

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

A.1

Committee: IAASB Consultative Advisory Group

Meeting Location: New York

Meeting Date: April 2-3, 2007

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

**Held on September 11-12, 2006
Toronto, Canada**

Members

David Damant

Conchita Manabat

Ju Xinhua

Marc Pickeur

Rebecca Todd McEnally

Linda de Beer

Jean-Philippe Rabine

Federico Diomeda

Jean-Luc Peyret

Hilde Blomme

Philip Johnson

Robert Roussey

Bengt Hallqvist

Tricia O'Malley

Sam Gutterman

George White

Claude Lamoureux

John Carchrae

Susan Koski-Grafer

Tomokazu Sekiguchi

Pat Sucher

Filip Cassel

Heriot Prentice

Mohini Singh

Rifaat Karim

Hayanari Uchino

David Morris

Yoseph Asmelash

John Hegarty

Thomas Krantz

Chair

Asian Financial Executives Institutes

Asian Financial Executives Institutes

Basel Committee on Banking Supervision

CFA Institute

Eastern Central and Southern African Federation of Accountants

European Commission

European Federation of Accountants and Auditors for SMEs

European Financial Executives Institutes

Fédération des Experts Comptables Européens

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 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 (Monday only)

United Nations Conference on Trade & Development

World Bank

World Federation of Exchanges

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

Observers

Dale Gislason

Tom Ray

IFAC Small and Medium Practices Committee

U.S. Public Company Accounting Oversight Board

IAASB

John Kellas

Denise Esdon

Philip Ashton

Craig Crawford

Josef Ferlings

John Fogarty

Diana Hillier

George Tucker

Hans Verkruijsse

Chairman

Deputy Chair

Member

Member

Member

Member

Member

Technical Advisor

Technical Advisor

Public Interest Oversight Board

Aulana Peters

IFAC Staff

Jim Sylph

Alta Prinsloo

Executive Director, Professional Standards

IAASB Deputy Director

By Invitation

Elena Lobanova

Graduate School of Financial Management, Russia

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

Introduction

Mr. Damant opened the meeting and welcomed the Representatives, members of the IAASB and public observers. He welcomed Dr. Peters from the Public Interest Oversight Board (PIOB), who observed the meeting. He also welcomed the new Representatives, and Mr. Gislason who was observing the meeting on behalf of the IFAC Small and Medium Practices Committee.

It was noted that the minutes of the previous meeting of CAG reflected the comments received from the Representatives. The minutes were approved.

The Representatives noted the written report backs on the following IAASB projects: (1) Communications with Those Charged with Governance; (2) Materiality and Misstatements; and (3) Modifications to the Independent Auditor's Report. No comments were raised on the report backs.

European Commission Update

Mr. Rabine provided an update on the process for considering International Standards on Auditing (ISAs) for adoption in the European Union.

He noted that the 8th Directive on statutory audit became effective during June 2006 and that Member States have to implement the directive by June 2008. The European Commission therefore has time to consider issues relating to adopting the ISAs. A target date for adopting the ISAs has not been set and there is no obligation on the European Commission to adopt the ISAs.

The European Commission's Audit Regulatory Committee, comprising representatives from the ministries of the Member States, is responsible for determining the form of adoption of secondary law measures. A meeting was held with this group in April 2006. John Kellas also attended this meeting. The European Group of Audit Oversight Bodies (EGAOB), through its ISA Subgroup, is responsible for identifying technical issues that the European Commission might have to deal with in adopting the ISAs. Several issues have been identified, but not decided.

Mr. Rabine noted that the following identified issues will be discussed with the Audit Regulatory Committee at its next meeting:

- The ISAs apply to both contractual audits and statutory audits. At present, most of the auditing standards in the Member States are directed to the statutory auditor. When adopting ISAs for the European Union, it will be necessary to clarify that they are mandatory for statutory audits only.
- The instrument for adopting the ISAs for the European Union still needs to be determined. Several options with different levels of authority are available. The option of commission regulation (which is used for adopting the International Financial Reporting Standards (IFRSs)) is being considered. However, adopting the application material through regulation may perhaps give it an authority that it is not meant to have.
- The 8th Directive allows Member States to carve out those requirements in the ISAs that conflict with national laws. There are several conditions that need to be met in this regard.
- The European Commission has commented on consultation documents issued as a result of the Clarity project and is confident that points raised so far can be resolved to the satisfaction

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

of the Member States. However, concerns remain about ISA 200, “Objective and General Principles Governing an Audit of Financial Statements” and ISA 230, “Audit Documentation.” In particular, the regulators at the European Union level question the concepts of reasonable assurance and of reducing audit risk to an acceptably low level; matters relating to the inherent limitations of an audit; and where the Glossary of Terms should be placed (e.g., it will be difficult to adopt the Glossary as a separate instrument).

- The EGAOB considers ISQC 1, “Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements” a key standard and will consider whether and how to adopt the standard.
- The results of a comprehensive survey on translation of ISAs performed by Fédération des Experts Comptables Européens would be used to address the issue of translation and to define the best possible way of translating ISAs. The translation of ISAs cannot be performed in a short period of time and this needs to be kept in mind when setting the timetable for adopting the ISAs.

Mr. Damant asked whether the European Commission is considering using existing credible translations of the ISAs. Mr. Rabine responded that the main issue is not having a translation at hand, but to implement an ongoing process of translation. Mr. Damant emphasized the importance of involving people with experience in the field of accounting and auditing in the translations.

Mr. Kellas noted that the IAASB is willing to work with the European Commission to solve as many of the identified issues as possible; however, there are limits to what can be done to standards that are already in existence. The concept of reasonable assurance, for example, is deeply embedded in the ISAs and in national auditing standards. It will not be possible to change the concept unilaterally if it is not a problem for other national standard setters. If there is a problem, it is not an issue that will be addressed by changing a few words. It is a conceptual issues, which would be a significant and long term project.

Material Weaknesses in Internal Control

Mr. Ashton explained that the impetus of the project was the need to clarify the meaning of the term “material weakness in internal control” in relation to financial reporting in the context of the ISAs.

The Representatives responded as follows to the Task Force’s recommended approach to communicating matters in the nature of reportable conditions and material weaknesses:

- Mr. Damant noted that it should be clear that when referring to material weaknesses, the reference is to material weaknesses *in internal control*, and that when referring to reporting, the reference is to reporting *to those charged with governance*.
- Mr. Cassel noted that this is an important project from an INTOSAI point of view. It is important that a single international definition of “material weakness in internal control” be developed. He agreed that material weaknesses in internal control is a subset of reportable conditions. He was of the view that a requirement for the auditor to report all identified reportable conditions to those charged with governance is generally in line with the IFAC Code of Ethics for Professional Accountants.

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

- Mr. Morris noted that the relevant IAASB CAG Working Group agreed with the two levels of reportable conditions, i.e., material weaknesses in internal control and other reportable conditions. However, it was not clear to the Working Group whether the auditor is required to report all identified reportable conditions or applies professional judgment in deciding whether to report reportable conditions other than material weaknesses in internal control. The Working Group was of the view that the auditor should report all identified reportable conditions to those charged with governance. Ms. Sucher was of a similar view.
- Mr. Sekiguchi outlined a requirement in his country for management to assess internal control over financial reporting and for the independent auditor to audit management's assessment. He indicated that "significant deficiencies" are not defined under that model, partly due to difficulty in translation. Based on those circumstances, he was of the personal view that the auditor should be required to report material weaknesses in internal control and encouraged to report other deficiencies as well. Ms. Blomme was also of the view that reporting of other identified reportable conditions should be left to the auditor's professional judgment. She noted that an audit performed in accordance with the ISAs does not include an audit of internal control; consequently, the auditor will not have a complete list of reportable conditions.
- Mr. White supported the requirement for the auditor to report all identified reportable conditions to those charged with governance. He noted that a definition of "material weakness in internal control" is to be developed, but that categorizing identified deficiencies in internal control as reportable conditions is left to the auditor's professional judgment. He was of the view that guidance should establish the circumstances in which a deficiency will be regarded a reportable condition. Mr. Ray was of a similar view. He also noted that the auditor should be guided to evaluating whether other audit findings are indicative of control deficiencies and the effect thereof on internal control.
- Ms. Todd McEnally was concerned that material weaknesses in internal control are limited to those that could result in a material misstatement of the financial statements. She emphasized the importance of open and clear communication between the auditor and those charged with governance about all identified deficiencies in internal control. Mr. Hallqvist was also of the view that identified deficiencies in internal control should not be categorized based on level of importance – when in doubt, the auditor should report the deficiency to those charged with governance.
- Mr. Rabine noted that the European Commission's 8th Directive requires reporting of material weaknesses in internal control identified during the course of the audit (the term "material weakness in internal control," however, is not defined). It does not require an audit of internal control or public reporting. Reporting is to the audit committee, which is only established for public interest entities.
- Mr. Pickeur asked to whom the auditor should report and whether it is a two-step report, i.e., a report to management and then a report to those charged with governance. Mr. Hallqvist noted that it is important to distinguish between reporting to management and reporting to those charged with governance.

Mr. Ashton confirmed that, as described in the meeting material, the Task Force is of the view that the auditor should apply professional judgment in categorizing identified deficiencies in

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

internal control as reportable conditions. The Task Force is also of the view that the auditor should be required to report all identified reportable conditions. This would enable the auditor to report more than just serious control issues, and would be seen as adding greater value from a client-service perspective. Mr. Roussey supported this view.

Mr. Kellas was of the view that the categorization of reportable conditions as material weaknesses in internal control and other reportable conditions may not be the best use of the auditor's time. This distinction might lead management, and possibly those charged with governance, to argue about the classification of a weakness which may not be productive. Mr. White was of the view that the proposal to include in the ISA a definition of "material weakness in internal control" establishes such categories. If the auditor fails to alert those charged with governance that a particular deficiency in internal control is a material weakness, it might expose the auditor. Mr. Ashton was of the view that "material weakness in internal control" has to be defined to prevent a proliferation of definitions.

The Representatives responded as follows to the request for their views on the appropriate terms to be used to describe the different reporting thresholds and how these terms should be defined:

- Mr. Damant noted that it might be difficult to define the term "significant" and suggested that it not be used.
- Mr. Morris noted that the relevant IAASB CAG Working Group is generally supportive of the Task Force's proposals, but is concerned that different definitions of "material weaknesses in internal control" could exist. This would create problems for preparers, auditors and users around the world. Mr. Ashton was of the view that different definitions will emphasize the difference in the scope of an audit performed in accordance with ISAs and the scope of an audit that includes an audit of internal control.
- Ms. Koski-Grafer questioned whether it is the definitions that are different or the way in which a single definition is applied in the different audit scopes.

XBRL

Mr. Krantz, who has been appointed as the chairman of the XBRL Advisory Board, provided a brief introduction to the subject. Mr. Verkruijse discussed how XBRL might affect the auditor. Mr. Pickeur explained how the European Banking Supervisors are promoting the use of XBRL.

Ms. Todd McEnally noted that her constituency is very supportive of the initiative. She emphasized the importance of the information in the notes to the financial statements and management discussions, which at present seemed not to be "tagged." Ms. Koski-Grafer noted that the US Securities and Exchange Commission's program for XBRL is voluntary and exploratory, and that more information is available on the SEC website (<http://www.sec.gov/spotlight/xbrl.htm>).

Mr. Pickeur noted that XBRL is used for sending regulatory reports to banking regulators in the US. In some countries it is also used by banks for obtaining information about entities to which they provide credit.

Mr. Morris noted that an initiative similar to XBRL was undertaken for purposes of public company reporting to federal banking regulators. That initiative gave rise to a substantial amount of work for preparers. It also showed that, although "tagging" might be possible at the

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

consolidation level, it might not be possible at the component level. Mr. Sekiguchi noted that it would be important to understand the audit issues that arise at the financial statement level as well as at the general ledger level.

Mr. Damant noted that Mr. Verkruijse is updating the IAASB on developments and that Mr. Krantz would do the same for the IAASB CAG. He encouraged the Representatives to monitor developments in this regard.

Accounting Estimates and Fair Values

Mr. Ashton presented a brief report back on the responses of the Task Force and IAASB to the November 30-December 1, 2005 proposals of Representatives. Mr. Gutterman noted that, although generally satisfied with the responses, he has identified drafting issues that may affect the implementation of the ISA. For example, he was not sure whether the term “arbitrary” is appropriate and applied in a consistent manner. Mr. Ashton agreed to consider Mr. Gutterman’s comments as part of the clarity redrafting of the ISA, and to liaise with him directly on specific drafting issues.

Mr. Ashton summarized the significant matters discussed at the March 2006 IAASB meeting. Referring to the close off document of ISA 540 (Revised), “Auditing Accounting Estimates and Related Disclosures (Other Than Those Involving Fair Value Measurements and Disclosures,” Mr. Gutterman noted that the relevant IAASB CAG Working Group discussed the required responses to the assessed risks of material misstatements of an accounting estimate in paragraph 46 of the close off document. The Working Group questioned whether any of the procedures should be performed if the assessed risk is not significant. It also questioned whether, in the case of a significant risk, the auditor will always test the operating effectiveness of the controls over how management made the accounting estimate together with appropriate substantive procedures (as per paragraph 46(c)). Mr. Ashton explained that responses to significant risks are addressed separately. For assessed risks of material misstatement, the auditor is required to perform *one or more* of the procedures. In some circumstances the auditor’s procedures may be limited to determining whether events occurring up to the date of the auditor’s report confirm or contradict the accounting estimate (as per paragraph 46(a)).

Mr. Ashton explained that the IAASB asked the Task Force to identify an optimal solution to the issue of the interrelationship between ISA 540 (Revised) and ISA 545, “Auditing Fair Value Measurements and Disclosures.” He summarized the Task Force’s proposals in this regard. The Representatives commented as follows on the proposals:

- Ms. Sucher was concerned about the proposed scope of the combined ISA. She did not agree that it should exclude audit considerations relating to items measured at fair value where there is readily available and reliable information about the prices at which actual exchanges occur (e.g., active and open markets). She was of the view that even in such cases there will be some form of estimation uncertainty. Mr. Ashton explained that the intention is not to exclude any items that involve estimation uncertainty. Mr. Gutterman responded that, even if an item does not involve estimation uncertainty, it may still require the auditor to consider, for example, whether the right market was chosen. Ms. Todd McEnally supported the views of Ms. Sucher and Mr. Gutterman.

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

- Mr. Morris supported the combination of ISAs 540 and 545, but was concerned that, based on the Task Force's proposals, audit considerations relating to derivatives (currently included in International Auditing Practice Statement (IAPS) 1012, "Auditing Derivative Financial Instruments") might be withdrawn in the process. Mr. Ashton explained that there is no intention to withdraw IAPS 1012. This was confirmed by Mr. Kellas.
- Mr. Damant suggested that the Task Force asks whether, based on the importance of derivatives and their pervasive effect on future cash flows, the guidance in IAPS 1012 should be included in the combined ISA. He noted that the authority of an IAPS is not the same as that of an ISA. He preferred a standard. Mr. Ashton explained that the principles relating to the audit of derivatives and their disclosure in the financial statements are captured in the combined ISA, but that IAPS 1012 provides additional implementation guidance. Mr. Damant asked the Task Force to ensure that, in combining ISAs 540 and 545, the requirements remain requirements – that is, requirements should not become guidance. Mr. Ashton confirmed that this is not the case.
- Ms. O'Malley was of the view that combining ISAs 540 and 545 is an imperative. The combination emphasizes the fact that fair values are just one kind of estimate on a spectrum. At one end of the spectrum, an estimate is a forecast of an actual outcome that will be observable. At the other end, an estimate of fair value is an estimate of the position today. It is not attempting to predict the future outcome, and any observed outcome will almost invariably have been affected by events subsequent to the measurement date. She explained the importance of emphasizing the need to understand the measurement objective of the financial reporting framework and to confirm that the entity's models are consistent with that measurement objective. Mr. Roussey supported this view, but cautioned against the potential complexity and length of a combined ISA.
- Mr. Damant asked Ms. O'Malley whether the effect on auditing is considered when developing financial reporting requirements for fair value measurements and disclosures. Ms. O'Malley explained that the current conceptual framework does not address the issue of verifiability, but that it is being considered as part of the revision of the framework. Mr. Damant encouraged the IAASB to comment on this issue, which is addressed in an IASB discussion paper.

Mr. Ashton summarized the discussion as follows: Generally, the idea of combining ISAs 540 and 545 makes sense. However, there are questions regarding the spectrum of items involving estimation uncertainty. It is important not to eliminate from the scope of the combined ISA items that are of a relatively low risk. Some topics may merit additional thought (e.g., derivatives), but related guidance should not necessarily form part of the combined ISA. It is also important to avoid excessive volume and complexity.

External Confirmations

Mr. Crawford summarized the issues highlighted for consideration by the IAASB CAG. The Representatives commented as follows:

- Ms. Sucher questioned the stated situations in which the auditor ordinarily seeks to obtain confirmations – that is, when (a) they are the most efficient means of obtaining the required audit evidence, or (b) the auditor concludes that obtaining evidence from a third party is the

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

only way to obtain sufficient appropriate audit evidence. She was of the view that they set up an argument for obtaining confirmations in fewer rather than more situations. Mr. Crawford noted that it is not a question of obtaining confirmations in more situations, but one of obtaining them when they are appropriate – that is, when it is the most efficient or the only way to respond to assessed risks of material misstatement. Ms. Koski-Grafer indicated that item (a) above sets up a discouraging tone for the use of confirmations. While not suggesting that confirmations should be mandatory, she suggested that the ISA be more neutral in this respect by emphasizing that there is value in using confirmations. She suggested considering a third situation – that is, when confirmations corroborate other audit evidence. She noted that IOSCO commented on the over reliance on confirmations: in the case of significant financial statement items, they should not be the only audit evidence.

- Mr. Rabine questioned the meaning of the words “most efficient.” He was not sure whether they relate to audit quality or audit cost. Mr. Morris asked whether efficiency is interpreted in the context of the auditor or the audit client. The confirmation may provide sufficient appropriate audit evidence to the auditor, but at a cost to the audit client. Mr. Crawford explained that the stated situations merely reflect current practice. The intention is not to establish them as criteria for obtaining confirmations. Mr. Ray agreed that text, which could be interpreted as discouraging the auditor from obtaining confirmations, should be avoided. He was of the view that the ISA should focus on the confirmation process rather than whether to obtain confirmations. In his view, a good confirmation process will help the auditor obtain persuasive audit evidence.
- Mmes. Blomme, De Beer and Singh and Messrs. Johnson, Lamoureux, Morris and Pickeur were of the view that confirmations should not be mandated.
 - Ms. Blomme and Mr. Gislason were supportive of the stated situations in which the auditor ordinarily seeks to obtain confirmations. Ms. Blomme suggested that “most efficient” be changed to “most effective.”
 - Mr. Pickeur noted that he was under the impression that the objective of the project is to enhance the reliability of confirmations, not to determine whether the auditor should be mandated to obtain them. He noted that the Basel Committee on Banking Supervision is willing to assist in improving the reliability of confirmations. Mr. Morris agreed that the focus should be enhancing the reliability of confirmations, including working with preparers to design better requests for confirmations.
 - Mr. Lamoureux was of the view that the auditor should be able to justify why he or she did not seek to obtain confirmations (rebuttable presumption).
 - Mr. Johnson was of the view that it is not possible to mandate confirmations in an international standard if international protocols for responding to requests for confirmations do not exist (e.g., lawyers letters).
- Mr. Rabine was of the view that it will not be efficient for the auditor to seek to obtain confirmations if from the outset it is known that the responses will not be reliable. However, the auditor should be mandated to consider whether confirmations may be the best means of obtaining audit evidence with regard to certain financial statement items. In particular, this may be the case for litigation and claims, and perhaps also for bank accounts. Mr. Ray suggested that the Task Force identify areas where it would be presumptive to obtain

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

confirmations and consider developing qualitative guidance that could assist the auditor in judging whether it would be appropriate to obtain confirmations, rather than simply stating that it is a matter of the auditor's professional judgment when performing the risk assessment. If the auditor judges it not appropriate to obtain confirmations because they will not be desirable, the auditor should be able to justify his or her decision.

- Ms. De Beer and Mr. Peyret were of the view that guidance is needed for circumstances where the auditor does not receive the expected response to a request for confirmation. Ms. Sucher referred to the fact that many audit failures involved confirmations. She suggested that fraud risk factors relating to confirmations be addressed in the ISA. Mr. Damant noted that confirmations required a degree of professional skepticism. Mr. Crawford indicated that the Task Force believes that the ISA should provide more guidance on using professional skepticism when reviewing confirmation responses. However, he believes that the IAASB will have to decide to what extent fraud risk factors with respect to confirmations are dealt with within ISA 240, "The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements" or this ISA.
- Mr. Damant noted that the Representatives' discussion of negative confirmations indicated that the Task Force is taking the right approach in this regard. Mr. Morris did not support use of negative confirmations because they are of limited value. In his view, preparers prefer the selective use of confirmations because they are a more efficient use of resources.
- Mr. White and Ms. Blomme agreed with the proposal to incorporate Part C of ISA 501 in the ISA on external confirmations. Ms. Blomme, however, questioned the proposal to move some of the text to ISA 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement." Mr. White noted that the extent to which a confirmation will make the auditor aware of litigation and claims will depend on the attorney client relationship and confidentiality. Mr. Crawford confirmed that differences in national protocols make it difficult to deal with this subject in a comprehensive manner.

Written Representations

Mr. Fogarty presented a brief report back on the responses of the Task Force and IAASB to the May 11-12, 2006 proposals of Representatives. The Representatives commented as follows:

- Ms. Sucher and Mr. Pickeur were of the view that the general representations, acknowledging the assumptions about management activities and beliefs, are matters for the engagement letter rather than for the representation letter. Ms. Singh also questioned the reason for including the assumptions in both the engagement and representation letters. Mr. Fogarty explained that engagement letters are not required in terms of the ISAs, and that they are prospective – that is, management is undertaking to do certain things. The representation letter confirms that management has done those things. Of particular importance is the representation whether all records, documentation, unusual matters of which management is aware, and other information relevant to the audit have been made available to the auditor. This representation can only be obtained at the end of the audit. Ms. Koski-Grafer was of the view that the concerns of Representatives could be addressed by explaining in the ISA that an audit is based on certain assumptions about management activities and belief, and that the auditor has to confirm the continued appropriateness of those assumptions.

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

- Mr. Johnson was of the view that the auditor states the assumptions in the engagement letter, obtains audit evidence during the audit that corroborates the continuing appropriateness of the assumptions, and obtains a representation letter at the end of the audit that confirms the continued appropriateness of the assumptions as well as other representations obtained during the audit. Mr. Johnson suggested that the IAASB communicate the objective of representation letters to preparers, auditors and users.
- Mr. White was of the view that the problem is one of semantics – that is, “corroborating audit evidence” vs. “sufficient audit evidence.” He described a process similar to that described by Mr. Johnson, noting that the representation letter is at best corroborating evidence of a series of understandings obtained during the audit. He suggested that the requirements and guidance rather reflect the process.
- In line with the comments of Messrs. Johnson and White, Dr. Manabat also explained that the audit is a process. The engagement letter contains the general terms for the engagement; however, it is likely that those who agreed the terms may not fully appreciate them. Also, as the audit progresses, relevant persons are asked to make specific representations. The representation letter confirms the terms of the engagement and other representations made during the audit. She was of the view that the representation letter is a very important document. Mr. Krantz was of a similar view.
- Ms. Koski-Grafer suggested that the Task Force review the objective stated in the ISA. It should be based on outcomes. Based on the discussion, it is also important to clarify what corroborates what – that is, is it the audit evidence obtained during the audit or the representation letter obtained at the end of the audit that corroborates the assumptions in the engagement letter? Mr. Fogarty was of the view that, based on the discussion, the objective could be for the auditor to determine whether the assumptions underlying an audit of financial statements exist for the particular audit engagement.
- Mr. Sekiguchi noted that it is important for the ISA to be specific as to the general representations to be obtained, as an inability to obtain general representations will give rise to a disclaimer of opinion. Words such as “including the following” (paragraph 6(b)) and “appropriate general representations” (paragraph 13) should not be used. Mr. Fogarty explained that those words are used because the applicable financial reporting framework may not address all the matters listed in the relevant paragraph. Mr. Sekiguchi also asked about the effect of identified material weaknesses in internal control on management’s general representation as to whether it has fulfilled its responsibility for internal control relevant to preparing and presenting financial statements that are free from material misstatement. Mr. Fogarty explained that the requirement is drafted to allow management to acknowledge that it has fulfilled its responsibility for internal control and to state any identified material weaknesses. Such a representation by itself will not give rise to a disclaimer of opinion.
- Mr. Lamoureux was concerned about the references to management, while the engagement letter is signed by the audit committee on behalf of the board of directors. Inconsistency in the assumptions stated in the engagement letter and the representation letter should be brought to the attention of those charged with governance. Dr. Peters was of a similar view. Mr. Fogarty confirmed that this was addressed in ISA 260 (Revised), “Communication with Those Charged with Governance.”

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

Referring to comments whether the representation letter is audit evidence, Mr. Fogarty explained that, even if the auditor has performed all the audit procedures but has not asked management whether it understands and has fulfilled its responsibility for internal control, whether the financial statements are fairly presented, in all material respects, and whether it has given him or her all the required information, the auditor will not be able to conclude that he or she has obtained sufficient appropriate audit evidence on which to base the audit opinion. Asking management to sign a representation letter reminds it of its responsibilities – if management has not fulfilled those responsibilities, it will cause management to pause. It is the reaction to the request for a representation letter that provides the evidentiary value. Ms. Koski-Grafer agreed that representation letters are necessary audit evidence, but was of the view that they are not sufficient audit evidence. This needs to be reflected in the ISA. Ms. Todd McEnally doubted whether management representations should be considered audit evidence because of the risk of over reliance.

Mr. Damant thanked the Task Force for the care taken with the proposals of the Representatives.

Audit Considerations relating to SME / SMP / Developing Nations

Mr. Damant introduced the agenda item. He noted that it is accepted that an audit is an audit, but that it is acknowledged that an assurance service other than an audit may be more appropriate for SMEs. As a result, the IAASB plans to gather views about this at forums to be scheduled for 2007. He invited the Representatives to submit papers that could be included in the material for the forums. Mr. Asmelash commented on the proposed locations for the forums, which did not cover all the jurisdictions where this matter is of relevance. Mr. Krantz congratulated the IAASB for addressing this matter. He noted that the markets do not want different levels of audit; however, the different tiers of the market have different needs, risks and expectations.

Mr. Damant explained that the purpose of this agenda item is to discuss SME / SMP / developing nations related matters that affect the IAASB pronouncements, in particular ISA 230 and ISQC 1.

Quality Control

Mr. Gislason summarized the matters addressed in the paper submitted by the IFAC SMP Committee. Referring to ISQC 1, he was of the view that it is an issue of implementation rather than of applicability. He noted that the IFAC SMP Committee is considering facilitating the development of guidance on how to implement ISQC 1 in an SMP. Ms. De Beer agreed that the principles of ISQC 1 apply to SMPs; however, practical implementation issues need to be addressed. Mr. Diomeda noted that it is important to understand how ISQC 1 will be addressed at European Union level. Mr. Rabine responded that the Member States have identified ISQC 1 as an important standard and that it will be considered at the next Audit Regulatory Committee meeting. Ms. Blomme noted that the small number of countries in Europe that have adopted ISQC 1 have not experienced major difficulties in implementing the standard. She noted that FEE is of the view that ISQC 1 could and should be applied by SMPs.

Audit Documentation

Mr. Gislason was very supportive of the Clarity project. The residual concern is about the possibility of an increase in requirements. While to date his issue seems to have been contained in the drafts issued by the IAASB, the concern is to ensure that this continues to be the case. The

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

simple equation is thought to be, or requirements equal more documentation. He also referred to the concept of “think small first,” which was explained in the paper submitted by FEE. He noted that 90% of companies in the European Union are SMEs. He emphasized the importance of requirements that apply to audits of all entities in all circumstances, with additional requirements established for large entities. It was noted, however, that in the case of larger audits, more procedures are likely to be necessary to fulfill the requirements.

Mr. Diomeda was of the view that it is difficult to determine the effect of the clarity redrafted ISAs on audit documentation since they have not yet been implemented. He was of the view that it would be helpful to provide for the auditor to apply professional judgment in determining whether a requirement is relevant in the circumstances. He noted that proposed application material in ISA 200 limited the auditor’s ability to apply professional judgment in this regard. Mr. Kellas explained that the criterion for a requirement is that it should apply in virtually all circumstances. Requirements that are close to procedures are also being avoided. He noted that it would be extremely helpful if those responding to exposure drafts of proposed clarity redrafted ISAs could indicate if a proposed requirement might not be applicable to an SME audit. Ms. De Beer supported the approach for identifying and drafting requirements. Mr. Asmelash noted that UNCTAD is willing to assist in identifying requirements that might not be applicable to SME audits.

Although not questioning the concept of “think small first,” Ms. Koski-Grafer was of the view that it is very important to develop ISAs that are suitable for public company audits. She was concerned that, if the requirements are drafted at the level of an audit of a micro-entity, they might not be suitable for large companies, unless there were additional requirements stated for listed companies, as is the case with IFAC’s independence standards. As regards smaller entity audits, particularly statutory audits of non-public companies, Ms. Koski-Grafer asked if it might not be possible for an auditor to perform a quality audit and give the same opinion without necessarily applying all the requirements that one would want to stipulate for listed company audits. For example, could there be cases where, in a very small entity audit, the auditor could accomplish all the objectives with abbreviated procedures? She noted that it might be helpful to identify and consult with the users of the SME financial statements and those who oversee application of the ISAs in SME audits (i.e., enforcers / oversight authorities).

Mr. Kellas cautioned against assuming that enforcement is the primary purpose of auditing standards, their role being to support a high-quality opinion on the financial statements. Ms. Sucher said that one could not disregard the enforcers / oversight authorities. Ms. De Beer noted that SME audits are not always conducted by SMPs, they may also be conducted by large firms.

Mr. Ray asked whether the objective of an audit of SMEs required by statute may be different than the objective of an audit of a public company. If the case, it will be necessary to understand how they are different, and whether they could be met by something other than an audit. He noted that the IAASB will be gathering information about an alternative service for small entities during 2007.

Mr. Gutterman suggested a focus on users and purpose of the financial statements and risk, rather than the size of the entity. Mr. Ray wondered whether it might be that the objective of an “audit” of the financial statements of an SME might be different from that of a public company. If this is so, a different engagement is requirement. Dr. Manabat supported requirements that apply to all

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

audits of all entities, but emphasized the importance of providing for the auditor to apply professional judgment in applying the requirements.

Conclusion

Mr. Damant concluded that it appears as though the matters highlighted for this agenda item are being addressed as part of the Clarity project and that interested parties have an opportunity to and should comment on the exposure drafts of proposed clarity redrafted ISAs.

Plan to Develop IAASB's Future Strategy and Work Program

Mr. Kellas noted that the IAASB is planning how to develop its future strategy and work program. At this stage, the question is how the IAASB should do this, not what the IAASB's strategy and program should actually be. IFAC Staff has presented preliminary proposals to the PIOB in this regard. The PIOB stressed the importance of obtaining IAASB CAG input.

Mr. Kellas summarized the proposals to be presented to the IAASB at its next meeting. He also noted that the proposed forums might be used to consider both the strategy and work program in general, and possible alternatives to audits for SMEs. The principal comments made were the following:

- Mr. Damant was of the view that the proposal for presentations to the IAASB should not exclude presentations by Representatives of IAASB CAG Member Organizations. Mr. Kellas responded that the IAASB has limited time available during its meetings and that the IAASB CAG and National Standard Setters have other established avenues for input. The idea was to give encouragement to others who might not regularly communicate with IAASB. Mr. Uchino emphasized the importance of obtaining input from the IAASB CAG before *and after* reaching out to broader audiences. Mr. Gutterman noted that it was important for the IAASB CAG to plan how to provide input on a proactive basis.
- Ms. Koski-Grafer suggested that the proposed survey include open-ended questions as well as structured questions, such as: what are the auditing issues that affect confidence in financial reporting, what does the audit opinion provide to users and what, if anything, do they want in addition? Respondents may not know what specific topics are covered in the standards but they will know what they want and expect from an audit. The IAASB could then translate such broad input into its standard setting activities or other activities of IFAC. Ms. Todd McEnally emphasized the importance of determining investors' understanding and expectations of the audit. Ms. Koski-Grafer suggested that the IAASB CAG provide input to the IAASB strategy and work program by completing a short questionnaire to be prepared and distributed before the next IAASB CAG meeting. (She also noted that an IOSCO member had suggested that the IAASB CAG should perform a self-assessment of its own processes, now that it had been in enhanced operation for a year.)
- Mr. Hegarty commented on the locations for the roundtables. These did not include countries such as Africa, Asia and Latin American that are using or considering using ISAs as the basis for national standards. He suggested that regional organizations could perhaps facilitate roundtables. Mr. Asmelash supported these sentiments.

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

- Mr. Rabine suggested that audit oversight bodies be invited to the roundtables. He also suggested that the internet might be used to consult more widely. Ms Sucher supported the view that the oversight bodies should be involved.
- Mr. Damant noted that forum participants should represent preparers, auditors and users. Mr. Lamoureux emphasized the importance of involving users. He thought that they would probably favor emphasizing audit, rather than other assurance services. Their views might help clarify their expectations about the auditor's role with regard to internal control and press releases.
- Mr. Hallqvist noted that the independent audit is an important aspect of corporate governance. Had the role of auditing in corporate governance been analyzed? It should also be clear who the auditor is servicing. He was of the view that, in the context of corporate governance, to the world outside the USA it was important to recognize that the auditor is serving the owners.
- Mr. Roussey was of the view that auditing is better served where the auditor is able to operate within a good corporate governance framework – that is, a framework in which all the relevant processes, including auditing, are combined to create an environment of good financial reporting. He asked whether the IAASB should be encouraged to identify the processes necessary to create such an environment. Mr. Kellas responded that this is part of the IFAC initiative to enhance the quality of the financial reporting supply chain but that placing the audit within this context was important. Ms. Blomme noted that FEE has a project on assurance on corporate governance and that some of FEE's papers might call on the IAASB to take certain actions. She also noted that FEE views internal control as an important area for further consideration. Mr. Hegarty agreed that the audit should not be considered in isolation: the ISAs should explain how the audit is linked to the other processes in the financial reporting supply chain. Further, if the ISAs explained exactly what they were and were not (for example, 'framework neutral'), it would be clear that "ISA Plus" has legitimacy.
- Ms. Sucher was concerned that standards sometimes seemed to be unduly influenced by problems encountered in a specific jurisdiction. She suggested a project to consider matters relating to developing ISAs capable of application in many jurisdictions and what is meant by framework neutral ISAs. It might also be helpful to consider more generally how auditing standards contribute to audit quality. After recent significant changes, such as the audit risk and quality control standards, a period of reflection drawing on the experience of the effect of these changes might be appropriate. She preferred a focus on auditing standards as opposed to assurance standards. Mr. Krantz, on the other hand, suggested increased focus on other assurance standards, such as reviews of environmental and social reports or other forms of assurance for smaller companies.

Mr. Kellas noted that the IAASB will consider matters identified during the consultation process; however, it could only address matters that fall within its mandate. Matters outside its mandate will be communicated to relevant parties. Mr. Sylph asked the IAASB CAG to be conscious of the fact that the IAASB is focusing its efforts on completing the clarity project. It has limited time available to devote to developing its future strategy and work program.

Mr. Damant noted that he will be asking Representatives to elaborate in writing the points raised during this discussion. This might be used to develop papers to be distributed in advance of the

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

forums. He will also encourage some Representatives to make presentations at the IAASB CAG or forums. Mr. Damant confirmed that an additional IAASB CAG meeting is likely to be held on June 29, 2007 to follow the roundtable in Brussels proposed for June 28, 2007. The April 2007 meeting would in that case be a two-day meeting (the possibility of a three-day meeting was communicated before). (The arrangements for these meetings were subsequently confirmed.)

Using the Work of an Expert

Mr. Ferlings presented a brief report back on the responses of the Task Force and IAASB to the May 11-12, 2006 proposals of Representatives. He also summarized the significant matters discussed at a subsequent IAASB meeting. The Representatives commented as follows:

- Mr. Damant was supportive of the proposal to limit the scope of the ISA to using the work of experts engaged by the auditor. It was important that every reference to “work of experts” be explicitly clear as to what sort of expert was referred to – experts engaged by the auditor, experts engaged by the client, or third party experts.
- Mr. Sekiguchi emphasized the importance of aligning the definition of “engagement team” in this ISA with that in proposed ISA 600, “The Audit of Group Financial Statements.” Mr. Sylph noted that responses to ED-ISA 600 may affect the proposed definition.
- Ms. Sucher was of the view that an expert can be more or less independent, but he or she is either objective or not objective. The issue is whether obtaining evidence about the expert’s objectivity is more or less important.
- Mr. Gutterman was concerned about creating lower objectivity standards for external experts than for internal experts. Mr. Ferlings explained that the auditor will not do less in the case of an external expert, but that his or her procedures to confirm the external expert’s objectivity will be different. In the case of internal experts, the auditor will be able to rely on the policies and procedures implemented in accordance with ISQC 1.
- Ms. Koski-Grafer was of the view that the contract between the auditor and the external expert should clarify what the auditor needs the external expert to be and do, but it should not drive what the auditor has to do in relation to the external expert and his or her work. She asked whether independence could be addressed in the contract. She also stated that she felt that the proposed revised standard could be made easier to understand.
- Mr. Asmelash questioned the effectiveness of criteria such as the importance of the expert’s work to the auditor’s evidence and the risk of material misstatement. He was of the view that, if the expert’s work is not important or addressing an assessed risk of material misstatement, the auditor should not engage an expert.
- Mr. Gutterman supported the use of principles rather than rules. He was of the view that the auditor’s procedures in relation to the expert and his or her work and the extent of related audit documentation are matters of professional judgment. Mr. Johnson emphasized the importance of documentation. He was of the view that the expert’s documentation should be at the same level as that of an auditor, and should enable the auditor to understand the procedures performed by the expert and the results thereof.
- Mr. Pickeur questioned whether the auditor would be able to evaluate the work of an external expert as prescribed in the ISA (paragraph 17 (d)). He was of the view that the auditor would

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

have to engage another expert to perform those procedures. Mr. Ferlings explained that prior-year experience might assist the auditor in performing those procedures. Ms. Koski-Grafer indicated that those procedures are not new, they are in the existing ISA. Mr. Pickeur noted that additional application material in this regard would be helpful.

- Ms. Gutterman was of the view that the selection of an expert is very important. He was also of the view that the ISA should cover experts in the field of accounting.
- Dr. Manabat suggested that the Task Force consider the rationale for using the work of an expert and that the requirements and guidance be based on the outcome of this consideration. The ISA should take account of the fact that the use of an expert is normally not a one-off event – that is, the auditor would have encountered similar incidences in the past. Whether the auditor could rely on the work of an expert would be affected by the reputation and past work of the expert. She noted that she has more questions than answers and that there is a need to revisit what has been done. Mr. Sylph responded that the project has progressed to a stage where it is not possible to revisit the proposals to the extent envisaged by Dr. Manabat. However, the Task Force will address the questions of clarity as communicated by the Representatives.

Service Organizations

Ms. Esdon and Mr. Tucker introduced the projects to revise ISA 402, “Audit Considerations Relating to Entities Using Service Organizations” and to develop a new International Standard on Assurance Engagements¹ (ISAE) 3402, “Assurance on Controls at a Service Organization.”

ISA 402

- Mr. Peyret emphasized the importance of a precise definition of the scope of ISA 402. He was of the view that the use of service organizations has a direct effect on the quality of the work of the user auditor. He suggested that local service organizations be distinguished from international service organizations. In particular, he was concerned about international shared service centers. Ms. Esdon explained that the ISA will deal with the audit of entities that typically use service organizations that are independent from them; however, it will acknowledge the existence of shared service centers, and the fact that many of the requirements and guidance might apply to entities with shared service centers.
- Dr. Manabat was concerned about situations where purchases are made, transactions processed, and accounting records maintained by international shared service centers, while the user organization is responsible only for distribution. She noted that, in such situations, management of the user organization might not have control over financial information reported by the user organization. She was of the view that the ISAs should recognize this paradigm shift. Mr. Roussey was concerned about Dr. Manabat’s statement that management of the user organization might not have control over financial reporting. He was of the view that the issue is beyond ISA 402 and ISAE 3402 – it is a matter of corporate governance.

¹ According to the “Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services,” International Standards on Auditing (ISAs) are to be applied in the audit of historical financial information and International Standards on Assurance Engagements (ISAEs) are to be applied in assurance engagements dealing with subject matters other than historical financial information.

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

- Ms. Todd McEnally emphasized the increased importance of ISA 402. She was not sure how the ISA will deal with situations where the core operations of an entity are outsourced, but suggested that the use of service organizations be addressed in its broadest sense. She referred to practical implementation issues such as the testing of controls of an entity (service organization) in another country.
- Mr. Cassel emphasized the increased importance of ISA 402 in the context of public sector audits. He noted that state agencies do not only outsource to other state agencies. They often use private sector service organizations. He noted the importance of having a clear understanding of the responsibilities of management of the user organization.
- Ms. Koski-Grafer asked whether the scope of the ISA should be described as dealing with service organizations that perform activities that are part of the entity's *internal control* relevant to the audit (as per the issues paper) or part of entity's *financial reporting system* relevant to the audit. Mr. Tucker explained that by definition (in ISA 315) the entity's internal control includes the processes by which transactions are processed and reported. If the service organization is doing that, by definition it would be part of the entity's internal control.
- Mr. Rabine noted that the use of service organizations could range from one that does not affect the user organization's internal control to one that forms a significant part of the user organization's internal control. He was concerned that this range of use is not apparent from the issues paper. He was wondering whether the introduction of a "sliding scale" (such as that discussed during the project of the use of the work of experts) could be helpful in the case of this ISA.
- Referring to the types of service organization to be encompassed by ISA 402, Dr. Manabat noted that the structure of doing business in the world has changed. She suggested that consideration be given as to how a business is created and operates. While each entity within the business might appear to be stand-alone, looking at the big picture, they are merely business units created to improve the bottom line. She was of the view that this creates audit concerns. She did not believe that the tests of ownership and influence applied by the auditors were always the correct ones. Ms. Sucher was of the view that, in situations where a service organization is acting as an agent for the user organization, there might be increased risk. She suggested that this might be another way of approaching the subject.
- Mr. Rabine was of the view that it would be difficult to design boundaries for activities of service organizations where those activities do not directly affect the user organization's internal control as it relates to preparing the financial statements. He preferred limiting the requirements and guidance to activities that directly affect the user organization's internal control as it relates to preparing the financial statements. Mr. Pickeur asked whether the ISA would distinguish between outsourcing within and outsourcing outside a group. He was of the view that outsourcing outside a group is more complicated, making it more difficult to establish boundaries. Mr. Roussey was of the view that it would be very difficult to design boundaries. He suggested a focus on activities that directly affect the user organization's internal control as it relates to preparing the financial statements. He also suggested that the IAASB consider a separate project addressing the extended enterprise concept. Mr. Johnson emphasized the importance of identifying the types of service provided to an entity and affect that each of them might have on the audit of the financial statements.

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

ISAE 3402

- The Representatives did not comment on the proposed scope of ISAE 3402. Mr. Damant noted that it was a matter for consideration by the Task Force and the IAASB.
- Referring to the types of service auditor report, Mr. Roussey suggested that the Task Force determine to what extent Type A reports are being used by user organizations and user auditors. Ms. Blomme preferred Type B reports. She noted that the user auditor is interested in the effectiveness of internal control at the service organization. In addition, Type B reports also include the information provided in Type A reports.
- Mr. Sekiguchi asked to what extent the service auditor's independence would be addressed in his or her report. Ms. Esdon explained that the service auditor's report is an assurance report. Although it would not address independence specifically, it would refer to the service auditor's compliance with relevant assurance standards and code of ethics.
- Referring to the level of assurance to be obtained by the service auditor, Ms. Blomme indicated that FEE prefers reasonable assurance. Ms. O'Malley was of the view that reasonable assurance is appropriate when the use of a particular service organization gives rise to risks of material misstatement. However, if not the case, a lower level of assurance might be appropriate. Mr. Roussey was of the view that, if user auditors typically issue reasonable assurance reports, it might not be appropriate for user organizations to request limited assurance reports. Mr. Johnson and Ms. Sucher were of a similar view.
- Referring to service organizations that use other service organizations, Mr. Roussey noted a preference for a service auditor report that addresses the activities of the main service organization and the other service organizations. This is subject to the user organization being able to read the report and identify controls relevant to it. Mr. Asmelash noted that the entire service rendered to the user organization could be performed by one of the other service organizations.

Mr. Damant asked that Representatives who wish to join the IAASB CAG Working Group for this project contact Ms. Prinsloo.

Related Parties

Ms. Hillier explained that the Task Force Chairman, Mr. Tremoliere was not able to attend the meeting. She reported on the significant comments received on the exposure draft of proposed ISA 550 (Revised and Redrafted), "Related Parties," and the Task Force's preliminary recommendations. The Representatives commented as follows:

- Mr. Roussey was of the view that the ISA would be simpler if intra-group related parties are addressed in proposed ISA 600. In the case of a group, the auditor knows who the intra-group related parties are and has to obtain an understanding of and identify and assess the risks relating to management's process for eliminating inter-company profits as part of the consolidation. Ms. O'Malley noted that a cross reference in ISA 550 to ISA 600 might be sufficient. Ms. Blomme supported these comments. Ms. Koski-Grafer noted that the auditor would still have to evaluate whether intra-group transactions are fully and properly priced, accounted for, and disclosed.

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

- Ms. O'Malley noted that it would be useful if the ISA could explain the reason for highlighting related parties as an audit consideration. She was of the view that it is because most financial reporting frameworks presume that transactions are conducted at an arm's length. However, many related party transactions might not fit that presumption. That is why the auditor has to identify them and understand their characteristics. Most financial reporting frameworks deal with this by requiring disclosure of related party relationships and transactions so that readers could draw their own conclusions about them.
- Messrs. Cassel, Johnson and Ray supported communicating the inherent limitations in the ISA. They were of the view that the current articulation achieves a good balance. Mr. Roussey was of the view that the inherent limitations are appropriate in the context of external related parties, but less appropriate when considering intra-group related parties. Mr. Rabine did not support communicating the inherent limitations in the ISA. He was concerned about the status of the Introduction section of the ISA. He believed that it would be better to communicate the inherent limitations in ISA 200. He also had concerns about the clarity of the communicated inherent limitations. Ms. Todd McEnally was troubled by the communication of the inherent limitations and suggested that a strong attempt be made to provide alternatives in the ISA so that the inherent limitations could be overcome.
- The Representatives were generally supportive of the approach to provide broad guidelines regarding the meaning of a related party based on the common characteristics of related parties. However, some were concerned about the emphasis on fraud over error. They also noted that the approach seemed very structured. Ms. O'Malley noted that the IASB, in revising International Accounting Standard (IAS) 24, "Related Party Disclosures," will be moving away from a rules-based definition to a definition based on principles and characteristics. She suggested that the IAASB and IASB coordinate closely in this regard.
- On balance, the Representatives were comfortable with the proposed split between risk assessment procedures and responses to assessed risks. Mr. Ray was concerned that the risk assessment procedures seem to be limited to inquiries only.
- Referring to the requirements and guidance for significant non-routine transactions, some Representatives were of the view that the link to ISA 240, "The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements" and ISA 315 could be enhanced. Ms. Koski-Grafer and Mr. Roussey were of the view that it is important for the auditor proactively to look for such transactions.
- Mr. Rabine questioned whether the definition of dominant party adds anything to the concept of related parties. Others noted that the definition is limited to an individual while, in practice, it may be a family or other group of individuals. Ms. O'Malley suggested that the Task Force consider whether the definition is still necessary in the context of the proposed description of a related party based on the common characteristics of related parties.
- Ms. Koski-Grafer noted that IOSCO had asked in its comment letter on the exposure draft that greater coverage is given to special purpose entities/vehicles in the requirement section of ISA, as only a brief mention appeared in the application material section of the exposure draft. She asked why the Task Force had not recommended additional coverage in response to this comment.

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

Forming an Opinion

Ms. Hillier explained the scope of a proposed new ISA on Forming an Opinion on the Financial Statements, which is to be developed as part of the Clarity project. The Representatives commented as follows:

- Mr. Roussey supported the project in general based on a past practice whereby the auditor used to sign an audit completion checklist (which formed part of the audit documentation) before signing the auditor's report. However, he was not sure whether it should be addressed in an ISA; he suggested a practice aid for audit engagement partners.
- Mr. Hegarty noted that the proposal to group requirements and guidance in accordance with their importance for the audit process is not applied consistently by all the Task Forces. He asked whether the view was that the structure of the ISAs is not aligned with the audit process. If the case, it should be considered whether the issue should be addressed for the ISAs as a whole, or when individual ISAs are being developed.
- Ms. Koski-Grafer noted that, although not yet formally discussed by her constituency, she is aware of two views. One view was that developing an ISA on the subject of forming an opinion is a good idea, but that at this time the large number of critical projects already on the IAASB agenda, with ambitious time targets, suggests that the IAASB should focus on its current work program and not address something like this until later. Another view was that pulling together a summary of requirements and guidance relevant to forming an opinion is a good idea, but that the project should develop an informative standalone ISA and not remove any text from the existing ISAs. The text could be duplicated in the new document. Dr. Manabat supported the latter view. She was concerned that moving text from the existing ISAs might be confusing. Ms. Blomme was of the view that the other aspects of the Clarity project are of a higher priority. She also preferred the duplication of text.

Mr. Damant asked that Representatives who wish to join the IAASB CAG Working Group for this project contact Ms. Prinsloo.

Improving the Clarity of IAASB Pronouncements

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 May 11-12, 2006. He also summarized the significant matters to be discussed at the IAASB meeting in September at which the IAASB will review the proposed revised Preface and four clarity redrafted ISAs for approval. The IAASB will review, but not approve, the form of the objectives. The relevant Task Forces will continue to refine the objectives as their projects progress; consequently, the objectives will not be released for consultation at this stage. The IAASB will also review, but not approve for exposure, certain proposed amendments to ISA 200, "Objectives and General Principles Governing an Audit of Financial Statements." and ISA 230, "Audit Documentation." One of the purposes of the amendments to ISA 200 is to incorporate the authority of objectives, requirements and other material in ISAs in response to the fact that the European Commission does not expect to endorse the Preface.

The Representatives commented as follows:

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

- Referring to the emphasis on a principles-based approach that acknowledged the need for judgment, Mr. Hegarty was of the view that there should be an emphasis on enforceability. He noted that the agenda papers suggested that is not always possible to map the methodologies of firms to the objectives in the ISAs. Consequently, it seemed that it may not be possible to determine whether the objectives have been achieved.
- Referring to the proposed amendments to ISA 230, Mr. Damant noted that priority should be given to determining what audit documentation is necessary. Ms. Koski-Grafer asked whether the Clarity project has created a belief that the auditor has to document more. She did not believe that auditors would have to prepare separate statements on how they have fulfilled each objective or requirement when the work is evidence in the audit workpapers; however, an experienced person familiar with audit should be able to determine how an auditor has achieved the objectives. Mr. Kellas noted that her interpretation is consistent with the intention of the IAASB; however, some auditors think that this is not clear and are also faced with monitoring agencies asking for further documentation. It is therefore necessary to clarify what needs to be documented. Mr. Gislason confirmed such pressures. Auditors therefore believe that more requirements will lead to more documentation. Mr. Johnson was of the view that there is an expectation gap between standards setters, auditors and regulators. He referred to a regulator that believes that if a matter is not documented the work was not done. This drives auditors to document more. Therefore, clarification is important – for large and small audits.
- Mr. Diomeda noted that the proposed amended ISA 230 (paragraph 15) explains that the documentation requirement applies only to requirements that are relevant in the circumstances, while the proposed amended ISA 200 (paragraph A54) provides guidance for determining whether a requirement is relevant in the circumstances. He asked how the auditor should interpret the connection between ISA 230.15 and the guidance in ISA 200.A54. Mr. Kellas explained that the fact that the guidance is provided in the application material does not mean that it does not have authority.
- Mr. Diomeda was of the view that the guidance in ISA 200.A54 limits the auditor's ability to use professional judgment to determine whether a requirement is relevant. Mr. Kellas explained that the limitation is intentional; otherwise the test that a requirement should be applicable in virtually all circumstances is not met. If there are many cases where a requirement is not considered to be relevant, then the IAASB has the requirement wrong. The Task Force believes that the requirements should not be irrelevant in any circumstances; a less tight definition of relevance could allow an auditor simply to dismiss a requirement as 'not relevant'. An important consideration for respondents to exposure drafts, and for the IAASB in considering responses, was whether proposed requirements were really set at the appropriate level to meet the test of being applicable in virtually all circumstances.
- Based on the stage of development of the objectives, the Representatives agreed that this might not be the best time to establish the IAASB CAG Working Group, which Mr. Damant had proposed to be responsible for reviewing the objectives. Mr. Kellas noted that the refined objectives will form part of the exposure drafts of proposed "clarified" ISAs and that Representatives will have an opportunity to comment on the exposure drafts. Mr. Hegarty volunteered to joint the Working Group, should it be established at a later date.

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

- Referring to the proposed amendments to ISA 200, Mr. Damant noted with approval that the objective of an audit is to evaluate whether the financial statements are prepared in accordance with the financial reporting framework. He was of the view that this clearly explains to “people in the street” what an auditor does. However, this objective had been removed from paragraph 2 of the old ISA, where it was suitably prominent, and was somewhat lost in paragraph 6. He questioned the logic of the proposed wording.
- Mr. Hegarty was of the view that ISA 200 could be used to set the audit in the context of the financial reporting supply chain and to explain the dependence of audit quality on other factors such as the financial reporting framework. He was of the view that the ISAs should be framework neutral but should recognize that legislators or regulators might therefore require an audit scope that is wider than that provided for in the ISAs.
- Mr. Rabine emphasized the importance of ISA 200. He noted that the EGAOB has not yet reviewed the proposed amendments to ISA 200; however, he was of the view that paragraphs A8 (authentication of documents) and A11 (professional judgment) might be problematic.
- Ms. Koski-Grafer noted that IOSCO continues to have concerns about the Clarity project, but realizes that the IAASB’s work needs to keep moving ahead. She noted that this project was so important and fundamental to the quality and suitability of ISAs that she could not offer comments about the questions that had recently been raised in the IAASB CAG papers until the IOSCO Standing Committee and Auditing Subcommittee had a chance to meet and discuss these matters in person. She stated that their next meetings would occur in mid-October.

Closing

Mr. Damant referred to the earlier remarks by Ms. Koski-Grafer that the IAASB CAG should at some stage perform a self assessment of its processes. He agreed with this approach and would discuss it with Mr. Sylph and others.

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.

IAASB CAG PAPER

IAASB CAG Agenda (April 2007)

Agenda Item A-1

Draft Minutes – September 11-12, 2006

Appendix

Membership of IAASB 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	Hegarty, Johnson, TBD
Corporate Governance and Investor Matters	TBD