should be more broadly on stakeholders generally, and not solely on the entity’s owners, as

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cases had arisen in the past where creditors and employees initiated legal action against auditors for not appropriately informing them of significant related party issues affecting the entity's ability to continue as a going concern.

Mr. Cassel agreed that the issue of the definition of a related party is of central importance to the standard. He noted that developments have occurred around the world to introduce greater accountability for public sector entities towards their stakeholders, principally taxpayers. Accordingly, there was a need for related parties not to be too narrowly defined. He shared Mr. Damant's view that it is important to consider the qualitative aspects of related party transactions and not just their quantitative characteristics, particularly given that many financial statements may not be very transparent in relation to those transactions.

Mr. Rabine was of the view that it would be sensible to consider the related party definition set out in IAS 24 in establishing a related party definition in the ISA as the IAS 24 definition is comprehensive. He questioned why the Task Force had redrafted the IAS 24 definition in a different way in the revised draft of the ISA. He acknowledged that the purpose of ISAs is not to establish accounting standards. However, the inclusion of any related party definition in the ISA based on the IAS 24 definition would not establish an accounting standard because that definition would be intended solely for the auditor's use for the purposes of the audit, such as to identify material misstatements due to fraud. Accordingly, he was of the view that the ISA should incorporate a definition based on the comprehensive IAS 24 definition.

Mr. Cassel shared a similar view. He noted that it was unclear whether the revised related party definition would capture all the different types of related party transactions, and accordingly whether that definition needed clarification. He was of the view that bringing back the IAS 24 definition in the ISA would establish a very strong benchmark for jurisdictions where the applicable financial reporting framework does not deal with related parties, or does so inadequately. In addition, he noted that although the re-exposure draft provided guidance indicating that the applicable financial reporting framework may deem transactions between the entity and those charged with governance to be significant regardless of the amounts involved, there did not appear to be a corresponding requirement for the auditor to evaluate such transactions. Mr. Damant agreed that the proposed ISA should be clarified in that respect.

Mr. Morris agreed that the related party definition should be clarified. However, he was not certain that the IAS 24 definition would capture all the various types of related party transactions that could lead to fraud, and therefore might itself need to be further refined. In addition, he felt that the revised draft of the ISA still retained a bias towards a presumption that all related party transactions are fraudulent. Accordingly, he was of the view that the ISA should adopt a more neutral stance.

Mr. Ju noted that the revised related party definition might not work in China as it is broader than the related party definition specified in Chinese accounting standards. He indicated that, for practitioners in China, the related party definition set out in auditing standards cannot override that set out in the accounting standards. He was of the view that the original approach to the related party definition in the previous exposure draft would work better and would be more framework-neutral. Accordingly, he asked the Task Force to give this further consideration.

Ms. Blomme noted that she was satisfied with the direction the Task Force had taken in the revised draft, particularly in moving away from a related party definition tied to IAS 24. She

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expressed support for a principles-based approach to the definition. However, she asked for clarification in the ISA regarding the meaning of “control.”

Ms. Koski-Grafer noted that some of the views expressed by Representatives seemed to be in conflict. In particular, regulators have generally embraced the principle that ISAs should be framework-neutral and that an auditing standard setter should not serve the role of an accounting standard setter. In her capacity as a securities regulator, she was of the view that auditing and accounting standards should set a high bar for transparency and also to enable the auditor to demonstrate that the auditor has a firm understanding of the entity. The question, therefore, was whether the goal of setting framework-neutral standards can be achieved if the aim is also to set a high bar for transparency. Mr. Damant noted that this consideration applied across the board and not just to related parties. Ms. Manabat noted that, as a result of globalization, there was no limit as to how management may structure transactions. Accordingly, complying with the standards may not be sufficient in itself. She was of the view that the Task Force had fulfilled its mandate but noted that there could be more questions that could be raised to which further thought should be given.

Mr. Lamoureux noted that most related party transactions are legitimate but professional skepticism should prevail. Mr. Sekiguchi was of the view that the framework-neutral approach that the IAASB had taken was helping convergence to, and acceptance of, ISAs. He noted that the issue was whether the IAASB can promote quality of auditing standards while taking a framework-neutral approach, considering the circumstances where national accounting standards are converged or being converged with International Financial Reporting Standards.

Mr. Kellas noted that the issue of framework neutrality is a very important consideration for standard setting and for global acceptability of the standards. The related party definition in the revised draft of the ISA does not override the definition that may be contained in the applicable financial reporting framework. In the absence of an accounting definition, the definition set out in the revised draft would assist the auditor to obtain an appropriate understanding of the entity’s related parties to identify the risks of material misstatement. He pointed out that the matter of transparency is a financial reporting framework issue and that the auditor has no authority to override accounting standards.

Mr. Damant was of the view that the revised draft should be clarified to ensure that it caters for the illustrative example set out in the CAG agenda paper, i.e., that related party transactions that are immaterial quantitatively but material qualitatively be appropriately addressed by the auditor. He encouraged the Representatives to submit comments to the IAASB on the re-exposure draft.

Using the Work of an Expert (Agenda Item C)

To RECEIVE an update on the status of the project, and DISCUSS a proposed exposure draft of ISA 620 (Revised and Redrafted). Approval of the proposed exposure draft was planned for April 2007.

Mr. Ferlings explained that the IAASB will consider a proposed exposure draft of the proposed revised and redrafted ISA at its April 2007 meeting. He summarized the issues highlighted for IAASB CAG consideration. The Representatives commented as follows:

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DEFINITION OF ENGAGEMENT TEAM

- Ms. Sucher was concerned about the unintended consequences of the definition of engagement team proposed by the International Ethics Standards Board for Accountants (IESBA), as explained by Mr. Ferlings. She noted that it is important that the IFAC *Code of Ethics for Professional Accountants* and the IAASB standards contain the same definition. She also noted that proposed ISA 600 (Revised and Redrafted), “Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)” contains yet a different definition for engagement team.
- Mr. Rabine supported the same definition of engagement team for both the Code and the IAASB standards. Referring to the Explanatory Memorandum accompanying the IESBA Exposure Draft, he noted that the IESBA and the Experts Task Force are aiming to achieve the same outcome, but that this is not clear. Mr. Ferlings explained that the Explanatory Memorandum will fall away when the revised Code is issued. It is therefore important that the proposed definition is capable of consistent interpretation without the Explanatory Memorandum.
- Mr. Morris noted that the IAASB CAG Working Group was of the view that the definition of engagement team should include both internal and external experts. However, from a personal point of view, he was also concerned about the unintended consequences of including external experts in the definition.
- Ms. Todd McEnally noted the importance of a longer term solution. She was of the view that, as transactions become more complex, increased audit risk will require increased use of experts. She believed that the longer term solution is education and training of auditors. Mr. Ferlings were of the view that, even if adequately educated and trained, auditors may still face unique situations in which experts will be needed.

Sliding Scale

- Mr. Morris noted that the IAASB CAG Working Group was in agreement with the Experts Task Force’s proposal in this regard.
- Ms. Sucher suggested that the auditor also consider how the audit evidence provided by the expert compares with other audit evidence obtained by the auditor. Although mentioned in the proposed ISA, she questioned the position of the text.

USING THE WORK OF MANAGEMENT’S EXPERT

- Mr. Roussey was concerned that the cross reference to ISA 315 (Redrafted), “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment” and ISA 330 (Redrafted), “The Auditor’s Responses to Assessed Risks” is in a footnote. If management engages an expert, the auditor should consider whether also to engage an expert. Mr. Damant agreed, but emphasized that matters relating to management’s expert and the auditor’s expert should be dealt with separately. Mr. Ferlings noted that the matter raised by Mr. Roussey is addressed in ISA 315 (Redrafted), but agreed that the Experts Task Force will consider whether it needs further clarification.

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- Mr. Morris was concerned that the proposed ISA may be read as implying that there is a weakness in internal control or a fraud risk factor when management decides to engage an expert. In fact, management may decide that it is more efficient to engage an expert.
- Mr. Peyret emphasized the importance of management not abdicating its responsibility to an expert it engages.

ACCOUNTING AND AUDITING EXPERTS

- Mr. Johnson was of the view that footnote 1 (explaining that, although the proposed ISA does not deal with experts in accounting or auditing, parts of it may nonetheless be helpful when using the work of such an expert) should be in the Introduction section. Mr. Damant was of a similar view. He also noted that the word “helpful” is weak. Mr. Kellas was of the view that the word “helpful” is appropriate because accounting and auditing experts are excluded from the scope of the proposed ISA and therefore not subject to the requirements.
- Ms. Rand asked whether the reference to accounting and auditing experts is in the context of consultation within the firm about accounting or audit related matters. In the United States, such consultations are dealt with in the quality control standards. Mr. Ferlings explained that the proposed ISA applies in the case of external experts, and that the reference should be read in that context.
- Mr. Sekiguchi suggested that the IAASB should explore ways to explain why the proposed ISA does not apply to accounting and auditing experts.

OTHER

- Mr. Pickeur was concerned that paragraph 10 of the proposed ISA (which requires the auditor to provide direction to the auditor’s expert and to communicate with the auditor’s expert) does not provide for two-way communication. Mr. Ferlings explained that the words “determining ... the nature, timing and extent of communication *between* them” imply two-way communication. Mr. Pickeur also asked why an engagement letter and expert’s report are not required. Mr. Ferlings explained that the Experts Task Force agreed not to propose documentation requirements, as documentation is affected by the “sliding scale,” i.e. it will vary depending on the circumstances.
- Referring to paragraph 11 of the proposed ISA (which requires the auditor to evaluate the adequacy of the evidence provided by the auditor’s expert), Mr. Sekiguchi asked why the auditor is not required also to understand the audit evidence, considering the importance of and difficulty in understanding the validity of assumptions when using the work of experts. Mr. Ferlings explained that understanding is a subset of evaluation. Mr. Sekiguchi also asked why the requirement refers to “adequacy of the evidence” and not “appropriateness of the evidence.” Mr. Ferlings explained that “adequacy” is used because the evidence provided by the expert only forms part of what may be appropriate evidence.
- Referring to paragraph A27 (which refers to specific procedures to evaluate evidence provided by the expert), Mr. Roussey was concerned that the words “reviewing the auditor’s expert’s working papers” may imply that the auditor does not have to review the expert’s working papers, while the auditor may not be able to evaluate the adequacy of the evidence provided by the expert if he or she does not review the expert’s working papers. Mr. Ferlings explained that the matter is dealt with in the preceding paragraph (which lists factors that may

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be relevant when considering the findings of the auditor's expert), but agreed that the Experts Task Force will consider whether further clarification is necessary.

Audit Firms and ISAs (Agenda Item D)

To NOTE a presentation on how the audit firms incorporate the ISAs into their methodologies.

Mr. Damant explained that, based on a request from Mr. Pickeur, he had asked Mr. Johnson to prepare a presentation on how the ISAs are implemented by the firms. Mr. Johnson led the IAASB CAG through the presentation, given in his personal capacity but which he had prepared in consultation with the Big Four firms.¹ His key points were:

- Large firms are compliant with the existing ISAs having invested heavily over a number of years.
- The 22 members of the Forum of Firms are committed to embedding the ISAs into their methodologies.
- Each large firm goes about the task of implementing changes to the ISAs differently due to differing methodologies.
- The challenges are greater for small firms, where a need for co-ordinated learning programs and compliant software exists.

Mr. Johnson noted that the clarity redrafted ISAs will create some challenges for global firms. He shared techniques used to assist global implementation within the firms. He also explained the effect of national requirements on the implementation of the ISAs, other implementation issues, and methodologies of transformation. In addition, he shared lessons learnt from implementing the ISAs in the United Kingdom and Ireland. Mr. Johnson suggested that sufficient time be allowed for implementing the clarity redrafted ISAs. He suggested an effective date of December 15, 2009. He was also in favor of a "moratorium."

Ms. Rand asked about the challenges to be created by the clarity redrafted ISAs. Mr. Johnson explained that small but important changes in the text of the ISAs, which are already implemented by the firms, may not be noticed by practitioners. Also, there is an increase in the number of requirements. Global methodologies have to be aligned with the clarity redrafted ISAs. In addition, these methodologies have to be considered at national level to ensure that they also take account of national requirements.

Ms. Sucher noted that the auditor's report states that the audit was conducted in accordance with the ISAs. It therefore is important that the firms' methodologies are aligned with the ISAs. Mr. Johnson agreed with this but responded that it is the scale of change that must be recognized. The volume of clarity redrafted ISAs to be issued in 2007 and 2008 will be very high.

Mr. Rabine asked how differing codes of ethics for professional accountants in different jurisdictions affect the firms' global methodologies. Mr. Johnson indicated that the implementation of a common code (for example, the IFAC *Code of Ethics for Professional Accountants*) within firms and across jurisdictions will assist implementation of the ISAs.

¹ The presentation can be accessed at <http://intranet.ifac.org/Uploads/?FileID=015151>.

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Mr. Roussey asked how firms communicate to staff the fact that the ISAs are high-level standards that require professional judgment and ethical behavior. Mr. Johnson noted that this is becoming more difficult as the need for specialization gives rise to people from different professions being appointed at different levels within the firms. He emphasized the importance of “tone at the top.” He also noted that these matters are built into learning programs attended by staff at various stages of their employment.

Ms. Rand asked how the firms deal with the application and other explanatory material in the ISAs. Mr. Johnson responded that such material provides guidance to the practitioners and are often included in practice manuals.

Mr. Kellas noted that the comments relating to the implementation of the ISAs illustrate that development of standards and implementation of those standards are equally important aspects of audit quality. He noted that the national auditing standard setters agreed that the professional accountancy bodies have an important responsibility with regard to the implementation of the standards.

Mr. Damant raised the issue of different sets of auditing standards for different types of entity and the effect that that have on firms’ methodologies. It was noted that, in the United States for example, three sets of standards exist – that is, those issued by the PCAOB, the Auditing Standards Board and the Government Accountability Office.

Mr. Monk stressed the importance of allowing sufficient time for firms, in particular SMPs and firms in developing nations, to become familiar with and implement the clarity redrafted ISAs.

Clarity Project (Agenda Item E)

REPORT BACK

Mr. Kellas presented a brief report back on the responses of the Task Force and IAASB to the minuted comments of Representatives who attended the IAASB CAG meeting of September 11-12, 2006. Mr. Damant commented that he was pleased to see that his point on the logical flow of the material on the objective of an audit and the overall objective of the auditor was accepted. The Representatives had no further comments.

REVISION OF ISA 200

To DISCUSS a proposed exposure draft of ISA 200 (Revised and Redrafted). Approval of the proposed exposure draft was planned for April 2007.

Obligation Attaching to Objectives

Mr. Kellas explained that proposed ISA 200 (Revised and Redrafted), “Overall Objective of the Independent Auditor, and Concepts Relevant to an Audit of Financial Statements” incorporates relevant provisions of the amended *Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services* (Preface) in response to the fact that the European Commission (EC) does not expect to endorse the Preface.

He indicated that some constituencies have suggested that the changes from the exposed version of the amended Preface were substantive and resulted in a weakening of the effect of objectives. The IAASB does not consider that the changes do represent a weakening, but that they were

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intended to respond to valid points made in response to the consultation draft. However, the revision of ISA 200 provides an opportunity to consider the most appropriate approach to the presentation in ISA 200 of the material relating to objectives derived from the amended Preface, and to provide further explanation of that material in this new context. He highlighted the proposed changes to ISA 200.

Sixteen of the Representatives present at the meeting indicated objection to the use of the phrase “aim to achieve” in the obligation attaching to objectives. The Representatives commented as follows:

- Ms. Sucher found it difficult to understand the effect of the ‘aim to’ wording, and was of the view that it weakens the obligation. She noted that if one accepts that the concepts of reasonable assurance, inherent limitations, and sufficient appropriate audit evidence are inherent to the auditor’s opinion, then it is unnecessary to qualify the obligation. Further, the wording adds an unnecessary layer of ‘softness’ that might be misinterpreted. Messrs. Karim and Rabine and Ms. Koski-Grafer supported Ms. Sucher’s views.
- Ms. Koski-Grafer was of the view that the wording of the obligation could suggest to auditors that it is acceptable to not achieve an objective yet still assert that the overall objective of the auditor has been achieved. If this is the case, it may lead some auditors to choose to achieve only some, but not all, of the objectives. Further, she was of the view that the ISA is unclear about the consequences if an objective is not achieved (e.g., is the auditor expected to document the fact that an individual objective has not been achieved, or assert why the auditor still believes that the overall objective has been achieved). In her opinion, it is imperative that the ISA explain what is required of the auditor with respect to individual objectives not achieved.
- Referring to the matter of documentation, Mr. Johnson was of the view that the failure to achieve an objective represents a significant matter arising from the audit that requires documentation under proposed ISA 230 (Redrafted), “Audit Documentation.” Ms. Koski-Grafer suggested that perhaps something could be added to the ISA to draw the auditor’s attention to this fact.
- Mr. Pickeur did not find the approach of bolstering the ‘weaker’ obligation through additional guidance to be effective. He was of the view that an objective is an absolute and that the wording of the obligation should reflect this (i.e., ‘shall’ or ‘must’ wording should be used). He suggested that a clear statement be made that the auditor must achieve the objectives, followed by a sentence explaining that in some cases an objective cannot be achieved. Mr. Rabine supported this view, and noted that in his opinion the obligation is a ‘best efforts’ one. Mr. Damant suggested as an alternative to remove the words ‘aim to’ and state that the auditor shall either: (i) achieve the objectives; or (ii) if an objective is not achieved, then [consequence]. Other alternatives were suggested variously.
- Mr. Johnson noted that words ‘must’ or ‘shall’ are absolute terms, and one cannot subsequently qualify them. He was of the view that the phrase ‘aim to achieve’ is appropriate taking into account the fact that concepts such as reasonable assurance and the inherent limitations of an audit underpin an audit conducted in accordance with ISAs. Mr. Kellas noted that an objective by definition is that which one aims towards; the use of ‘aim to achieve’ is therefore consistent with the meaning of an objective.

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- Mr. Rabine and Mmes. Koski-Grafer and Sucher were also of the view that the obligation could be enhanced by explaining how the auditor should achieve the objectives. This could be accomplished by, for example, bringing forward the requirement in proposed ISA 200 (Revised and Redrafted) for the auditor to obtain sufficient appropriate audit evidence.

Referring to the application material of proposed ISA 200 (Revised and Redrafted) that states that the achievement of objectives is a matter of professional judgment, Mr. Pickeur was of the view that different auditors should arrive at the same conclusion about whether the objectives have been achieved; provision for differences in judgment on this matter should not be allowed for. Mr. Kellas noted that professional judgment is a personal quality, and judgments may therefore differ between experienced auditors. Rather, the expectation should be one of whether other experienced auditors can agree that the exercise of professional judgment in any particular case was reasonable. Mr. Kellas also noted that the nature of auditing itself, including the expression of an opinion on the financial statements, requires the exercise of professional judgment, and that the ISAs provide a framework to assist in this regard.

Mr. Kellas indicated that he will report the outcome of the CAG discussions to the IAASB at its April meeting. He indicated, however, that he would probably recommend that the IAASB should not change the wording of material derived from the amended Preface at this stage given that it has recently approved the amended Preface following due process. Rather, his recommendation would be that the explanatory memorandum accompanying the exposure draft should draw attention to the issues raised regarding the wording of the obligation attaching to objectives, and ask for respondents to comment thereon so that a decision could be taken in the light of comments from a wide range of respondents.

Concepts Relevant to an Audit, Including Inherent Limitations of an Audit

Mr. Kellas explained that in revising ISA 200 the IAASB has sought to amplify as appropriate the discussion of the concepts relevant to an audit of financial statements. These concepts provide the basis for a proper understanding of the overall objective of the auditor and the objectives and requirements of the ISAs.

He noted that particular interest has been expressed on the subject of the inherent limitations of an audit. The IAASB is of the view that it would be neither appropriate nor practicable to provide a complete list of inherent limitations. Rather, it has been suggested that proposed ISA 200 (Revised and Redrafted) should approach this matter by focusing on the source and nature of different limitations, and the use of general categories for this purpose. The IAASB is also of the view that individual ISAs should not repeat the inherent limitations, except where necessary to provide further explanation of specific limitations that are of particular importance to their subject matter.

Mr. Damant emphasized the importance of this material in relation to the public's understanding and expectations of an audit.

Referring to the inherent limitations of an audit, the Representatives commented as follows:

- Mr. Johnson reported that FEE has prepared a paper for the EC on the inherent limitations of an audit, from the perspective of the financial reporting supply chain as a whole. He noted that the paper emphasizes the need to view the expertise and professional judgment of the auditor as matters that mitigate, to some degree, the inherent limitations of an audit. He also

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noted that the paper recommends that revised ISA 200 could address further the sources of general inherent limitations and the degree of control that an auditor can exercise over these, and the degree to which the auditor can mitigate them. Further, revised ISA 200 ought to include an explanation of the distinction between general categories of inherent limitations and specific inherent limitations.

- Mr. Rabine was of the view that there is a lack of clarity about how the inherent limitations relate to the auditor's opinion on the financial statement (e.g., does the opinion suggest that the limitation have been mitigated, or overcome), and about the difference between absolute and reasonable assurance. He was also of the view that the discussion of inherent limitations should be as complete as possible, and that the best way to achieve this is to present them by categories of limitations.
- Ms. Rand was of the view that the phrase 'inherent limitation cannot be overcome' in the application material is too stark. Mr. Kellas explained that an audit is constrained by limitations, and that the auditor seeks to mitigate their effect but cannot overcome them; they are essentially matters that prevent the auditor from obtaining absolute assurance. Ms. Koski-Grafer suggested that a solution may be to re-order the sentence so that it begins with what is expected of the auditor in relation to minimizing the effect of the inherent limitations. Mr. Rabine supported the comments of Mmes. Rand and Koski-Grafer.

Mr. Diomeda was of the view that the application material in proposed ISA 200 (Revised and Redrafted) that discusses the concepts relevant to an audit is extremely important to a proper understanding of the overall objective of the auditor and hence, should be seen as authoritative. The material is necessary and should therefore form part of the ISA to be adopted by the EC irrespective of the treatment it determines for the application material of other ISAs. Mr. Rabine indicated that the EC is considering its options with respect to application material in general, including the use of non-binding legislative instruments. He asked whether the IAASB could somehow present the material in proposed ISA 200 (Revised and Redrafted) differently or with a higher level of authority than afforded application material in other ISAs. Mr. Kellas replied that he thought that the IAASB would be reluctant to create a further category of material. It is a matter for the EC to consider, as the IAASB cannot determine what would be appropriate for legislative purposes.

Mr. Kellas noted that the IAASB is scheduled to review comments received on the future exposure of proposed ISA 200 (Revised and Redrafted) at its March 2008 meeting, and to approve the final ISA in September 2008.

Mr. Damant indicated that all Member Organizations are invited to comment on the exposure draft, and encouraged respondents to provide recommendations for solutions to identified issues.

APPLICATION OF THE CLARITY CONVENTIONS TO DATE, AND PROPOSED REDRAFTED ISAS
DISCUSSED AT THE FEBRUARY 2007 IAASB MEETING

To DISCUSS matters relating to proposed redrafted ISAs 530, 570, 700, 705, 706, 800, 805 highlighted for the consideration of the IAASB CAG. The IAASB approved proposed ISA 570 (Redrafted) and conducted first reads of the other ISAs in February 2007.

Application of the Clarity Conventions to Date

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Mr. Kellas noted that a general concern by many at the outset of the IAASB's work in applying the clarity conventions was the potential for the elimination of the present tense to increase very substantially the number of requirements in the ISAs, thereby resulting in over-prescriptive standards. He referred the Representatives to a summary prepared by IAASB staff of the approximate increase in the number of requirements as a result of the finalized or exposed clarified ISAs as of March 2007. Mr. Kellas indicated that, based on the recent meeting of national auditing standard setters hosted by the IAASB, those that were most concerned with the potential increase in the requirements as a result of the Clarity project would agree their worst fears have not materialized.

He also noted that at a past meeting the Representatives have encouraged the IAASB not to interpret its guidelines for determining requirements such as to exclude as requirements those action or procedures that are important to the consistent application of the ISAs, even though such actions or procedures are not expected to be applicable in virtually all audit engagements. Accordingly, the IAASB has included some conditional requirements in the clarified ISAs to address such circumstances where the action specified in relation to the circumstance envisioned is expected to be appropriate in virtually all such circumstances. The IAASB determines whether to specify a conditional requirement on a case-by-case basis.

Mr. Kellas referred the Representatives to the agenda material that shows how the IAASB has dealt with the present tense statements in the exposure drafts that have recently been approved. He explained the IAASB's practice of treating certain material within the extant ISAs as essential explanatory material within the Requirements section, or as part of the Introduction section, of the redrafted ISAs.

Mr. Damant and Ms. Koski-Grafer commended Mr. Kellas and IAASB staff on the mapping documents, noting that they help considerably in demonstrating the process behind the redrafting of the ISAs.

Ms. Lovell questioned whether the IAASB evaluates whether ISAs subject to redrafting should be prioritized for revision. She noted that proposed ISA 610 (Redrafted), "The Auditor's Consideration of the Internal Audit Function," now includes a requirement for the auditor to assess the internal audit function, yet the internal audit function is not explicitly defined. Mr. Kellas noted that such recommendations (for definitions) might be considered at this stage. However, it would not be possible to consider substantive comments on ISAs that are simply being 'clarified' at present. Such comments may indicate, however, that the relevant standards should be considered for further revision after the end of the Clarity project. He also indicated that as part of the IAASB strategy review some respondents may suggest revising some or all such standards.

Proposed Redrafted ISAs Discussed at the February 2007 IAASB Meeting

Referring to proposed ISA 700 (Redrafted), "The Independent Auditor's Report on General Purpose Financial Statements" discussed at the February 2007 IAASB meeting, Mr. Kellas noted that the question of compliance frameworks and whether they are misleading is becoming a priority as the IAASB distinguishes in the ISAs more clearly between fair presentation frameworks and compliance frameworks. In his view, a compliance framework ought not to be simply a "check-the-box" exercise, and the auditor should stand-back when opining on the financial statements to ensure that the auditor is not associated with misleading financial

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information. He understands that the IAASB agrees in principle that there should be a requirement for the auditor to consider whether the financial statements could be misleading.

Mr. Damant noted the difficulties with the term “misleading,” but reiterated that a compliance framework means that the auditor and management are required to follow the requirements of the framework.

The Representatives commented as follows:

- Mr. Sekiguchi noted that if the auditor is precluded by ethical requirements from accepting an engagement to audit information that may be misleading, he has difficulty understanding how the situation could arise. Mr. Kellas noted that while the auditor’s decision about engagement acceptance is the first line of defense for the auditor to avoid being associated with misleading information, there could be rare situations in which the auditor has deemed the framework to be acceptable but in following the rules of a compliance framework the result could be misleading. The auditor typically has the ability to modify the auditor’s report in such circumstances.
- Mr. Rabine believed that in Europe it is unlikely that a compliance framework, which is not understood by the users, would be used. He was of the view that to require the auditor to ensure that financial statements prepared in accordance with a compliance framework are not misleading is tantamount to asking the auditor to opine on the framework itself. Mr. Kellas agreed that a situation in which the framework is misleading would be extremely rare.
- Mr. Upton agreed with the concern of Mr. Rabine, subject to his understanding that a compliance framework is one that was never designed to tell the reader anything other than what is required by its rules.
- Mr. Hallqvist believed that the problem is not that the financial statements are misleading, rather that the auditor’s opinion is not being read. He noted that this matter is a significant challenge that the IAASB will need to face.

PROPOSED REDRAFTED ISAs FOR APPROVAL AS EXPOSURE DRAFTS AT THE APRIL 2007 IAASB MEETING

To DISCUSS matters relating to proposed redrafted ISAs 210, 220 (and possibly ISQC 1), 250 and 500 highlighted for the consideration of the IAASB CAG. Approval of the exposure drafts was planned for April 2007.

Mr. Kellas indicated that the ISAs referred to in Agenda Item E.3 of the agenda material are scheduled for approval by the IAASB as exposure drafts at its April 2007 meeting. He explained that the approach adopted by the IAASB for purposes of implementing its Clarity project distinguishes revision and redrafting. Each of the ISAs to be discussed is subject to redrafting to reflect only the IAASB clarity conventions and matters of clarity generally. Except for ISA 220, “Quality Control for Audits of Historical Financial Information” and ISQC 1, “Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements,” which have been revised in 2004, the ISAs have not been recently revised but are generally considered acceptable.

Mr. Kellas referred the Representatives to the matters noted for their consideration in the agenda material.

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ISQC 1 and ISA 220

Mr. Damant noted that ISQC 1 and ISA 220 may pose some challenges in some environments, particularly for smaller practices. Mr. Kellas noted that some national auditing standard setters have issued guidance to assist in the implementation of ISQC 1, and that the IFAC SMP Committee is also considering the development of additional guidance. The development of implementation guidance is ordinarily beyond the remit of a standards setter.

Ms. Sucher questioned the balance between requirements and application material. She noted, for example, that she would expect all of the matters listed in paragraphs A18 and A19 of proposed ISA 220 (Redrafted) to be elevated as requirements. She found the basis for elevating some, but not all, of the matters listed in the corresponding paragraphs of extant ISA 220 unclear. Mr. Kellas explained that the relevant requirement instructs the engagement quality control reviewer to consider significant judgments, and that the matters listed in paragraph A19 represent a few examples of matters that would require significant judgment.

Ms. Blomme suggested that ISQC 1 include material relating to its authority and the obligations on those following the standard within the standard itself (for example, as part of the Requirements section similar to the approach taken in proposed ISA 200 (Revised and Redrafted)). Presenting such material in a separate Preface document, or as part of the application material of the standard, is unlikely to assist the EC.

ISA 250

Ms. Sucher expressed concern with the proposal that ISA 250 (Redrafted), “The Auditor’s Responsibilities Relating to Laws and Regulations in an Audit of Financial Statements” distinguish between different categories of law and regulation. The proposal will lead inevitably to questions about which specific laws and regulation fit into which category, and to varying judgments about how they affect the financial statements. She was of the view that the proposal may be more of a revision of the ISA than a clarification. She noted that in her opinion ISA 250 is out of date and will likely need to be revised in the future.

Mr. Kellas was of the view that the proposed categorization between laws and regulation that have a direct and material effect on the financial statement (and thereby the auditor is required to understand them, for example tax laws or regulation), and those that may affect the financial statements but for which the breadth of regulations is so large that the auditor would not be expected to know them all, is a helpful improvement to the clarity of the ISA. He did not think that it was more of a revision than a clarification.

Ms. Blomme was of the view that proposed ISA 250 (Redrafted) should be more flexible in terms of what is required of the auditor when non-compliance with laws and regulations is discovered.

ISA 500

Ms. Sucher found it difficult to understand the meaning and effect of the objective in proposed ISA 500 (Redrafted), “Audit Evidence,” in particular the wording “...procedures *capable of providing* sufficient appropriate audit evidence.” She observed that there do not appear to be any requirements which directly assist the auditor in achieving the objective. She therefore questioned whether the link between the objective and the requirements is adequate.

Ms. Blomme was of the view that the following do not represent requirements:

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- The auditor’s consideration of the objective of the procedures in determining the relevance and reliability of the information to be used as audit evidence (paragraph 11); and
- The auditor’s determination of means of selecting items for testing that are effective in meeting the objectives of the audit procedure (paragraph 13).

Ms. Koski-Grafer noted that proposed ISA 500 (Redrafted) addresses several important areas which will require careful consideration. She suggested that an exposure period longer than 90 days might be appropriate.

ISA 210

Mr. Lamoureux questioned whether proposed ISA 210 (Redrafted), “Terms of Audit Engagements” prohibits the auditor from using the phrase “true and fair view” based on the wording in the draft “unless the auditor is required by law or regulation to use the phrase ‘true and fair view.’” Mr. Kellas noted that this was meant to indicate unusual circumstances in which an auditor deems the financial reporting framework to be unacceptable but nevertheless has an obligation to accept the engagement.

Mr. Lamoureux also questioned whether it is appropriate for the ISAs to refer to management and those charged with governance together. He noted that in most cases those charged with governance oversee the activities of management, and are not responsible for the preparation of the financial statements. Mr. Kellas indicated that the changes to ISA 210 represent amendments as a result of proposed ISA 580 (Revised and Redrafted), “Written Representations.” The wording reflects the fact that in some jurisdictions those charged with governance have the same responsibilities as management and the IAASB has sought to develop language that assists in making the ISAs jurisdictional-neutral.

Mr. Kellas asked the Representatives to bear in mind the objective of the redrafting of the ISAs when responding to the clarity exposure drafts. However, he encouraged the Representatives to indicate in a separate section in their comment letters whether they believe substantive issues exist, to identify specifically what those issues are, and to indicate the priority that they would attach to a future revision of the individual ISA. He indicated that the IAASB will consider whether these questions should be asked of all respondents to future clarity exposure drafts.

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Report Back – Accounting Estimates (Agenda Item G)

To NOTE how the respective IAASB Task Forces and the IAASB have considered the CAG Representatives’ comments.

Mr. Ashton presented a brief report back on the responses of the Task Force and IAASB to the minuted comments of Representatives who attended the IAASB CAG meeting of September 11-12, 2006. The Representatives had no further comments.

Mr. Ashton noted that there has been indication from some stakeholders in the financial services area that further guidance may be needed in proposed ISA 540 (Revised and Redrafted), “Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures” with respect to the audit of complex fair value accounting estimates. He noted that

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the Task Force had received input from an expert in the auditing of complex financial instruments measured at fair value, and that the expert was of the view that the guidance in proposed ISA 540 (Revised and Redrafted) was appropriate. He encouraged the Representatives and their organizations to be as specific as possible in their comment letters as to the additional guidance, if any, that may be needed.

Mr. Damant questioned what would happen in the case that the IAASB received a considerable number of requests for more guidance on specific aspects of auditing fair values, or on auditing derivative financial instruments given that IAPS 1012, “Auditing Derivative Financial Instruments” is not currently under review. Mr. Ashton indicated that the Task Force would consider whether recommendations for specific additional guidance could be incorporated in the ISA. Referring to derivative financial instruments, the Task Force could potentially recommend that IAPS 1012 be updated. However, he stressed the importance of achieving an appropriate balance in the ISA between understandability and including an overwhelming amount of guidance that addresses all potentially relevant circumstances.

The Representatives commented as follows:

- Mr. Uchino was of the view that further detail on matters such as the measurement at fair value of financial instruments and the assumptions used therein may be better dealt with through a vehicle designed specifically for industry-specific implementation guidance.
- Mr. Morris expressed concern about basing the need for additional guidance in the ISA on specific comments from respondents. Those that respond to the exposure draft may not in fact be those most in need of further guidance, nor do they ordinarily have the expertise to evaluate the adequacy of the guidance on this complex subject.
- Mr. Pickeur was of the view that the ISA needs to provide additional guidance on three areas: (1) modeling; (2) situations in which there is no clear observable market data; and (3) disclosures which are derived from fair value accounting under IFRS 7, “Financial Instruments: Disclosures.” He noted that the Basel Committee on Banking Supervision is also of the view that the ISA could be more explicit as to what action the auditor should undertake in response to assessed risks of material misstatement. He suggested that it would be useful for the IAASB to involve specialists from the banking industry who are knowledgeable about issues such as fair value modeling in the revision process. Ms. Sucher supported Mr. Pickeur’s recommendation, and suggested that specialists should also include those from the insurance industry. Mr. Damant noted that it could be somewhat difficult to include detailed guidance within the ISA regarding, for example, modeling given that so many types of models exist.
- Mr. Krantz noted that the issues surrounding fair values span more than the banking and insurance industries. He noted that auditors are finding it increasingly difficult to find individuals with the appropriate expertise for purposes of their audit engagements. He also noted that difficulties are being encountered in evaluating a company’s risk management process due to the high degree of computerization that was not anticipated. He stressed that these matters should be considered by the IAASB going forward.

Mr. Kellas indicated that he intends to write to representatives of the major accounting firms to ensure they involve appropriate experts in preparing their responses to the exposure draft. He was

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of the view, however, that the role of the IAASB and ISAs is not to explain further the accounting requirements of the applicable financial reporting framework.

Mr. Damant reminded the Representatives that comments on the exposure draft were due by April 30, and encouraged the Member Organizations to respond.

Report Back – Written Representations (Agenda Item G)

To NOTE how the respective IAASB Task Forces and the IAASB have considered the CAG Representatives' comments.

Ms. Prinsloo provided a brief report back on the September 11-12, 2006 proposals of Representatives on proposed ISA 580 (Revised and Redrafted), "Written Representations." She noted that Representatives had expressed important views at various stages of the development of the proposed ISA. Mr. Damant invited Representatives to share views on the exposure draft that may be relevant to those Member Organizations or individuals that intend to respond to the exposure draft.

Mr. Peyret was of the view that it would be helpful if the auditor explains to the audit committee how materiality for planning and performing the audit is determined with reference to materiality referred to in the applicable financial reporting framework.

Ms. Sucher was of the view that the IAASB should determine whether written representations corroborate other audit evidence (as implied by the proposed objective) or whether other audit evidence corroborates the written representations.

Ms. Blomme was concerned that the requirements may be too prescriptive. For example, she did not support requesting relevant persons to confirm whether they believe that the internal control they have maintained is adequate for purposes of preparing and presenting financial statements that are free from material misstatement.

Mr. Sekiguchi was of the view that the exposure draft has significant implications for business. He suggested that the IAASB should be proactive in promoting wider participation from people in business and investors be alerted to the exposure draft.

Material Weaknesses in Internal Control (Agenda Item H)

To DISCUSS a proposed exposure draft of the new ISA on Material Weaknesses in Internal Control. The IAASB conducted a first read of the proposed exposure draft in April 2007.

Mr. Ashton introduced the topic, noting that the IAASB CAG discussed significant issues in September 2006 and the IAASB in October 2006. On the basis of the recommendations of the Representatives and the IAASB, the Task Force had prepared a first draft of proposed ISA XXX, "Control Deficiencies Noted in an Audit," to be discussed at the April 2007 IAASB meeting.

CONTROL DEFICIENCIES TO BE REPORTED

Mr. Ashton explained that although the term "material weakness" has long been in existence in the ISAs, the consensus the IAASB had reached was that the communication of control deficiencies should not be limited to only material weaknesses. Many other control-related matters could be of interest to management and those charged with governance. Accordingly, the

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Task Force had developed a practical approach whereby reportable weaknesses (including material weaknesses) would be communicated to management and material weaknesses to those charged with governance. The auditor would also inform those charged with governance of the general nature and significance of other control-related matters communicated to management.

Mr. Morris noted that the IAASB CAG Working Group was generally satisfied with the Task Force's proposed approach. He was of the view that the auditor should be required to communicate material weaknesses to those charged with governance, and inform or advise those charged with governance of any other control-related matters the auditor has communicated to management. Mr. Rabine indicated that the proposals were compliant with the requirement embodied in the EC's revised 8th Company Law Directive for the auditor to communicate material weaknesses to the audit committee.

Ms. Todd McEnally acknowledged the concern that the auditor could overwhelm those charged with governance with large volumes of control-related matters. However, she was concerned about the approach the Task Force had taken would place the auditor in the difficulty of having to evaluate the materiality of control deficiencies that have come to the auditor's attention. She believed that it would be better for the auditor to communicate all control deficiencies the auditor has become aware of and to let those charged with governance make their own decisions. Mr. Lamoureux was of a similar view. He believed that if the auditor has noted a pattern of control deficiencies, those charged with governance should be made aware of that fact and the auditor should allow them the opportunity to decide which ones are important. Mr. Hallqvist shared the same view.

Mr. Ashton noted, however, that the key question was how those charged with governance would determine which control deficiencies are the most serious ones if the auditor had communicated a very large number of these to them.

Ms. Rand noted that the term "reportable weakness" was not consistent with the term "significant deficiency" as used by the US PCAOB in its internal control auditing standard. She also pointed out that the reporting structure the Task Force had adopted was different from that of the PCAOB. Mr. Ashton noted that the scope of an audit of financial statements performed under the ISAs is different from that of an audit of internal control that is integrated with an audit of financial statements as performed under PCAOB standards. The Task Force's intention was to encourage the communication of reportable weaknesses as opposed to mandating such communication. In relation to the terminology, he also explained that the Task Force wanted the definition of reportable weakness to be as flexible as possible to encourage the auditor to report any control-related matter the auditor would consider appropriate to bring to management's attention, consistent with the different scope of an audit performed under the ISAs.

Mr. Krantz expressed support for the direction the Task Force had taken. He was of the view that some prioritization of the matters reported to management and those charged with governance was important. He also agreed with the Task Force's emphasis on the application of professional judgment in evaluating the importance of the matters to be communicated. Mr. Cassel was of the same view and agreed with the Task Force's formulation of the proposed communication requirement as set out in the first draft of the ISA.

Mr. Monk agreed with the Task Force's approach. He noted that care was required in formulating the requirements so as not to lose the significance of the matters being reported. He added that

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there was a risk that the communication effort could become meaningless if too much was communicated, as could be the case in audits of smaller entities as well as those of large listed groups. Mr. Johnson commented that, as a practitioner, he found the Task Force's proposed communication requirement to management and those charged with governance to be appropriately balanced. He was of the view that those charged with governance should focus on the real control issues but should also be made aware of other control matters of lesser importance. He highlighted the risk that if the auditor were to be required to report more control matters, there could be an opposite effect as this could turn into a disincentive for the auditor to report at all.

Mr. Roussey noted that those charged with governance are empowered to set up a feedback mechanism with management regarding action taken to address the control matters reported, and that the Task Force's proposed approach to the communication requirement allowed for that. He added that the auditor could choose to be involved in such feedback mechanism.

With regard to the form of the communication, the Representatives generally agreed with the Task Force that this should be in writing.

THRESHOLD FOR REPORTABLE WEAKNESSES

In relation to the Task Force's proposed approach to setting the reporting threshold for reportable weaknesses, Mr. Morris indicated that the IAASB CAG Working Group agreed with that approach and believed that the proposed definition of "reportable weakness" was workable. He also noted that the IAASB CAG Working Group agreed with the Task Force's proposed guidance in relation to the communication of control-related matters that do not give rise to misstatements in the financial statements. He believed that this was important, particularly for preparers.

DEFINITION OF MATERIAL WEAKNESS

Ms. Blomme noted that she was concerned with the use of the term "reasonable possibility" in the definition of a material weakness. She was of the view that the term "greater than acceptably low risk" was more in line with terminology used in the ISAs and not inconsistent with PCAOB standards.

Mr. Ashton explained that the IAASB had discussed this issue at some length. The IAASB generally recognized that management would not normally think of such control matters in audit terms such as "greater than acceptably low risk." He noted that the substance of the two different terms should be the same. Mr. Rabine encouraged the Task Force to give further consideration to the definition so as to have maximum harmonization around the world and to avoid different definitions.

Ms. Blomme also highlighted that the term "reasonable possibility" could be difficult to translate in the European Union and asked the Task Force to give this issue particular consideration. Mr. Damant shared the same concern. Mr. Ashton suggested that the Task Force consider the outcome of the PCAOB's deliberations in finalizing its revised definition of material weakness as part of its proposed new internal control auditing standard.

In relation to the restriction of the proposed definition of material weakness to current year financial statements only, Mr. Roussey noted that the definition was effectively implying that although there *could* be a material misstatement in the financial statements, the auditor would have carried out sufficient further work in the audit to ensure that there were no such

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misstatements in the current year financial statements. This would, however, not preclude the possibility of material misstatements arising in the future. Mr. Ashton noted that the fact that the auditor completed all necessary audit work at the end of the audit would not change the fact that a material weakness existed during the earlier part of the year. Mr. Roussey asked the Task Force to consider whether guidance was needed to explain this.

Group Audits (Agenda Item I)

To DISCUSS a summary of significant comments on the March 2006 exposure draft and the revised proposed ISA. The IAASB reviewed the comments on the exposure draft and considered preliminary approval of the revised proposed ISA in April 2007. Final approval of the proposed ISA was planned for July 2007.

Mr. Hansen explained that the IAASB will consider the final ISA at its April 2007 meeting, but that approval will be delayed until July 2007 to allow the IAASB to discuss the proposed Basis for Conclusions with the IAASB CAG at its June 2007 meeting. He summarized the issues highlighted for IAASB CAG consideration.

AUDIT QUALITY AND PUBLIC INTEREST VS. COST

Mr. Hansen asked Representatives whether the requirements are set at an appropriate level of specificity. Mr. Hallqvist noted that it is mainly auditor associations that are concerned about increased costs; however, it is the owners that decide how much to pay for a quality audit. Mr. Krantz noted that management may have to assist the owners in understanding the cost of a quality audit.

Mr. Roussey noted that the IAASB CAG Working Group did not consider the proposed ISA; however, he was of the view that the proposed approach is reasonable. He noted that the proposed ISA provides solutions to very difficult matters, such as those of group engagement partner and group engagement team.

OBJECTIVES OF THE STANDARD

Ms. Sucher asked how the group engagement team will determine that it has achieved part (b) of the objectives (i.e., to effectively communicate with component auditors). Mr. Morris questioned whether “communicate” is the correct word. He suggested “supervise” or “monitor.” Mr. Hansen responded that monitoring is dealt with in part (c) of the objectives (i.e., to obtain sufficient appropriate audit evidence about the financial information of the components and the consolidation process to express an opinion whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework).

Mr. Johnson referred to paragraph 40 (which requires the group engagement team to communicate specified matters to component auditors), paragraph 41 (which requires the group engagement team to request component auditors to communicate specified matters), and paragraphs 42 and 43 (which deal with the evaluation of that information). He was of the view that “communicate” was the correct word based on these requirements. He noted that the objective should not be read in isolation. Mr. Roussey suggested a clearer link between the objectives and the requirements. This could be achieved by headings.

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Mr. Hallqvist and Dr. Manabat were of the view that in certain circumstances the group engagement team should be able to rely on the work of component auditors and limit procedures to a review of the component auditors' working papers. Mr. Hansen explained that the proposed ISA follows a risk-based approach. In the case of significant components, the group engagement team is required to be involved in the component auditor's work.

DEFINITIONS

Mr. Damant was of the view that the proposed definitions of group engagement partner, group engagement team and component auditor are much clearer. Mr. Rabine also supported the proposed definitions. He was of the view that the ISA is moving in the right direction, and that it clearly reflects the duties and responsibilities of those involved in a group audit. Ms. Sucher was of a similar view.

Ms. Rand asked that the Task Force consider the outcome of the discussion of the definition of engagement team in proposed ISA 620 (Revised and Redrafted) and how it affects the definition of group engagement team in the proposed ISA. Mr. Hansen was of the view that the single entity audit solution should apply equally in the case of a group audit.

Mr. Sekiguchi noted that the definition of group engagement partner does not provide for more than one partner or other person in the firm signing the group auditor's report. He was of view that such partners or other persons in the firm are collectively responsible for the group audit engagement and its performance. Mr. Damant suggested that the proposed ISA clarify that the singular includes the plural. Mr. Kellas noted that this was not about joint audits, but about joint signatories. He cautioned against taking a definitive view in this regard in the proposed ISA. He noted that multiple signatories may be a matter of national law, while it may be clear that one partner or other person in the firm is responsible for the performance of the group audit.

THE GROUP ENGAGEMENT TEAM'S PROCEDURES IN RELATION TO COMPONENT AUDITORS

Ms. Rand was of the view that the proposed ISA provides insufficient application material with regard to the requirement for the group engagement team to obtain an understanding of whether the component auditor operates in a regulatory environment that actively oversees and enforces the independence and professional competence of auditors, and the quality control systems of their firms. Mr. Rabine was of a similar view. He noted that this is a driver of lower costs. Mr. Hansen agreed, noting that it may positively affect the nature and extent of the group engagement team's involvement in the component auditors' work.

RESPONSIBILITIES OF COMPONENT AUDITORS

Mr. Pickeur referred to the Task Force's view "... that the relationship is between the group engagement partner and those charged with governance of the group; not between the group engagement partner and the component auditor. A requirement for the component auditor to cooperate with the group engagement team may have legal implications." He asked what the reference to "relationship" mean. He also asked about the reference to "legal implications." Mr. Hansen noted that the word "relationship" could be replaced with "engagement" or "contract." He explained that the Task Force obtained input from certain jurisdictions that a requirement for component auditors to cooperate with the group engagement team may have legal implications.

OTHER TASK FORCE PROPOSALS

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Mr. Rabine suggested that the requirements relating to the consolidation process clarify that the group engagement team has to obtain and understanding of and evaluate the process.

The Representatives did not have comments on the other proposals of the Task Force.

Financial Reporting Standards Described by Reference to IFRSs (Agenda Item J)

To DISCUSS proposed changes to the ISAs to address the matter of financial reporting frameworks described by reference to International Financial Reporting Standards.

Mr. Kellas provided background to the project and explained the IAASB proposal.

Mr. Upton provided an update on the IASB activities in this regard. He noted that companies that comply with the full set of current IFRSs are very upset with companies that do not because users are not able to distinguish the two cases from the notes in the financial statements. He was of the view that only a small number of listed companies in Europe are making use of the EC carve out, and that therefore most are in full compliance, although the reference to the accounting framework is to “IFRS as adopted ...” It would be helpful if auditors could give a second opinion that refers only to IFRS, where full compliance is achieved. As regards the IASB’s proposed disclosures, affected groups do not seem comfortable with it. Part of the discomfort is because the proposal is read as requiring reconciliation between the national financial reporting framework (modified IFRSs) and the full set of current IFRSs, which is not the intention. He agreed that it is important that the IASB clarify the proposal before the exposure draft is issued.

Mr. Kellas noted that Mr. Upton highlighted a further dimension to the issue than dealt with in the IAASB proposal. That is, the possibility of two separate audit opinions in the case where a jurisdiction has adopted modified IFRSs, but companies are able to comply with both the national financial reporting framework and the full set of current IFRSs.

Ms. Todd McEnally noted her disappointment with the lack of progress in dealing with the matter. She was of the view that the global bodies do not seem anxious to deal with the matter, and that the IASB cannot do it alone. She supported the IASB proposal, noting that it provides a short-term solution. She supported quantitative disclosures of the differences between the national financial reporting framework (modified IFRSs) and the full set of current IFRSs. She encouraged the affected groups also to find a long-term solution.

Ms. Singh noted that the Institute of International Finance has discussed the matter in the context of the reconciliation required by the US SEC reconciliation. She noted that the US SEC has indicated that it will not eliminate the reconciliation until there is full compliance with IFRSs. The Institute’s member firms support disclosure of all material differences; however, it did not discuss whether those disclosures should be qualitative or quantitative. Ms. Singh supported quantitative disclosures.

Ms. De Beer noted that the credibility of financial reporting is important in developing economies and many developing economies therefore have adopted the international standards. However, there are examples of fairly large developing economies where compliance with IFRSs is claimed while certain IFRSs have not been adopted. She supported the IASB proposal, but suggested that it be clarified. She was also concerned that the proposed requirement may be carved out by the national standard setter. The matter therefore also needs to be addressed from another perspective. She was of the view that the IAASB proposal will assist in this regard.

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Mr. Lamoureux was of the view that a reconciliation between the national financial reporting framework (modified IFRSs) and the full set of current IFRSs should be mandatory.

Mr. Morris was concerned that preparers should receive equal treatment. He considered that an emphasis of matter paragraph should be required in all cases rather than left to the auditor's judgment. He also noted that the requirement proposed by the IASB could be carved out by the national standard setter, thereby leading to jurisdictional inconsistencies.

Ms. Sucher noted that within IOSCO there is a range of opinions about the IASB proposal. Members expressed various concerns, which include the fact that the proposed requirement may be carved out and, more importantly, that the IASB proposal may condone an incomplete approach to IFRSs. She indicated that IOSCO is still considering the matter.

Mr. Rabine noted that the relevant committee of the EC is considering the matter, and that it will be important to understand the exact meaning of the IASB proposal. He was not sure that it was appropriate to make the auditor alone responsible. Ms. Blomme also indicated that the proposal may create issues for auditors in Europe if there is no requirement for companies to make the relevant disclosures.

Mr. Damant suggested that, due to the importance of the matter, it be referred to the Financial Stability Forum.

External Confirmations (Agenda Item K)

To DISCUSS the proposed revised and redrafted ISA reviewed by the IAASB in February 2007, including a summary of the comments of the IAASB. Approval of the exposure draft was planned for July 2007.

Mr. Crawford reported on the progress with regard to the project to revise and redraft ISA 505, "External Confirmations," and led a review of substantive changes to the proposed ISA based on the IAASB recommendations in February. The Representatives commented as follows:

- Ms. Sucher asked whether legal confirmations were covered by proposed ISA 505 (Revised and Redrafted). Mr. Crawford noted that such confirmations were covered in ISA 501, "Audit Evidence—Additional Considerations for Specific Items." Ms. Sucher suggested that a cross reference to ISA 501 be inserted in proposed ISA 505 (Revised and Redrafted).
- Mmes. Blomme and De Beer supported the Task Force's view that external confirmations should not be mandatory.
- Ms. De Beer supported the change in tone to encourage confirmations. She noted that ECSAFA was comfortable with the language in paragraphs 8 and 9, in that auditors often find instances where they would consider not using external confirmations. Mr. Crawford noted that, while the specific paragraphs are to be deleted, the concepts will be retained in application material.
- A number of Representatives expressed concern over negative confirmations.
 - Ms. De Beer was of the view that negative confirmations should be prohibited. Mr. Crawford noted this had been considered by the Task Force. The Task Force concluded that it is difficult to preclude the auditor from doing something. The key is to ensure that

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- there is sufficient cautionary language in the proposed ISA so that the auditor can understand the limitations of these types of confirmations
- Mr. Damant was of the view that the relevant language in the application material (i.e., paragraph A13) should be changed to be less positive regarding the use of negative confirmations.
 - Mr. Morris noted that preparers are unlikely to find value in the auditor electing to use negative confirmations.
 - Mr. Sekiguchi asked whether the definition of “external confirmation” should specifically state that the confirmation could be written or oral, as paragraph 15 of the proposed ISA appears to indicate that oral confirmation is permitted. He also noted that paragraph A20 acknowledges that the auditor may use facsimile transmission, electronic mail or the internet. He believed that in most cases auditors will mail a request for a confirmation and will request confirmation via fax in an emergency. Mr. Crawford agreed that the definition of “external confirmation” was inconsistent with paragraph 15, and noted that the Task Force intends to revise the definition to include only written confirmations. Mr. Crawford also noted that paragraph A20 was not intended to require the auditor to follow up confirmations received by other means with a mailed response; rather, it was meant to point out that there may be issues with reliability of information obtained via these means because of the potential for the information to be altered.
 - Messrs. Morris and Pickeur noted potential difficulties with paragraph A21. External confirmations may be requested from the accounting or auditing department of a bank, rather than the official responsible for the banking relationship. They suggested that the proposed ISA be changed to include language indicating that there could be different people involved in the process.
 - Mr. Pickeur suggested additional language in paragraph A27 to address the circumstance in which management requests the auditor not to confirm with a related party, as this could have serious implications.

IAASB Future Strategy and Work Program (Agenda Item L)

To RECEIVE a progress report on the development of the IAASB's future strategy and work program.

Mr. Kellas presented the findings of the IAASB Strategy Review Survey. He noted that the findings will form the basis of discussions in both the April 13 (Sydney) and June 28 (Brussels) forums. Representatives have been invited to attend the June 28 forum. Mr. Damant noted that the morning session of the June 29 IAASB CAG meeting will be devoted to discussing the matters explored during the two forums.

Mr. Kellas noted that the IAASB is planning to issue an exposure draft on the proposed future strategy and work program in October; the length of the exposure draft period has not yet been determined.

Mr. Damant indicated that Representatives will receive a strategy review paper in advance of the Brussels forum. He urged the Representatives to draw the attention of their organizations to the

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matters that the IAASB will be discussing so as to gather official views of their organizations where possible.

Mr. Hansen asked for clarification whether the proposal to develop an alternative assurance service for SMEs is aimed at the situation where a company may be exempted from statutory audit in a particular jurisdiction, such as Europe, but wants auditor association with its financial statements. Mr. Kellas indicated that the statement was correct and the need for this service may also exist in jurisdictions other than Europe. He indicated that this may be addressed by updating the IAASB's review standards; Mr. Damant noted that in some jurisdictions compilation engagements are common.

Closing

Mr. Damant reminded the Representatives that the next meeting to be held on June 29 in Brussels was open to the public. Member Organizations having offices or other links in Brussels were encouraged to suggest to their colleagues in Brussels (as well as from elsewhere) to attend the IAASB CAG meeting as observers. Mr. Sylph noted that observers should register on the IAASB website.

Mr. Damant thanked Mr. Kellas and the other IAASB members for their contribution to the meeting. He also thanked Mr. Sylph and his staff for their support. He then closed the meeting.