

IAASB CAG PAPER



International Federation of Accountants

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Agenda Item

A-1

Committee: IAASB Consultative Advisory Group

Meeting Location: Toronto

Meeting Date: September 11-12, 2006

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

Held on May 11-12, 2006

Paris, France

Members

David Damant
Conchita Manabat
Ju Xinhua
Gerald Edwards
Marc Pickeur
Rebecca Todd McEnally
Linda de Beer
Ndung'u Gathinji
Jean-Philippe Rabine
Federico Diomeda
Georges Couvois
Jean-Luc Peyret
Hilde Blomme
Andrew Popham
Robert Roussey
Bengt Hallqvist
Wayne Upton
Sam Gutterman
George White
Claude Lamoureux
Susan Koski-Grafer
Tomokazu Sekiguchi
Pat Sucher
Filip Cassel
Brenda DeWeese Lovell
Mohini Singh
Rifaat Karim
Hayanari Uchino
David Morris
Yoseph Asmelash
Erik van der Plaats
Thomas Krantz

Chair

Asian Financial Executives Institutes
Asian Financial Executives Institutes
Basel Committee on Banking Supervision
Basel Committee on Banking Supervision
CFA Institute
Eastern Central and Southern African Federation of Accountants
Eastern Central and Southern African Federation of Accountants
European Commission
European Federation of Accountants and Auditors for SMEs
European Financial Executives Institutes
European Financial Executives Institutes
Fédération des Experts Comptables Européens
Fédération des Experts Comptables Européens
Information Systems Audit and Control Association
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 Securities Commissions
International Organization of Securities Commissions
International Organization of Supreme Audit Institutions
Institute of Internal Auditors
Institute of International Finance
Islamic Financial Services Board
Japan Securities Dealers Association
North American Financial Executives Institute
United Nations Conference on Trade & Development
World Bank
World Federation of Exchanges

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Observers

Jennifer Rand

U.S. Public Company Accounting Oversight Board

IAASB

John Kellas

Chairman

Denise Esdon

Deputy Chair

Josef Ferlings

Member

John Fogarty

Member

Jan Bo Hansen

Member

David Swanney

Member

Public Interest Oversight Board

Antoine Bracchi

IFAC Staff

Jim Sylph

Technical Director

Alta Prinsloo

IAASB Deputy Director

By Invitation

Bernard Scicluna

IFAC Small and Medium Practices Committee

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Introduction

Mr. Damant opened the meeting and welcomed the Representatives. He welcomed Mr. Bracchi from the Public Interest Oversight Board (PIOB), who observed the meeting. He welcomed the new Member Organizations and Representatives, and Mr. Scicluna who was observing the meeting on behalf of the IFAC Small and Medium Practices Committee.

Mr. Damant welcomed the public observers. This was the first CAG meeting open to the public. He noted that, in line with the high level of transparency observed by the IAASB, it has been his desire that the CAG meetings would be open to the public and that meeting material would be available to all through the internet.

During the meeting some Representatives indicated that, due to the short period between distribution of the meeting material and the meeting, they were not able to obtain the views of their constituencies on all the matters highlighted for CAG's consideration. The views expressed during the meeting therefore may or may not represent the views of their constituencies.

Previous Minutes (Agenda Item A)

Mr. Damant explained that the minutes record significant views expressed by Representatives at CAG meetings. A report back mechanism implemented by IAASB staff provides for IAASB task force chairs to report back at subsequent CAG meetings on how the IAASB task forces or the IAASB has taken account of those views.

Ms. Koski-Grafer noted that the previous minutes of the discussion about whether the objectives (developed as part of the Clarity Project) should be expressed in the terms of the relevant element of the *audit process*, rather than in terms of an expectation of *the auditor*, did not correctly present the view she had expressed. She was of the view that the point raised by Mr. Karim may be worth exploring as the objectives are being developed, although she was not taking a position on whether the wording should or should not be changed.

The draft minutes of the previous meeting of CAG were approved, subject to the above correction.

Terms of Reference and Chair's Roles and Responsibilities (Agenda Item B)

Mr. Damant noted that the CAG Terms of Reference and Roles and Responsibilities of the CAG Chair were approved by the PIOB in December 2005.

Mr. Gathinji noted that the objective of CAG was to provide (a) advice on the IAASB's agenda and project timetable, (b) technical advice on projects, and (c) advice on other matters of relevance to the activities of the IAASB. He was concerned that CAG may be giving too much attention to (b), and not enough attention to (a) and (c). He did not see much distinction between the agenda of CAG and that of the IAASB. Mr. Damant responded that the membership of CAG is broader than that of the IAASB. This enabled the IAASB to obtain technical advice from a broader range of organizations. Mr. Kellas responded that the agendas for CAG meetings are in the hands of CAG. With the appointment of Mr. Damant as CAG Chair, the agendas are driven by CAG rather than the IAASB. He was also of the view that there is a difference in the level of technical discussions at meetings of CAG, compared to those of the IAASB. The discussions at the IAASB meetings tend to be far more technical. Mr. Edwards reminded CAG of the discussion of the Clarity Project timetable at the previous CAG meeting, and the fact that it led to the IAASB accelerating the

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completion of the project from 2011 to 2008.

Mr. Damant indicated that he intends to have a discussion at the next CAG meeting about matters relating to SME audits and audits in developing nations, in particular on audit documentation, but also on the implementation of International Standard on Quality Control (ISQC) 1, “Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements.”

Comments from the PIOB (Agenda Item C)

Mr. Bracchi reported that the PIOB considers the CAGs as an important part of the reformed IFAC structure. In the case of the IAASB, CAG plays a key role in the various stages of developing a standard. Expressing views that represent a broad spectrum of the public, CAG’s advice is of significant importance to the IAASB, and the PIOB. It assists in developing standards that serve the public interest. The PIOB will maintain close and regular dialogue through the CAG chair.

The PIOB believes that a high level of transparency should prevail in all IFAC processes; it therefore commends CAG on its “sunshine policy.”

Improving the Clarity of IAASB Standards (Agenda Items D)

Mr. Kellas presented the results of the consultation that ended at the end of February 2006. He noted that the Task Force is tentative in its responses to some of the issues. Preliminary discussions will be held at the May 2006 IAASB meeting. Matters presented to CAG, therefore, were not authoritative.

Forty-six responses were received on the exposure draft. Responses focused on important issues and gave examples of how to deal with them. In particular, support was expressed for the identification of objectives, separation of requirements and application material, placement of SME audit guidance at relevant points in the application material, and the steps taken to improve the readability of the standards. The main areas of concern were in relation to aspects of the objectives, the application of the guidelines for specifying the requirements, and implementation timetable.

OBJECTIVES

The majority of respondents called for the development of a complete set of objectives and consideration of how the objectives relate to the overall objective of an audit. Specific areas of concern were the form and coherence of objectives, their extent and the obligation placed on the auditor to meet them. Respondents had different views of what the “outcomes to be achieved” (as stated in the objective) of a standard should be. The obligation to achieve the objective was seen as key strength; in particular, by regulators. The Task Force has attempted to keep the obligation, but revised the wording to retain the benefits of objectives, while responding to the concerns raised by respondents.

The objectives were further discussed under Agenda Item E.

REQUIREMENTS

Application Concerns

Respondents had varying views on how well the guidelines for specifying requirements had been

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applied. Those considering them to be applied appropriately were more or less at par with those considering them to be applied inappropriately. Only a small number of respondents noted some missed elevations of present tenses to requirements. Application concerns were as follows: the guidelines were not applied rigorously, a view particularly held by those dealing with SME audits; potential for undue or disproportionate increase in the extent of requirements; no evidence that the test of “proportionality” was applied. Representatives were asked for their comments.

Ms. Sucher was of the view that the focus should not be on the number of requirements, but whether the requirements are the right ones. Ms. Koski-Grafer and Mr. Krantz supported this view.

Mr. Pickeur found the mapping documents very helpful. He emphasized the importance of bearing in mind that the objective of the project is to clarify the standards, not to revise them. On this basis, he had not identified major areas where the standards have been weakened.

Mr. Popham noted that the IAASB explained why present tense statements were not elevated, but it did not explain why present tense statements were elevated, which suggested a presumption that elevation was to be the norm. He was of the view that proportionality is important – there should not be too many requirements for low risk areas. This will have a negative effect on audit focus. He suggested that the “stand back” proposed by the Task Force also include considering whether the number of requirements is proportionate with the risk to be addressed by the standard. Ms. Koski-Grafer was of the view that the IAASB can make general assessments about risk based on the subject of a standard; however, risk is greatly affected by the circumstances of the engagement. Mr. Popham responded that too many requirements will not allow the auditor to make judgments about risk based on the circumstances of the engagement. He noted that it is not clear from the structure of the standards that requirements need not be undertaken if there is no risk.

Mr. Scicluna was of the view that the requirements do not always apply, for example, to audits of micro entities. He asked whether an audit is the best service to obtain assurance on the financial statements of micro entities. Mr. Damant was of the view that this is a matter for the regulators. Ms. De Beer noted that CAG may want to consider including this matter on its agenda. Ms. Koski-Grafer suggested that it be considered whether the “audit is an audit” principle might nevertheless incorporate the notion that something more might be required for public entities, rather than focusing the issue as less for SMEs.

SME Audit Considerations

Mr. Kellas reported that respondents noted the following SME considerations regarding the requirements: the extent of specific documentation and communication requirements; assessing the cost vs. benefit of the requirements; documenting departures from relevant requirements; wording of the requirements; and substance of SME audit guidance on applying the requirements. He noted that some National Standard Setters are jointly considering how the audit documentation requirements could be interpreted in a sensible way for SME audits. The IAASB will also look at the clarified standards to see if there is more that could be said about audit documentation for SME audits. Representatives were asked for their comments.

Mr. Sylph noted that the IFAC Small and Medium Practices Committee has commissioned proposals from external service providers to develop an ISA implementation guide, targeted at non public entities. The timing of the project will be affected by the Clarity Project and its implementation proposals. Mr. Gathinji did not think that this should be the case. Mr. Scicluna noted that the proposed guide may not alone provide the hands-on advice that SMPs need. The

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Committee is therefore discussing whether to develop practice aids (i.e., in addition to the proposed guide). Its recommendation on the service provider and other related matters will be considered by the IFAC Board in June 2006.

Ms. De Beer was of the view that SME and SMP issues are often confused. In the case of SMPs, the issue is often related to training (i.e., how to apply the ISAs). The main issue, however, is how to apply the ISAs in SME audits. She was of the view that the Clarity Project can deal with this by going further than what is currently intended. The application material should not only highlight the fact that an SME environment may be less complex, but should also explain what the auditor should do in such an environment.

Other Concerns

Mr. Kellas noted that there was significant concern over “shall consider” requirements. Respondents also asked that the phrase “... relevant in the circumstances” be clarified. Other concerns included essential explanatory material in the requirements section; inconsistency in drafting; the extent to which drafting improvements were applied; and the placement of definitions.

IMPLEMENTATION

The majority of respondents asked that the proposed 2011 target date for completing the Clarity Project be accelerated. Mr. Kellas explained that the project timetable will be made available to interested parties after it has been reviewed by the IAASB Steering Committee and the IAASB. The project timetable shows that, with the help of National Standard Setters, it may be possible to complete the Clarity Project by 2008. This is ambitious but would coincide with Member States’ implementation of the European Commission’s 8th Directive. It will also allow the European Commission to have made progress in endorsing the ISAs. However, the result would be that not all ISAs would be revised.

Mr. Kellas noted that respondents indicated the following ISAs as those where revision may be warranted: ISA 250, “Laws and Regulations;” ISA 570, “Going Concern;” ISA 720, “Other Information;” and ISA 560, “Subsequent Events.” He noted that it was not clear why these ISAs should be revised. The IAASB Steering Committee considered ISA 250 and concluded that it was not necessary to revise the standard. With regard to ISA 570, a matter relating to national law in a single country has been brought to the attention of the IAASB.

Mr. Kellas explained that, if the 2008 target date is approved by the IAASB, the Task Force recommends that all the standards become effective at a single date. However, the standards will be approved when they are finalized and made available to auditors as soon as possible after their approval.

Representatives were asked for their comments.

Mr. Rabine noted that the 8th Directive is due to be signed on May 17, 2006 by the President of the European Council and the President of the European Parliament. The European Commission welcomes the shorter implementation period.

Ms. Koski-Grafer noted that IOSCO supports the accelerated project timetable. She will, however, be concerned if the acceleration gives rise to comments by the IAASB that there is not enough time to improve the standards. IOSCO had noted in its comment letter that the process of

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redrafting the standards for clarification may lead to the identification of gaps, which need to be addressed within the accelerated timetable. If not addressed as part of the accelerated timetable, it may be a long time before the IAASB addresses them. Mr. Kellas emphasized that the improvement of the standards is limited to applying the clarity drafting conventions. Comments that go beyond this will be filed for consideration when a standard is revised in the future. Mr. Edwards was of the view that gaps directly related to the improvement of the standards should be addressed, but that the IAASB should remain conscious of the resources necessary to achieve the 2008 target date.

Objectives (Agenda Item E)

Mr. Kellas explained the approach considered by the Task Force in developing the complete set of objectives. He referred to a first draft of the list of objectives, which was developed by IAASB Staff. The draft was considered at the IAASB / National Standard Setters meeting, but has not been discussed with the IAASB. The draft follows a “top down approach.” It links the overall objective of an audit to the overall objective of the auditor. It also links the overall objective of the auditor to the objectives of the ISAs. CAG was asked to comment on the completeness of the objectives.

Mr. Upton noted that two things needed to be clear: what benefit is the IAASB expecting from the objectives, and what does the IAASB want to achieve in terms of the authority of the objectives. He also asked about exceptions or practical experience that may be contrary to an objective. Mr. Kellas responded that an objective provides a guide for setting the requirement. It also assists in addressing the comprehensiveness of the requirements. For the auditor, he or she achieves an objective by fulfilling the requirements, and through the objectives determines whether he or she has done enough. If the objectives are set at an appropriate level, exceptions should not exist.

Ms. Todd McEnally was strongly supportive of the general direction that the objectives are taking. She noted that very few investors understand what an audit is. In addition to providing direction, rigor and clarity to the auditor, it may be possible for the CFA Institute to build the objectives into its examination curriculum. She had some reservation about the language of the objectives, but noted that it could be discussed outside the meeting.

OVERALL OBJECTIVE OF AN AUDIT

Mr. Damant asked Mr. Kellas to confirm that the reference to the applicable financial reporting framework in the overall objective includes not only the financial reporting standards but also national law and regulation, and that the overall objective does not include the auditor commenting on the effectiveness of internal control. Mr. Kellas confirmed that that was the case. Mr. Roussey was of the view that the overall objective should contain the phrase “give a true and fair view” or “present fairly, in all material respects.” Without this phrase, it is not possible to determine whether the objectives are complete. Mr. Van Der Plaats emphasized that ISAs cannot supersede the mandate of a statutory audit as defined in laws and regulations. Mr. Kellas explained that the overall objective is drafted in a way that accommodates both “true and fair / fairly present” opinions and “compliance” opinions.

Mr. Hallqvist did not agree with the auditors determining the objectives. The objectives should be determined by the audit clients. He used the audit engagement letter as an example where auditors, instead of the audit clients, decide what needs to be done. Mr. Lamoureux agreed that the audit engagement letter was designed to protect the auditor. He was also concerned that press releases about companies’ financial results are issued without involving the auditors. Sometimes these

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press releases are misleading. Mr. Roussey was of the view that these considerations go beyond press releases. He referred to telephone / internet conversations between management and analysts, and forward looking comments. Mr. Hallqvist was of the view that the real client of the auditor is the investor, while Mr. White responded that the legal client of the auditor is the company. Mr. Uchino supported the comments of Messrs. Hallqvist, Lamoureux and Roussey. Mr. Popham, however, was of the view that it is not the auditor's responsibility to fill gaps in the corporate governance of an entity because the auditor needs to be independent of the entity. The way an entity portrays itself to the public is a matter for consideration by management. He noted that in the United Kingdom there is a requirement for the auditor to approve preliminary announcements; however, the development of such requirements and guidance at an international level may be difficult.

Mr. Morris was of the view that the overall objective is too self serving. Management is preparing financial statements to convey financial information to investors. Management hires the auditor to make sure that there is no mistake in such information. The overall objective should be rewritten to reflect this focus.

Ms. Koski-Grafer noted that, although not incorrect and maybe well understood by experienced auditors, the objectives of ISAs are often expressed in terms such as "reduce audit risk to an acceptably low level" that are auditor-focused and not oriented to the needs of the users of financial statements. She believed such statements are jargon that is not easily understood by others outside the standards setting environment. She referred to previous discussions about objectives based on audit process vs. objectives based on auditor expectation. She was of the view that these should not be mutually exclusive and that perhaps the goals and objectives of audits could be communicated better by talking "about" objectives in a section at the beginning of each ISA rather than trying to reduce the objectives to a single statement. What is expected by the users of the financial statements should be delivered by the audit process and executed by the auditor. Mr. Van Der Plaats supported the view that the overall objective for the auditor was written in a too audit esoteric manner. The World Bank is of the view that terms such as "reducing audit risk to an acceptably low level" do not promote public understanding of the objective of an audit.

Mr. Rabine reminded the Task Force that the auditor operates in a regulatory environment. The auditor's responsibilities are set out in law or regulation. The ISAs should set out how those responsibilities should be implemented. Mr. Van Der Plaats supported this view, noting that it would be helpful if this point could be clarified in the overall objective. Mr. White noted that there may be circumstances where the auditor's responsibilities go beyond what is in the overall objective. ISAs should not be used as an excuse by auditors not to become involved in those types of engagement where the appropriate regulators or users of the financial statements demand it.

Mr. Kellas noted that CAG's discussion focused on the overall objective, and where an audit starts and finishes. He agreed that these are issues that should be debated at some point. Some of them are to be resolved by regulators and others between those charged with governance and the auditor. The ISAs, however, are directed at the auditor expressing an audit opinion on an entity's financial statements. It is true that the auditor can and indeed may do other things, but in the context of completeness of the objectives the focus is on expressing an audit opinion on the financial statements. It is accepted that the ISAs should not constrain the nature of an audit. If there are regulatory or other requirements, ISAs do not prevent the auditor from fulfilling them.

Mr. Scicluna was of the view that the overall objective of the audit / for the auditor could be better

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described as the overall objective of the ISAs (the handbook).

COMPLETENESS OF THE OBJECTIVES

Mr. Rabine noted that the European Commission is supportive of the Task Force's approach in seeking completeness of the objectives; in particular, the focus on public interest. He noted that the terminology used in the objectives are integral to certain concepts. The ISA Subgroup of the European Group of Audit Oversight Bodies indicated that it is necessary to better understand these concepts before redrafting the ISAs.

OBJECTIVE FOR EVERY ISA

Mr. Kellas noted that the Task Force considered whether it is necessary for every ISA to have an objective. It is clear that the objectives for audit process type ISAs are coherent and independent; however, this may not always be the case for the objectives of ISAs that deal with specific topics (e.g., accounting estimates). Requirements and guidance in specific topic type ISAs can be viewed as an application of the audit process type ISAs in the context of a specific financial statement item.

Messrs. Pickeur, Popham, Rabine, Roussey, and Van Der Plaats and Mmes. Rand and Sucher were of the view that every ISA should have an objective. Mr. Van Der Plaats was of the view that, if an objective cannot be identified, there is no reason to have a separate ISA. Also, when assessing the financial reporting structure of a country, ISA objectives will help the World Bank in using the ISAs as a benchmark for auditing standards. Mr. Rabine noted that the Clarity Project is built on the premises that requirements have to be read in context of the objectives. If an ISA does not have an objective, it will be difficult to assess whether the auditor has gone far enough (or too far) in his or her procedures to meet the objective. Also, for purposes of adopting the ISAs in the European Union, the European Commission will endorse the individual standards – having an objective in each ISA will assist in achieving this.

Mr. Diomeda was of the view that there could be ISAs without objectives if they are clearly linked to ISAs with objectives. Mr. Damant noted that, if an ISA does not have objective because it serves the objective of other ISAs, this should be stated and the statement becomes the objective. Mr. Upton was of a similar view. Mr. Popham was of the view that Mr. Damant's suggestion may provide a short term solution; however, over the longer term an objective should be determined for every ISA. Mr. Asmelash supported this view.

OBLIGATION

Mr. Kellas noted that respondents were of the view that the obligation is too absolute. The Task Force aimed to respond to the comments without diluting the obligation; by drafting a clear and simple statement that there is an obligation to achieve the objectives in a realistic way. The draft redrafted obligation reads as follows: "The professional accountant shall achieve the objectives stated at the beginning of each standard relevant to the engagement. If, having complied with the requirements of the standards, the professional accountant concludes that the objectives have not been achieved in the circumstances of the engagement, the professional accountant shall perform such other procedures as the professional accountant deems necessary in order to do so. When an objective is not met, the professional accountant shall consider the implications for the auditor's report. These obligations are subject to, and are to be understood in the context of, the inherent limitations of an assurance engagement and the level of assurance appropriate to the engagement."

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Ms. Sucher asked why “must” was changed to “shall.” Mr. Kellas explained that it was changed because “must” was not defined and, when the obligation is incorporated in the ISAs, it should follow the format of the ISAs. Mr. Upton agreed with the language of the redrafted obligation. He noted that the way the obligation had been worded was important to avoid a box-ticking approach.

Mr. White was concerned about the language of the redrafted obligation. He was not sure whether, from a lawyer’s standpoint, it will fully achieve placing the liability of the auditor in an appropriate context. The obligation is in terms of the auditor, while the qualification is in terms of the process. The fact that the auditor is expected to apply reasonable due care should be in the qualification. Mr. Roussey supported Mr. White’s comment. He found the redrafted obligation confusing. Mr. Popham suggested that the IAASB obtain legal advice before finalizing the obligation as the use of “must” results in the assumption that the auditor failed in case of an enquiry, which however is to be investigated.

Mr. Van Der Plaats was concerned about the fact that, even though the auditor complies with the requirements, he or she may conclude that the objectives have not been achieved. This may imply that the ISAs are not good enough; that is, the ISAs do not lead to achieving its own objectives. The question is what an auditor is expected to do in these circumstances. Another question is whether the auditor can depart from a requirement because based on his professional judgment he or she is of the view that the objective can be achieved in a more effective and efficient way.

WAY FORWARD

Ms. Sucher asked whether the objectives will be exposed more generally for comment. She also noted that CAG was asked to limit comments to completeness (because of the draft nature of the objectives), but that it is not always possible to separate comments on completeness from comments on language. Mr. Kellas responded that the IAASB will debate whether the consultation with National Standards Setters and CAG is sufficient, or whether wider consultation is necessary. He suggested that if additional consultation were to be considered necessary, it should take place concurrently with the implementation of the proposals to specific standards.

Ms. Koski-Grafer asked whether a Member Organization will be able to respond to matters raised for the consideration of CAG at this meeting after they have had a chance to consider them as an organization (which was not possible in advance of the meeting). Mr. Kellas noted that the Task Force is attempting to respond to the comments received on the exposure draft. Any additional comments from Member Organizations should be limited to refining the Task Force’s recommendations or improving the drafting. These comments, including comments on the redrafted objectives of the four clarity ISAs, should be submitted to Mr. Damant before the end of May 2006 to be considered by the Task Force at its June 2006 meeting. The IAASB will review the four clarity redrafted ISAs in July 2006 and approve them in September 2006.

Mr. Damant noted that two important matters were highlighted during the discussion. The need to perform a detailed review of the objectives and the need to consider, from a corporate governance point of view, the scope of the auditor’s activities. Mr. Damant indicated that he will establish to separate working groups to consider these matters. The working group responsible for reviewing the objectives will provide input to the Clarity Project. It will work in parallel with the project and will not delay progress thereof.

Modifications (Agenda Item F)

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Mr. Hansen presented a report back on matters that were raised at the November 30-December 1, 2005 CAG meeting and additional matters that were discussed with the IAASB. “Close off” versions of proposed ISA 705, “Modifications to the Opinion in the Independent Auditor’s Report” and proposed ISA 706, “Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor’s Report” will be considered for approval at the May 2006 IAASB meeting.

PROPOSED ISA 705

Description of Pervasiveness in relation to Misstatements

The Representatives were asked for their views on the Task Force’s proposed approach to explaining the meaning of pervasiveness in relation to the effects of misstatements.

Mr. Rabine and Ms. Sucher supported the approach. Ms. Sucher asked that it is clarified that the decision about pervasiveness is made in the context of the auditor’s professional judgment.

Mr. Van Der Plaats noted that the table in paragraph 8 of proposed ISA 705 provides for four situations and indicates a qualified opinion for two of those situations. He was of the view that, in principle, there should be four different types of consequence for the four different situations. Mr. Hansen responded that the only difference in the auditor’s report would be the words “possible effects.” In one situation the auditor will know the effects and in the other he or she will not.

Multiple Uncertainties Leading to a Disclaimer of Opinion

The Representatives were asked whether they agree with the majority view of the IAASB on the rationale for the auditor to disclaim an opinion in cases of multiple uncertainties.

Mr. Van Der Plaats was of the view that the paragraph did not provide sufficient guidance on what the auditor should consider before coming to the conclusion that it is not possible to form an opinion on the financial statements as a whole due to the cumulative possible effects of the uncertainties.

Ms. Koski-Grafer noted that, when discussed before, some IOSCO members strongly supported the approach that linked the disclaimer of opinion to the inability to obtain sufficient appropriate audit evidence about management’s assertions regarding the uncertainties. In following an approach that links the disclaimer of opinion to the cumulative possible effects of the uncertainties, it is necessary to clarify that the existence of multiple uncertainties would not automatically lead to a disclaimer of opinion. Mr. Uchino, on the other had, was concerned that the lack of a requirement, as well as leaving it to the auditor’s professional judgment, may lead to the auditor not disclaiming an opinion where it is appropriate.

Mmes. Koski-Grafer and Sucher were concerned about the phrase “in extremely rare circumstances.” Mr. Kellas suggested that the paragraph be redrafted to link the phrase to the appropriate words (i.e., to indicate that “in extremely rare circumstances the auditor may conclude ...”), and to clarify how extremely rare such circumstances are.

Mr. Rabine was of the view that it would be difficult to evaluate when the cumulative possible effects of the uncertainties would warrant a disclaimer of opinion. He also asked whether this type of misstatement was considered to be a subset of a pervasive misstatement. Mr. Hansen responded that, in the case of a pervasive misstatement, the auditor will express an adverse opinion. In the case of multiple uncertainties, the auditor may be comfortable with the possible effects of the

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individual uncertainties, but when considering the cumulative possible effects he or she is no longer sufficiently confident that the financial statements as a whole are not materially misstated. The only solution therefore is to disclaim an opinion. Mr. Rabine appreciated the public interest focus of the requirement, but cautioned against the guidance moving into the area of a financial reporting framework override.

Disclosure of Omitted Information in the Auditor's Report

The Representatives were asked whether they agree with the IAASB's position on the disclosure of omitted information in the auditor's report in light of the revised and enhanced guidance on impracticability.

Mr. Popham was of the view that the auditor will not be able to disclose omitted information in the auditor's report without assuming management's responsibility. Mr. Fogarty explained the situation in the United States with regard to private investment funds that do not list specified investments in a separate statement as required by the applicable financial reporting framework. The auditor expresses a modified opinion based on noncompliance with the applicable financial reporting framework. Because the information is available, the auditor is able to include it in the auditor's report without assuming any management responsibility. Mr. Popham was concerned that the auditor has no means of knowing whether the information is accurate and complete because management has not made any representations about it. Mr. Fogarty responded that, in his example, the auditor has audited the investment line item on the balance sheet. Mr. Popham was of the view that it should be clarified that the auditor normally would only describe the nature of omitted information; however, if management has made representations about such information, it may be possible to quantify it.

Other Matter Raised by Representatives

Referring to paragraphs 25 and 29 of proposed ISA 705, Mr. Van Der Plaats asked whether it is possible for the auditor to limit his or her reaction to management obstructing the performance of the audit to modifying the audit opinion. Mr. Hansen acknowledged that management obstruction may have other implications for the audit. Because proposed ISA 705 is a reporting standard, it does not deal with the other implications. They are dealt with in the audit performance type ISAs (e.g., proposed ISA 600 (Revised), "The Audit of Group Financial Statements"). Mr. Peyret was of the view that management could also obstruct the performance of the audit by cutting the audit fees. Mr. Van Der Plaats responded that the auditor should eventually not accept the engagement in such circumstances.

Mr. Rabine was of the view that it may help if the order in the reference to non acceptance / resignation and disclaimer of opinion in the proposed ISA is changed around; that is, in the first instance the auditor should disclaim an opinion, and in the second instance he or she should consider not accepting the engagement or resigning from the engagement. Mr. Hansen responded that it is a matter of timing. For example, a scope limitation may take place at the acceptance stage of the audit, in which case it may be appropriate not to accept the engagement (as provided for the Assurance Framework). But if it takes place reasonably late in the audit, it may be appropriate to complete the audit and describe the scope limitation in the basis of conclusion paragraph in the modified auditor's report.

PROPOSED ISA 706

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Criteria for Emphasis of Matter Paragraphs

Representatives were asked whether they agree that the revised approach for emphasis of matter paragraphs in the auditor's report provides appropriate flexibility to the auditor in highlighting matters the auditor considers necessary to bring to the attention of the users of the financial statements, yet adequately limits their use to specified circumstances.

Ms. Koski-Grafer was of the view that the restriction on the use of emphasis of matter paragraphs seems excessive for standards that seek to be principles-based. The provisions are unusually prescriptive in that several criteria are listed and all of them must be met before an emphasis of matter paragraph may be considered by the auditor. She asked if the possible overuse or misuse of such paragraphs could be addressed with less prescriptive language. Mr. Hansen responded that less prescriptive language does not enhance current practice where the auditor decides when to include an emphasis of matter paragraph. Emphasis of matter paragraphs should be included in rare circumstances.

Ms. Koski-Grafer and Mr. Rabine were concerned that the auditor will not be allowed to draw attention to an uncertainty that is in the ordinary course of business. Mr. Rabin noted that uncertainties relating to impairment tests are in the ordinary course of business, but are matters that may need to be emphasized.

Ms. Sucher was of the view that the proposed ISA should contain more examples of auditors' reports that include emphasis of matter paragraphs. She also noted that the last sentence of paragraph 12 of proposed ISA 706 should be made much stronger by clearly explaining that, in the case of an auditor's report that includes a modified opinion and an emphasis of matter paragraph, there should be no relationship between the modification and the matter being emphasized.

Other Matter Raised by Representatives

Mr. Sekiguchi asked whether other matters that are not required to be recognized or disclosed in the financial statements by the applicable financial reporting framework (paragraph 19 of proposed ISA 706) include a description of the auditor's independence as required by law or regulation in some jurisdictions. He was of the view that it might be useful for the IAASB to consider including a reference to the auditor's independence in an other matter paragraph, since some countries require such a reference in the auditor's report.

Materiality and Misstatements (Agenda Item G)

Ms. Esdon presented a report back on matters that were raised at the November 30-December 1, 2005 CAG meeting and additional matters that will be discussed with the IAASB. "Close off" versions of proposed ISA 320 (Revised), "Materiality in Planning and Performing an Audit" and proposed ISA 450, "Evaluation of Misstatements Identified during the Audit" will be considered for approval at the May 2006 IAASB meeting.

PROPOSED ISA 320 (REVISED)

Representatives commented as follow:

- With regard to the implicit references to management materiality in ISA 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement," Mr. Damant was of the view that the ISAs are widely used and not everybody may be able to identify such implicit references. It therefore may be necessary to make an explicit reference

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somewhere in the ISAs.

- Mr. Hallqvist was of the view that the auditor should define what is material in the audit engagement letter and state that his or her audit procedures will be sufficient to confirm that there is no material fraud or error in the financial statements. He was also concerned about the auditor adjusting materiality when the final financial results are different from those on which materiality was originally based. Ms. Esdon responded that some of the matters raised by Mr. Hallqvist are dealt with in proposed ISA 260, “Communication with Those Charged with Governance.” Proposed ISA 320 (Revised) emphasizes that it is helpful to discuss expectations of those charged with governance and that materiality needs to be considered as the audit progresses.

PROPOSED ISA 450

Representatives commented as follow:

- Ms. Blomme asked the Task Force to ensure that the reference to fair presentation frameworks in the definition of misstatements is aligned with the direction taken by the Special Reports Project.
- With regard to the suggested fourth category of misstatement (i.e., misstatements as a result of the improper application of an accounting policy that may become material in the future), Mr. Popham was of the view that this is a common problem and should at least be included as an example in the application material.

Group Audits (Agenda Item H)

Mr. Hansen presented a report back on matters that were raised at the November 30-December 1, 2005 CAG meeting and additional matters that were discussed with the IAASB. The IAASB approved the exposure draft of proposed ISA 600 (Revised), “The Audit of Group Financial Statements” in March 2006. Representatives’ commented as follow:

- Ms. Koski-Grafer noted that IOSCO will review the revised definition of group auditor and other related definitions to determine how concerns raised in IOSCO comment letters have been addressed. She also noted that it was not clear whether the group engagement partner will consider the qualifications and competence of members of the engagement team who are not known to him or her. She was concerned about the group engagement partner placing automatic reliance on the quality control system of a network firm.
- Mr. Rabine noted that the 8th Directive provides for the group auditor also to be an audit firm. He wanted to know whether the proposed ISA contained a similar provision. Mr. Hansen responded that the proposed ISA assumes that there is an individual who takes responsibility for the quality of the audit; that individual needs to be satisfied with the qualifications and competence of the members of the engagement team.
- Mr. Gutterman noted that it was necessary to align the definition of engagement team in the proposed ISA and proposed ISA 620 (Revised), “Using the Work of an Expert.”
- Mr. Popham noted that the elimination of the distinction between related and unrelated auditors could inspire “fraudster companies” to “divide” auditors, resulting in less genuine communication and cooperation among auditors. This should be taken into account when accepting or continuing a group audit engagement.

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- Mr. Popham remained concerned that the example of a percentage to be used in identifying components that are of individual financial significance may be considered by inspectors as a rule that has to be applied in all circumstances; even though it is included in the application material. He preferred deletion of the example, but noted that, should it be retained, it should be stated at 20% and not 15%. Mr. Hansen responded that the example is presented in a format that is consistent with other ISAs (e.g., ISA 320 (Revised), “Materiality in Planning and Performing an Audit”). He also noted that it is important to have a robust identification of significant components, as the entire standard is centered on significant components.
- Mr. Van Der Plaats was concerned that the proposed ISA allows the group auditor to limit the work on a component that is not significant to analytical procedures for an indefinite period of time. He also noted that the group auditor is not required to perform work on the scope of the consolidation. In addition, the proposed ISA contains implicit references to IFRSs (i.e., in the way it describes certain methods of consolidation); this should not be the case, as the ISAs are applied in jurisdictions that have not adopted IFRSs.

Mr. Damant encouraged the Member Organizations to submit comments letters on the exposure draft. Mr. Sylph emphasized that the IAASB is requesting comments on specific matters listed in the Explanatory Memorandum. He also asked that Member Organizations meet the comment deadline of July 31, 2006 to enable the Task Force to report at the next CAG meeting.

Communications (Agenda Item I)

Mr. Sylph noted that the Task Force Chair was not able to attend the meeting. He presented a report back on matters that were raised at the November 30-December 1, 2005 CAG meeting. The IAASB will be asked to approve the clarity exposure draft of proposed ISA 260 (Revised), “Communication with Those Charged with Governance” at its May 2006 meeting.

REPORT BACK

Representatives commented as follow:

- As a general comment, Ms. Koski-Grafer noted that it would be helpful if, space permitting, the revised text could be included in the table indicating how the IAASB Task Force or IAASB has responded to the Representatives’ comments.
- Mr. Popham asked whether it was necessary to use both “significant” and “material.” Jurisdictions do not appear to interpret these terms in a similar manner. Some find significance to be greater than materiality; others find the reverse. Mr. Damant noted that the International Accounting Standards Board had a similar debate and concluded that a matter is either material or not. Another level should not be introduced. After reading the definition of significance in the Glossary of Terms, Ms. Koski-Grafer agreed that there should only be one term.
- Mr. Popham remained of the view that the guidance does not clearly indicate what the auditor does not have to communicate when management and those charged with governance are the same people. He was of the view that there is a lot that do not need to be communicated to a sole proprietor or to management / those charged with governance of a wholly-owned subsidiary. Mr. Damant was of the view that SME audit considerations could be better highlighted in the proposed ISA.
- Referring to his comment on disclosing the communications to supervisors/regulators at the

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previous CAG meeting, Mr. Pickeur was concerned that paragraph 61 still provided a restriction on disclosure or distribution to supervisors/regulators. He believed that supervisors/regulators would find this unacceptable,

- Mr. Hallqvist was of the view that, except perhaps for the companies in the United States which have broad share ownership, every company has a group of key shareholders, and that it is important for the auditor to communicate with those shareholders. Mr. Damant noted that in some countries the state may be the dominant shareholder. Mr. Van Der Plaats noted that it is important that minority shareholders are equally well informed. Mr. Krantz noted that information targeted at minority shareholders will capture all shareholders, while information targeted at majority shareholders may exclude minority shareholders. Mr. Scicluna noted that shareholders do not fall within the definition of those charged with governance. Mr. Sylph agreed to ask the Task Force whether it has considered this matter.

OTHER MATTERS FOR CONSIDERATION BY CAG

Mr. Sylph referred CAG to paragraph 43 in proposed ISA 260 (Revised), which contains additional requirements for audits of listed entities. Although the IAASB applies the principle of “an audit is an audit,” in a limited number of cases it may be necessary to go beyond this principle. Although not a new requirement, Mr. Sylph wanted to reaffirm it. He explained that the term “listed entities” is in line with that used in the IFAC *Code of Ethics for Professional Accountants*; however, the term and definition are being reviewed as part of a review of the Code and if the Code broadens its definition to include public interest entities, the same interpretation would apply within ISA 260. .

Mr. Sylph also noted that the Task Force will ask the IAASB whether it is necessary to re-expose the requirements and guidance because a requirement in the exposure draft is now presented as application material. The responses to the exposure did not clearly indicate where this text should be placed. He indicated that in his role as Technical Director he would advise the IAASB that this matter on its own does not necessitate re-exposure. CAG did not have any views of this matter.

Written Representations (Agenda Item L)

Mr. Fogarty presented the issues highlighted for CAGs consideration. He noted that the meeting material included proposed ISA 580 (Revised and Redrafted), “Written Representations,” which was reviewed at the December 2005 IAASB meeting. A subsequent draft has been prepared based on comments received from the IAASB; however, this draft is under review by the Task Force. The proposed exposure draft will be reviewed for approval at the July 2006 IAASB meeting.

Mr. Fogarty explained the reasons for written representations. General written representations require management to acknowledge its responsibilities and to confirm that it has fulfilled them. Management’s behavior is affected by this requirement – it calls for diligence in responding and management often implements processes to enable such response. This improves the quality of financial reporting. Where management refuses to respond, it is often an indicator of something management wishes to conceal. As a result, general written representations also affect the auditor’s behavior.

Mr. Fogarty noted that there is a concern about over reliance on written representations; however, the Task Force has gone to considerable lengths to clarify that written representations are necessary evidence but not sufficient evidence. The Task Force has also tried to reduce the volume

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of specific written representations.

Representatives commented as follow:

- Mr. Popham noted that the Working Group is of the view that general written representations fulfill a useful purpose, reminding management of its responsibilities. Although the objective of the proposed ISA refers to relevant persons acknowledging their responsibilities and the fact that they have fulfilled them, he was of the view that this is not reflected in the requirements and guidance that follow. The requirements and guidance seem to be auditor driven.
- Mr. Hallqvist was concerned about the interaction of the representation letter with the engagement letter. The engagement letter gives the idea that auditors are avoiding accepting responsibility for their work. He was also concerned that auditors may avoid addressing an audit problem or performing audit work by including a matter in the representation letter. Mr. Damant noted that the requirements and guidance should be drafted in a way that a non auditor will understand that the representation letter is not a substitute for objective enquiry or other audit work.
- Mr. Peyret was of the view that the auditor should make management aware of changes in the applicable financial reporting framework that have a significant effect on the financial statements. If there is a financial reporting failure because management was not aware of a change, the auditor should not be able to hide behind the representation letter. Although in agreement, Ms. Rand cautioned against the auditor becoming involved in the preparation of the financial statements because he or she has the expertise.
- Ms. Manabat noted that the reason for changing the title of the proposed ISA is not clear. She was also of the view that the proposed ISA should explain who the relevant persons are. She asked whether specific written communications could be in the form of electronic mail communications between the relevant person and the auditor; whether general written representations signed by persons other than the relevant persons would be similar to a refusal by relevant persons to provide such representations and, therefore, give rise to a scope limitation; and what the liability would be for relevant persons who refuse to provide written representations. She also noted that written representations are required in the context of an audit of financial statements, but no reference is made to a review of financial statements.
- Mr. Upton asked whether it is the Task Force's expectation that the representation letter is independent of the legal framework; that is, whether it is a contractual representation of management's responsibilities. Mr. Fogarty responded that it is independent of law or regulation. The Task Force wanted the minimum requirement to be clear across all jurisdictions.
- Ms. Todd McEnally did not agree that written representations constitute audit evidence. Mr. Fogarty noted that if they do not constitute audit evidence, it is not clear how they fit into the requirement to obtain sufficient appropriate audit evidence. He suggested that the guidance be redrafted to make it clearer that on their own written representations do not constitute audit evidence. Mr. Van Der Plaats agreed with this suggestion – he noted inconsistencies in this regard in the proposed ISA. Ms. Todd McEnally noted that it may be an audit oversight issue – if regulators see that less attention is given to areas where written representations are being obtained, they should be concerned. Mr. White explained that the auditor ultimately has to determine whether he or she cumulatively has enough audit evidence to support conclusions

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with respect to the financial statements. He suggested that the proposed ISA clarify that the auditor is responsible for determining whether he or she has sufficient other audit evidence to support the reliance he or she places on written representations.

- Ms. Sucher was of the view that written representations represent a different level of quality of audit evidence. The level of risk should be taken into account in considering the quality of audit evidence. In the case of high risk areas, written representations constitute “less” audit evidence. Ms. Sucher also noted that the proposed ISA indicates that specific written representations do not constitute sufficient appropriate audit evidence; however, the same is not said about general written representations. Mr. Fogarty agreed that, if the case, it should be corrected.
- Ms. Sucher was concerned about the requirement to express a disclaimer of opinion or withdraw from the engagement if the auditor is unable to obtain the general written representations. She asked whether such inability would give rise to a scope limitation in all circumstances, even if only one general written representation is omitted. She was of the view that the auditor should be allowed to exercise professional judgment. Mr. Rabine supported this view. Mr. Fogarty noted that he cannot think of an example where the auditor would express an audit opinion on financial statements for which management are not willing to take responsibility. Mr. Popham noted that the Working Group did not have a united view about the auditor disclaiming an opinion or withdrawing from the engagement when not able to obtain general written representations. He suggested that the proposed ISA clarify that such circumstances would be extremely rare. He was of the view that it does not serve the public interest if the auditor disclaims an opinion or withdraws from the engagement. He also suggested that the wording in the application material be softened. Mr. Upton could not see when a disclaimer of opinion would not be necessary, even if sufficient appropriate other audit evidence has been obtained.
- Mr. Sekiguchi noted that preliminary discussions of the relevant IOSCO subcommittee indicated that many members believe that, regardless of whether general written representations are obtained, the auditor needs to obtain sufficient appropriate audit evidence on which to base the audit opinion. Some members are concerned about the content of the representation letter. In practice there may be side agreements that are confirmed in the representation letter. These members were of the view that if management refuses to include side agreements or a specified matter in the representation letter, it may not be necessary for the auditor to disclaim an opinion or resign from the engagement, as required by the proposed ISA. Some members were also of the view that the statement that “general written representations to the auditor are a prerequisite of audit completion” is too strong, as it precludes the possibility of the auditor obtaining sufficient appropriate audit evidence by other means.
- Ms. Koski-Grafer noted that she was from a reporting environment where representation letters were customary and useful, but wished to raise the question why it was not possible for the auditor to simply do more work when needed to make up for a lack of written representations. Mr. Fogarty said that such an audit, where the client was unwilling to accept responsibility for the financial statements and make representations, would create a situation that was more like an investigation than a financial statement audit. Reference was made to the situation where a governmental auditor has the right of audit without the cooperation of the entity being audited. Mr. Fogarty noted that this situation is different from a public company

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audit based on a requirement for an audit and a contractual relationship.

- Mr. Rabine read the proposed ISA as a document that attempts to establish management's responsibility. He noted that this will cause difficulties when the exposure draft is discussed at European Union level. He was concerned that the guidance in the proposed ISA may imply that the description of management's responsibilities in law or regulation may not be complete and that the proposed ISA therefore should establish such responsibilities. He suggested that the guidance be amended to remind the auditor of the legal environment in which the audit is being conducted. This could also be referred to in the representation letter.
- Mr. Pickeur noted that it is important to determine whether the proposed ISA is about audit evidence or establishing management's responsibilities. He did not think that an auditing standard should establish management responsibilities; that is a matter for law or regulation. Mr. Fogarty responded that the proposed ISA is about audit evidence, but it also recognizes that in some jurisdictions management's responsibilities are not fully described in law or regulation. He agreed that the proposed ISA could not establish management's responsibilities; however, it can say that the auditor has conducted an audit on the basis that management has the stated responsibilities.
- Mr. White was of the view that it is not possible to completely divorce the concept of responsibility from the definition of that responsibility. He understood the desire to have a minimum acknowledgement of responsibility where there is no applicable legislation; however, where there is applicable legislation, it should be incorporated in the representation letter. He also noted that the one size fits all approach in the proposed ISA may not be appropriate. The requirements, guidance and example representation letter may require a fair amount of tailoring to conform to the corporate governance arrangements and applicable legislation in particular jurisdictions. In addition, he noted a disconnect between the proposed ISA and proposed ISA 705, "Modifications to the Opinion in the Independent Auditor's Report," which envisages the possibility of a material but not pervasive misstatement that leads to a qualified audit opinion. He was also concerned about the auditor disclaiming an opinion on the financial statements because of failure to obtain general written representations, while a modification based on a departure from generally accepted accounting practice is more appropriate.
- Mr. Popham suggested that the proposed ISA be redrafted to discuss first that management's responsibilities should be considered in the context of applicable legislation; and second what management's responsibilities should be if not established in applicable legislation. Mr. Upton's point about a contractual representation is relevant in the case of the latter, which may be considered in the context of the engagement letter. Mr. Upton, however, was of the view that, as far as possible, the requirements and guidance should be independent from the legal framework.
- Mr. Scicluna was of the view that, in the context of SME audits, it is important that it is clear who is responsible for what. Where there is a high number of adjustments, which is often the case in SME audits, responsibilities can become blurred. Mr. Upton supported this view.
- Mr. Gutterman noted that management may acknowledge responsibility for the financial statements while an expert determined significant numbers in those financial statements. He was concerned about the basis for management's acknowledgement.

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- Mr. Popham was concerned that the requirement for specific written representation may lead to a paper chase. He suggested that the Task Force consider text that reduces specific written representations. He also noted that, if a matter is so important that it warrants a specific written representation from a person other than management, management may want to know about it – in which case it could be included in the general written representations. He asked whether specific written representations are really necessary.
- Mr. Edwards noted that the wording of the example representation letter does not align with that of the requirements and guidance. He suggested that they be aligned. He also suggested that the example representation letter include a separate representation about whether the financial statements “give a true and fair view of [or present fairly, in all material respects,] ... in accordance with the applicable financial reporting framework.”
- Ms. Rand noted that she was supportive of the approach taken in the proposed ISA.
- Mr. Popham noted that it may be helpful to explain to the preparer community at large why written representations are important.

Audit Considerations Relating to Entities Using Service Organizations (Agenda Item N)

Ms. Esdon noted that the IAASB has approved a project to revise ISA 402, “Audit Considerations Relating to Entities Using Service Organizations” and a project to develop a new International Standard on Assurance Engagements (ISAE) 3402, “Assurance Report on Service Organizations’ Controls.” She outlined the scopes of the projects and noted that issues papers will be reviewed at the September 2006 IAASB meeting.

Ms. Koski-Grafer noted that the scope of service organizations is broad and that careful consideration should be given to the definition of service organization.

Mr. Peyret noted that international groups are increasingly making use of international shared service centers. This may lead to the local CFO, who is responsible for the local entity’s financial statements, not having control over what is presented to him or her as the financial statements of the local entity. Mr. Popham noted that this is particularly important in the context of proposed ISA 600 (Revised), “The Audit of Group Financial Statements.”

Mr. Popham was of the view that it would not be appropriate to adopt SAS 70 of the United States. Service organizations are more sophisticated than what is provided for in SAS 70. The first step should be to identify service organizations to be addressed in the proposed ISA – those in large groups are most probably the most common.

Mr. Morris suggested that the ISAE 3402 Task Force also consider the service organization in terms of a revenue source; that is, both selling and buying services.

Mr. Roussey offered to be on the Working Group. He noted that his organization has information that may be useful to the Task Forces. He also suggested that, if the projects do not cover the extended enterprise concept, the concept should be included on a future CAG agenda.

Using the Work of an Expert (Agenda Item M)

Mr. Ferlings presented a report back on matters that were raised at the November 30-December 1, 2005 CAG meeting, and additional matters for CAG’s consideration. The IAASB will review a first draft of the proposed exposure draft of proposed ISA 620, “Using the Work of an Expert” at its July 2006 meeting.

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REPORT BACK

Messrs. Gutterman and Sekiguchi noted that the IAASB asked the Task Force to present a proposed ISA on the basis of accounting and auditing experts being excluded, but to note how the draft would be affected if they were to be included. They asked that this point be explained. Mr. Ferlings responded that the IAASB presumes accounting and auditing expertise to be within the engagement team and, therefore, asked the Task Force not to include such experts in the proposed ISA. However, they should be kept in mind when deliberating the requirements and guidance in order to present changes that may be necessary to the proposed ISA should it be decided at a future date that those experts should be included.

The IAASB asked that tax experts be included in the proposed ISA. The auditor may have to involve a tax expert because different tax rules exist in different countries, the tax rules are often complex, and they are not necessarily linked to the financial reporting standards.

DEFINITION OF ENGAGEMENT TEAM

Mr. Ferlings explained that to ensure consistent interpretation, the definition of engagement team in the Glossary should be amended, or at least supplemented with explanatory material. The Task Force is currently of the view that only experts who are personnel should be considered part of the engagement team. The Representatives were asked for any suggestions regarding the definition of engagement team. They commented as follow:

- Mr. Lamoureux suggested that the examples of when an auditor may involve an expert include estimating non-marketable assets. He was also concerned about experts who claim that they are independent when in fact they are not. He referred to compensation consulting as an example. Mr. Gathinji asked whether lawyers, who estimate the likely outcome of legal cases, and translators, who translate financial reporting and audit related matters, are considered to be experts.
- Mr. Gathinji noted that SMPs may not have in-house experts and that this should be taken into account in developing the requirements and guidance.
- Mr. Popham was of the view that the flowchart included in the meeting material provides a good presentation of the use of entity experts, in-house experts and external experts. Referring to the fact that the auditor has to evaluate the external expert's objectivity, Mr. Popham noted that the independence rules for auditors provide a benchmark for evaluating auditors' objectivity, while such benchmark may not exist for evaluating the objectivity of external experts. Mr. Lamoureux suggested that auditors obtain written representations from external experts about their independence. Ms. Koski-Grafer noted that, if the requirements for in-house experts are more stringent than those for external experts, it may create an incentive to hire external experts to achieve the lowest requirement.
- Mr. Rabine was of the view that the external expert's report is likely to indicate his or her responsibilities and the professional standards applied in fulfilling them. It is not relevant to require the external expert to state again his or her independence. If the auditor has to be convinced of the external expert's independence, the starting point could be the external expert's report. Mr. Popham was of the view that independence considerations are particularly important in the case of external experts. The auditor makes a public statement about the financial statements – he or she should therefore be convinced of the external expert's

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independence.

- Ms. Rand noted that the PCAOB Standing Advisory Group had similar discussions about the independence / objectivity of experts who are part of the engagement team and those who are not, and came to the same conclusion as the Task Force. The United States have rigorous independence rules for auditors; the PCAOB staff was of the view that it would be difficult to impose the auditor independence requirements on external experts. The PCAOB staff was of the view that objectivity may be a better evaluation for external experts. Mr. White noted that, from the stand point of the user community, it is important to maintain a clear distinction between independence and objectivity; independence is a very high standard. Professional service firms outside the accounting community may not have systems in place to meet the independence rules for auditors.
- Mr. Edwards was of the view that the flowchart should include a minimum requirement for external experts that provide “principle evidence;” that is, such experts should not have financial relationships that could impair their objectivity. A written representation may be one way of obtaining such information.
- Mr. Sekiguchi asked whether the Task Force has considered how the auditor could utilize the fact that some external experts are required to comply with independence / objectivity requirements of their professions / industries. Ms. Koski-Grafer suggested that the Task Force expand the concept of considering the expert’s commitment to ethical principles, as described in the flowchart.

AUDIT RISK MODEL

The Representatives were asked whether they have any suggestions for the Task Force regarding consistency with the audit risk model, particularly use of the “principal evidence” concept. They commented as follow:

- Mr. Asmelash noted that an expert is used because the auditor does not have a certain expertise. The auditor, however, is responsible for evaluating the expert’s work. He asked what level of expertise the auditor needs to make such evaluation. Ms. Koski-Grafer agreed that it will be difficult for the auditor to evaluate the work of an expert. Mr. Scicluna noted that the auditor would have evaluated the expert. He asked whether, based on the evaluation of the expert, the auditor could limit his evaluation of the expert’s work to identifying whether anything may be wrong.
- Ms. Rand asked how far the auditor has to go. She noted that this was also discussed at the PCAOB Standing Advisory Group. She was concerned about the auditor evaluating experts and then accepting their reports without evaluating their work. Currently, auditors in the United States are not required to consider the reasonableness of the experts’ work. Rather, the auditors’ obligation is to determine that the experts’ findings are not unreasonable.
- Mr. Gathinji suggested that the written representations include a requirement for management to consider when to contract an expert and confirmation that it has done so.
- Ms. Sucher noted that this may be a matter for liaison with the International Accounting Education Standards Board (IAESB). Ms. Todd McEnally was of the view that the level of standards of education for auditors in different areas ought to be considered at a general level. Mr. Sylph encouraged the Representatives to read the proposed *Competence Requirements for*

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Audit Professionals, which was issued by the IAESB in April 2005.

Special Reports (Agenda Item J)

Mr. Kellas noted that the Task Force Chair was not able to attend the meeting. He provided background to the project and presented the significant comments received on the exposure draft of Proposed ISA 701, “The Independent Auditor’s Report on Other Historical Financial Information,” the Task Force’s recommendations and the IAASB’s responses. The IAASB will review first drafts of proposed ISA 701 and proposed amendments to ISA 200, “Objective and General Principles Governing an Audit of Financial Statements,” ISA 210, “Terms of Audit Engagements,” and ISA 700 (Revised), “The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements” at its May 2006 meeting.

DESCRIPTION OF THE FINANCIAL REPORTING FRAMEWORK

The Representatives were asked whether they agreed with the proposed description of the financial reporting framework. They commented as follow:

- Mr. Van Der Plaats was of the view that whether the financial reporting framework applied in preparing the financial statements is acceptable may not be something that could be determined at the audit engagement level. Although not sure where it should take place, he noted that the Reports on the Observance of Standards and Codes (ROSCs) prepared by the World Bank may be a possibility for judging the acceptability of financial reporting frameworks.
- Ms. Blomme was of the view that more guidance should be provided as to how the auditor should consider the authority of the different sources and any conflicts that may exist.
- Mr. Rabine was concerned that the financial reporting framework applied in preparing financial statements that are subject to statutory audit may not be a general purpose framework. Mr. Kellas responded that such financial statements almost always will be prepared in accordance with a general purpose framework; however, this is not to say that the framework is designed to achieve fair presentation, which in turn affects the form of opinion.

WHAT FORM OF OPINION SHOULD BE EXPRESSED IN WHICH CIRCUMSTANCES

The Representatives were asked for their views on whether users of financial statements understand the difference between the proposed forms of opinion. They commented as follow:

- Ms. Todd McEnally noted that there has been a huge push amongst the investor community to achieve convergence with the major standards in the world to reduce costs. Thus, a reference in the audit opinion to the financial reporting framework of country X, as opposed to IFRSs, is problematic. Referring to the form of opinion, she suggested that auditors are careful in using the phrases “give a true and fair view of” and “are presented fairly, in all material respects.” She also noted that the challenges or hurdles that the two forms of opinion may create in the field are not clear.
- Mr. Damant was of the view that it is not a matter for those involved in the institutional markets, who are used to dealing with all sorts of uncertainties and understand the effect that cultural differences may have. He was of the view that Task Force’s concern should be with the public; it is a matter of public perception and expectation.

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- Mr. Popham was of the view that the proposals are fine for jurisdictions where there are a clear understanding of which financial reporting framework achieves fair presentation. However, where this is not the case, it puts too much onus on the auditor who will have to measure the framework against the proposed description of a fair presentation framework (which in his view was not a complete description), and convince the audit client that it is not a fair presentation framework. He also noted that the Task Force seemed to be moving towards the “legends program,” which had proved to be difficult to enforce in some countries because of the operation of law.
- Mr. Sekiguchi noted that business transactions are sometimes developing faster than financial reporting standards. This may give rise to highly developed financial reporting frameworks not achieving fair presentation at a specific point in time. This makes it very difficult for the auditor to determine whether a framework is a fair presentation framework. He thought that to ask the auditor to determine whether the framework is designed to achieve fair presentation was going beyond the legitimate expectations that users could have of auditors.
- Referring to the examples of auditors’ reports in the exposure draft, Mr. Roussey was of the view that the description of the circumstances in which the reports are issued in the boxes that precede the reports will be very useful to readers of the reports and should form part of the reports. Mr. Kellas responded that the circumstances were already embedded in the reports. Mr. Roussey was of the view that the presentation thereof in a box would highlight them to the readers.

The Representatives were also asked for their views on the proposed form of opinion for single financial statements. Mr. Kellas noted that a number of people are not comfortable with a “true and fair / fairly present” opinion on single financial statements; in particular, in the context of IFRSs. He acknowledged that it is perhaps a matter of more interest to auditors than to CAG.

Mr. Upton noted that IAS 1, “Presentation of Financial Statements” does not address the question of whether a single financial statement could achieve fair presentation. IAS 1 is drafted in the context of a complete set of financial statements, which could create a presumption that an opinion on anything else than a complete set of financial statements is therefore by definition not consistent with IFRSs. This issue has not been raised with the International Accounting Standards Board or International Financial Reporting Interpretations Committee. He suggested that it be done by the IAASB or audit firms.

Dates and Locations of Future CAG Meetings (Agenda Item K)

The Representatives indicated a preference to meet in New York on April 3-4, 2007, rather than San Francisco. Mr. Damant indicated that it may be necessary to hold a three-day meeting, in which case CAG will also meet on April 5. Mr. Damant noted that the September 20-21, 2007 meeting probably will be held in London (this was later confirmed).

Mr. Damant asked Representatives to communicate to him whether they are of the view that CAG should meet in Asia in 2008.

Mr. Gathinji noted that it is also important to consider Africa and South America. Mr. Van Der Plaats was supportive of holding CAG meetings outside the European Union or the United States. He also emphasized the importance of linking the IAASB CAG meeting to those of the Ethics CAG. Mr. Asmelash was supportive of CAG meetings being held in different parts of the world. He suggested reaching out to local organizations, inviting them to attend as observers, and meeting

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with them in other effective ways.

Other Matters

Mr. Damant asked the Representatives to communicate with him should they be of the view that the matter of the acceptability of the financial reporting framework should be on CAG's agenda and why. Based on this he will decide whether to include it on the agenda for the next meeting.

Mr. Damant suggested that the following be included on the agenda for the next meeting:

- Questions about certain aspects of SME audits and audits in developing nations (i.e., in the context of "an audit is an audit")
- A short presentation on XBRL by Messrs. Krantz and Verkruijsse of the XBRL Assurance Working Group.

Mr. Roussey noted that the presentations by the task force chairs were very valuable. He suggested that consideration be given as to how the expertise of the task force chairs could be utilized to provide training. One way may be to produce a short video at the completion of each project. This would give task force chairs the opportunity to share their knowledge of the project with users of the ISAs. It maybe possible to make it available on the internet. Ms. Koski-Grafer supported this idea. Mr. Scicluna noted that the exact same point was made in the IFAC Small and Medium Practices Committee. Mr. Damant expressed the wish that this suggestion be passed to the International Accounting Education Standards Board.

Closing

Messrs Damant and Kellas thanked the Representatives for their valuable input. Mr. Damant also thanked the IAASB Members and Staff for their hard work. Mr. Damant closed the meeting.

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Appendix

Membership of CAG Working Groups

Project	Working Group Members
Communications with Those Charged with Governance (ISA 260)	Diomeda, Johnson, Manabat
Materiality / Misstatements (ISAs 320&450)	Blomme, Morris
Service Organizations (ISA 402 and ISAE 3402)	Roussey, TBD
External Confirmations (ISA 505)	De Beer, Morris, Pickeur, Van Der Plaats
Auditing Accounting Estimates (ISA 540)	Gutterman, Pickeur, Sucher
Related Parties (ISA 550)	Cassel, Roussey
Management Representations (ISA 580)	Morris, Peyret
Group Audits (ISA 600)	Hegarty, Roussey
Use of Experts (ISA 620)	Gutterman, Morris, Roussey
Special Reports (ISAs 701&800)	Blomme, Gielen, Lamoureux, Singh
Modifications / EOM (ISAs 705&706)	Lamoureux, Sucher
Material Weaknesses in Internal Control	Blomme, Morris, Peyret
SMP /SME / Developing Nations Matters	Asmelash, De Beer, Diomeda, Hegarty

Working Groups established subsequent to the May 11-12 IAASB CAG meeting:

Auditing Fair Value Measurements and Disclosures	Basel Committee Representative, Gutterman, Sucher
List of Clarity Objectives	Johnson, TBD
Corporate Governance and Investor Matters	TBD