

IAASB CAG PAPER



International Federation of Accountants

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Agenda Item

A

Committee: IAASB Consultative Advisory Group

Meeting Location: Basel

Meeting Date: March 3-4, 2008

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

Held on September 20-21, 2007

London, United Kingdom

PRESENT

Members

David Damant	Chair
Conchita Manabat	Asian Financial Executives Institutes
Xinhua Ju	Asian Financial Executives Institutes
Marc Pickeur	Basel Committee on Banking Supervision
Kristian Koktvedgaard	BUSINESSEUROPE
Rebecca Todd McEnally	CFA Institute
Elena Lobanova	Dean of the Graduate School of Financial Management, Russia (September 20)
Jean-Philippe Rabine	European Commission
Federico Diomeda	European Federation of Accountants and Auditors for SMEs
Jean-Luc Peyret	European Financial Executives Institutes
Hilde Blomme	Fédération des Experts Comptables Européens
Philip Johnson	Fédération des Experts Comptables Européens (September 20)
Robert Roussey	Information Systems Audit and Control Association
Mohini Singh	Institute of International Finance
Bengt Hallqvist	Instituto Brasileiro de Governanca Corporativa
Sam Gutterman	International Actuarial Association
George White	International Bar Association
Christianna Wood	International Corporate Governance Network
Len Jui	International Organization of Securities Commissions
Tomokazu Sekiguchi	International Organization of Securities Commissions
Pat Sucher	International Organization of Securities Commissions
Filip Cassel	International Organization of Supreme Audit Institutions
Lori Cox	Institute of Internal Auditors
Hayanari Uchino	Japan Securities Dealers Association (September 21)
David Morris	North American Financial Executives' Institute
Ajith Ratnayake	Sri Lanka Accounting and Auditing Standards Monitoring Board
John Hegarty	World Bank
Thomas Krantz	World Federation of Exchanges

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Observers

Tom Ray U.S. Public Company Accounting Oversight Board

By Invitation

Ben Scicluna IFAC Small and Medium Practices Committee
Paul Pacter Director of Standards for SMEs, International Accounting Standards Board

IAASB

John Kellas Chairman
Philip Ashton Member
John Fogarty Member (By telephone for Written Representations only)
Diana Hillier Member (September 21)
George Tucker Task Force Chair (By telephone for Service Organizations only)

Public Interest Oversight Board

Michael Hafeman Member

IFAC Staff

Jim Sylph Executive Director, Professional Standards
Alta Prinsloo IAASB Deputy Director
Michael Nugent IAASB Manager (September 21)

APOLOGIES

Members

Nelson Carvalho Chairman of the Standards Advisory Council of the International Accounting Standards Board
Gerald Edwards Basel Committee on Banking Supervision
Vickson Ncube Eastern Central and Southern African Federation of Accountants
Wayne Upton International Accounting Standards Board
John Carchrae International Organization of Securities Commissions
Susan Koski-Grafer International Organization of Securities Commissions
Rifaat Karim Islamic Financial Services Board
Yoseph Asmelash United Nations Conference on Trade and Development

Observers

Hisashi Yamaura Japanese Financial Services Agency

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Introduction (Agenda Item A)

Mr. Damant opened the meeting and welcomed those present. He noted that:

- Mr. Ratnayake represents the new Member Organization, the Sri Lanka Accounting and Auditing Standards Monitoring Board;
- Ms. Christianna Wood is the new Representative of the International Corporate Governance Network, Ms. Lori Cox a Representative of the Institute of Internal Auditors, and Mr. Len Jui an alternate Representative of the International Organization of Securities Exchanges;
- Mr. Hafeman was observing the meeting on behalf of the Public Interest Oversight Board;
- Mr. Scicluna was observing the meeting on behalf of the IFAC Small and Medium Practices Committee; and
- Mr. Pacter was invited to attend the meeting to give a short presentation about the International Accounting Standards Board's project on financial reporting by SMEs.

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

Mr. Damant referred to a request at the previous meeting for the agenda to allow for Representatives to discuss points that are in addition to those raised by IAASB task forces or that may not be directly related to IAASB projects. He noted that the Representatives were asked to identify additional topics for discussion when the proposed agenda was distributed for comment. He indicated that he will be inviting Representatives during the meeting to raise the points they had communicated to him. He also invited the other Representatives to raise any points that they may have at the appropriate times.

Mr. Damant noted that the next meeting of the IAASB CAG will be held on March 3-4, 2008 in Basel. The meeting will be hosted by the Bank of International Settlements. He explained that, except for proposed ISA 320 (Revised and Redrafted), "Materiality in Planning and Performing an Audit" and proposed ISA 450 (Revised and Redrafted), "Evaluation of Misstatements Identified during the Audit," the IAASB CAG will be considering all final ISAs to be approved by the IAASB in September and December 2007. He asked the Representatives to forward any comments that they may have in relation to proposed ISAs 320 and 450 to IAASB staff.

Report Back on IAASB Projects (Agenda Item B)

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

The Representatives noted report backs on the following projects: external confirmations (proposed ISA 505 (Revised and Redrafted)), group audits (ISA 600 (Revised and Redrafted)), using the work of an expert (proposed ISA 620 (Revised and Redrafted)) and financial reporting frameworks described by reference to International Financial Reporting Standards (IFRSs) (incorporated in proposed ISA 700 (Revised and Redrafted)).

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The Representatives did not have additional comments on the report back on external confirmations.

The following was noted with regard to the report back on group audits:

- Mr. Hallqvist was concerned about the fact that subsidiaries may apply deficient financial reporting frameworks, while the group engagement team only determines the acceptability of the financial reporting framework applied in preparing the group financial statements. Mr. Kellas explained that the audit involves evaluating whether the financial information of subsidiaries that is incorporated in the group financial statements is prepared in accordance with the financial reporting framework applied in preparing the group financial statements.
- Referring to the point that Mr. Pickeur had raised in relation to the responsibilities of component auditors, Mr. Kellas indicated that ISA 600 (Revised and Redrafted), “Special Considerations – The Audit of Group Financial Statements (Including the Work of Component Auditors)” now provides for the group engagement team to request component auditors to confirm that they will cooperate with the group engagement team.

The following was noted with regard to the report back on using the work of an expert:

- Mr. Sekiguchi asked whether the IAASB still intends to explain in the explanatory memorandum accompanying the exposure draft why the proposed ISA does not apply to accounting and auditing experts, asking respondents to comment on the appropriateness of excluding them. Mr. Kellas confirmed that it is still the intention.

The following was noted with regard to the report back on financial reporting frameworks described by reference to IFRSs:

- Mr. Damant was of the view that the text of the proposed amendment to International Accounting Standard (IAS) 1, “Presentation of Financial Statements” is not satisfactory. He noted that members / staff of the International Accounting Standards Board (IASB) have indicated that the proposed amendment does not require quantification of the differences between the financial reporting framework applied in preparing the financial statements and IFRSs; however, the drafting was far from clear. He encouraged the Member Organizations to comment to the IASB on the proposed amendment.
- Mr. Johnson noted that IFRSs provide a “common language.” Describing a financial reporting framework by reference to IFRSs, without quantifying the effect on the financial statements of the difference between the framework and IFRSs may confuse users of the financial statements. It will also place the auditor in a difficult position, as the auditor will be required to make judgments about materiality based on inadequate information. He was of the view that the difference should be quantified by the preparers of the financial statements. Ms. Todd McEnally supported this view. Mr. White noted that a narrative description of the difference by the preparers is normally at a level of generality that is unhelpful to users. Mr. Peyret was of the view that quantification of the difference by the preparers, and the audit of such quantification by the auditors, will avoid suspicion / doubt by the users.
- Mr. Koktvedgaard was concerned about the resources necessary to quantify the difference. He was of the view that disclosure of significant differences is sufficient. Mr. Krantz noted that some differences may not be quantifiable, for example, those associated with certain “exotic” financial instruments.

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- Ms. Sucher was of the view that it is the responsibility of management to disclose to investors the significant accounting policies and the financial reporting framework applied in preparing the financial statements. The auditor is responsible for reporting whether the financial statements are prepared in accordance with the framework. In doing so, the auditor is required to evaluate whether the financial statements adequately disclose the significant accounting policies (as per proposed ISA 700 (Redrafted)). The question is, however, at what point does the description of the framework become misleading. Greater consideration should be given to the responsibility of the auditor in the case of misleading information.
- Mr. Hegarty noted that, as a result of delays due to translation, many jurisdictions may not implement IFRSs when they become effective. He asked whether the auditor has a responsibility to make users aware of the fact that the IFRSs applied in preparing the financial statements are not the currently effective IFRSs. Mr. Sylph noted that this matter is also relevant to International Standards on Auditing (ISAs). Mr. Hegarty was also concerned that the preparers in some jurisdictions may not have the knowledge to quantify the difference. Mr. Roussey asked whether a long form auditor's report, in which the auditor describes the financial reporting environment in the jurisdiction, may address the issue. Mr. Ray indicated that the matter of a long form auditor's report may be considered by the Standing Advisory Group of the U.S. Public Company Accounting Oversight Board (PCAOB). Mr. Sekiguchi referred to matters relating to the auditor's report raised at the IOSCO Roundtable (held in Paris on June 1, 2007), and the need to undertake a study of the form of the auditor's report. Mr. Hegarty suggested that the IAASB CAG undertake a medium term project to consider how the auditor's report could provide relevant information to users.
- Mr. Kellas noted that there are limits to what the auditor can do. It will not be appropriate for the auditor to quantify the difference or to require that the difference be quantified. Proposed ISA 700 (Redrafted) explains that it is preferable to describe the financial reporting framework without reference to IFRSs. However, law or regulation may require a description by reference to IFRSs. Given that such cases exist, the IASB and IAASB have two options – seek some sort of disclosure or say there is nothing that could be done. Both options may be unsatisfactory; however, it is worse to do nothing. (Mr. Rabine indicated that the description of the financial reporting framework in the European Union (by reference to IFRSs) is not required by law or regulation. It is an opinion of the European Commission.)
- Mr. Kellas summarized the discussion as follows: (1) As ISAs are being promoted around the world, the IAASB should be careful not to place obstacles in the way of convergence; however, the auditor cannot accept a deficient financial reporting framework. (2) Although the description of the framework and quantification of the difference are accounting issues, the auditor has to consider whether the description of the framework could be misleading. Therefore, it is also an issue for the IAASB.

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Appointment / Re-appointment of CAG Member Organizations and the CAG Chair (Agenda Item C)¹

To REVIEW and APPROVE a proposed amendment to the IAASB CAG Terms of Reference and proposed procedures for appointing / re-appointing IAASB CAG Member Organizations and the IAASB CAG Chair.

Mr. Damant provided background to the proposed amendment to the IAASB CAG Terms of Reference and proposed procedures for appointing / re-appointing IAASB CAG Member Organizations and the IAASB CAG Chair. He also explained the operating procedures of the IAASB CAG Membership Panel. He noted that the Public Interest Oversight Board (PIOB) will consider the proposals at its September 24-25, 2007 meeting and that he will report any comments that the Representatives may have at that meeting.

Mr. Hafeman, noting his personal view as opposed to that of the PIOB, indicated that the proposals seem appropriate and in line with discussions at PIOB meetings.

The Representatives commented as follows:

- Referring to paragraph 2.2.2 of the proposed operating procedures, Mr. Gutterman noted that it is unusual for the Chair to be involved in the re-appointment of the Chair. Mr. Damant responded that it is necessary for the Chair to start the process, but agreed that the proposed procedure should be amended to indicate that the Chair is not present when the Representatives discuss his/her re-appointment. In any case it would be one of the identified Representatives who would act as Chair for the duration of the discussion.
- Referring to the proposed amendment to paragraph 7 of the IAASB CAG Terms of Reference, Mr. Sekiguchi noted that it may be helpful to the PIOB if the IAASB CAG Membership Panel provides it with the information it considers in determining the completeness of public interest segments represented on the IAASB CAG.

Written Representations (Agenda Item D)

To REVIEW a summary of significant comments on the exposure draft of proposed ISA 580 (Revised and Redrafted) and the Task Force's recommendations.

Mr. Fogarty provided a brief overview of the significant comments received on the exposure draft of proposed ISA 580 (Revised and Redrafted), "Written Representations" and the Task Force's related recommendations, which will be discussed at the September IAASB meeting. It is envisaged that the final ISA will be approved at the December IAASB meeting. The Representatives commented as follows:

¹ The Terms of Reference and procedures for appointing / re-appointing IAASB CAG Member Organizations and the IAASB CAG Chair are approved by the Public Interest Oversight Board in September 2007 are attached to the minutes.

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FUNDAMENTAL PREMISE

- Mr. Morris, reporting on behalf of the IAASB CAG Working Group, indicated that the Working Group agrees with the revised description of the fundamental premise and the related conforming amendments to proposed ISA 200 (Revised and Redrafted), “Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing,” proposed ISA 210 (Redrafted), “Agreeing the Terms of Audit Engagements,” and proposed ISA 700 (Redrafted), “The Independent Auditor’s Report on General Purpose Financial Statements.” Ms. Blomme and Messrs. Rabine and Ray supported the revised premise.
- Referring to the conforming amendment to proposed ISA 200 (Revised and Redrafted), Mr. Gutterman noted that it is not necessary to refer both to the fact that ISAs are written in the context of the premise and the fact that audits are conducted based on the premise.
- Mr. Pickeur was concerned about the fact that the auditor is required to use the description of management’s responsibilities in the premise if law or regulation does not prescribe similar responsibilities. He was of the view that management cannot be forced to sign a representation letter that describes responsibilities for management that are different from those prescribed by law or regulation. Mr. Damant explained that the requirement is necessary to fill “gaps” between management’s responsibilities described in the premise and those prescribed by law or regulation. Mr. White was of the view that the proposed amendment to the exposure draft should address Mr. Pickeur’s concern.
- Mr. Ray noted that the proposed ISA places a responsibility on the auditor to judge the similarity of management’s responsibilities described in the premise and those prescribed by law or regulation. Mr. Fogarty noted that the word “similar” in this context means that management’s responsibilities prescribed by law or regulation cover the same aspects as those described in the premise. Mr. Fogarty suggested that the Task Force consider whether the word “similar” is strong enough and whether it is the right word.
- Referring to management’s responsibility “to provide the auditor with all the information the auditor requires in connection with the audit of the entity,” Mr. Scicluna asked whether it is the information that the auditor requires or the information that the auditor requests. Is management expected to know what information the auditor requires? Mr. Rabine had a similar question. Mr. Fogarty explained that, if the responsibility is limited to information that the auditor requests, management may withhold relevant information on the basis that the auditor has not requested it. Ms. Blomme suggested that this aspect of the premise be read in the context of the requirement for the auditor to obtain a written representation about the completeness of information. Mr. Fogarty suggested that the Task Force consider developing additional application material in this regard.
- Mr. Ju suggested that the reference to “audit of the entity” be replaced with “audit of the financial statements.” Mr. Fogarty agreed.

OBJECTIVE

- Ms. Sucher was concerned about the word “corroborate” in the objective and elsewhere. She was of the view that the word is too strong; it does not reflect the nature of the evidence

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obtained through written representations. Mr. Damant noted that the word “corroborate” will be difficult to translate. Mr. Fogarty responded that, based on the comments on the exposure draft, the Task Force considered alternative words, but was unable to identify a different word. He agreed to discuss the matter with the IAASB.

WRITTEN REPRESENTATIONS

- Mr. Morris noted that the Working Group has trouble understanding why the distinction between general and specific written representations was eliminated. He also noted that it is not clear whether the auditor will obtain only one representation letter. Mr. Fogarty explained that, in response to comments on the exposure draft, the proposed ISA now refers to written representations about the premise, written representations required by other ISAs, and written representations about assertions of the financial statements which involve management’s judgment or intent, or which may not be complete. It is hoped that the proposed ISA will lead auditors to reduce the number of requested written representations. The intention is to obtain one representation letter; however, additional letters are not prohibited.

UNRELIABLE WRITTEN REPRESENTATIONS / REFUSAL TO PROVIDE WRITTEN REPRESENTATIONS – DISCLAIMER OF OPINION

- Ms. Sucher noted that the amendments to the proposed ISA address some of the concerns about the requirement to disclaim an opinion when the auditor concludes that the written representations about the premise are not reliable or management does not provide such representations. However, she continues to believe that the auditor should apply professional judgment rather than automatically disclaim an opinion in the described circumstances.
- Mr. Rabine asked whether the IAASB has assessed the potential effect that the proposed requirement may have on auditors’ reports in the European Union. Mr. Fogarty responded that such an assessment has not been undertaken. However, the comments on the exposure draft and comments from other sources indicated that (1) permitting a description of management’s responsibilities in line with those prescribed by law or regulation, to the extent that they are similar, and (2) deleting the detailed elements of the written representations about the premise will reduce the number of disclaimer of opinions. The exposure draft was amended to take account of these proposals. Mr. Rabine responded that in theory the requirement appears to be fair; however, from a regulatory perspective it needs to be asked how many disclaimers of opinion will be issued based on the requirement. Mr. Kellas noted that, irrespective of the outcome of such an assessment, auditors will not be able to express an opinion when written representations about the premise are unreliable or when management does not provide them.

OTHER

- Mr. Koktvedgaard suggested that the paragraph requiring the written representation about the completeness of information to include whether all transactions have been recorded and whether management has disclosed to the auditor all control deficiencies be amended to indicate that the representation is based on management’s knowledge and belief. Mr. Fogarty agreed.
- Mr. Sekiguchi asked why the date of the written representations about the premise could not be the same as the date of the auditor’s report. Mr. Fogarty responded that the Task Force did

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not consider permitting different dates for written representations about the premise and other written representations. He was of the view that this will increase the complexity of the requirement. In response to comments on the exposure draft, the requirement was amended to refer to a date “as near as practicable to, but not after, the date of the auditor’s report.”

Mr. Damant noted that overall the Representatives appear to be satisfied with the way in which the exposure draft was amended to respond to comments.

IAASB Future Strategy and Work Program (Agenda Item E)

To REVIEW a proposed consultation paper to be approved by the IAASB in September 2007.

Mr. Kellas noted that the discussions at the June IAASB CAG meeting indicated that the IAASB should focus on the development of standards and, in particular, auditing standards. This view is reflected in the proposed consultation paper, which will be approved at the September IAASB meeting. A sixty-day comment period is proposed. It is envisaged that the consultation paper will be issued on October 1 with a comment date of November 30. This will enable the IAASB to review the comments, consult with the IAASB CAG and report to the PIOB before the IAASB approves the Strategy and Work Program for 2009 – 2011 in March 2008, subject to any further comments that the PIOB may have.

Representatives commented as follows on the possible actions to contribute to the effective operation of the world’s capital markets and to assist with the implementation of standards:

- Mr. Damant was pleased with the focus on the world’s capital markets.
- Ms. Singh was pleased with the proposal to assess the impact of new standards. She encouraged the IAASB to include cost/benefit analyses in the assessments.
- Mr. Johnson noted that the possible actions do not include the development of a conceptual framework, although a number of regulators are of the view that such framework will be useful. Mr. Jui added that the development of a conceptual framework was supported by participants in the IOSCO Roundtable (held in Paris on June 1, 2007). Mr. Kellas explained that it was a matter of managing the IAASB’s limited resources. He was not convinced that the potential increase in audit quality that would arise from such a framework justifies the resources necessary to develop it.
- Mr. Sekiguchi indicated that the proposed consultation paper did not prioritize the possible actions. Mr. Kellas responded that the initial consultations indicated that the possible actions to contribute to the effective operation of the world’s capital markets are most important. The possible actions to assist with the implementation of standards will also contribute to that aim. The possible actions to address the needs of SMEs and their auditors are separate. The proposed consultation paper asks respondents to comment on the prioritization of the possible actions. The Work Program for 2009 – 2011 will be based on their comments.

Mr. Pacter was invited by Mr. Damant to provide a brief overview of the IASB’s project on financial reporting by SMEs, so that Representatives would have knowledge of the parallel work going forward. Mr. Pacter explained the objective of the proposed IFRS for SMEs, namely: (1) To produce general purpose financial statements for external users, including non-manager owners; existing and potential lenders; vendors, creditors and customers; and credit rating agencies. (2) To

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enable users to understand and compare SMEs' financial position, financial performance, and cash flows. (3) To allow the auditor to express an opinion on the fair presentation of the financial position, financial performance and cash flows of an SME. Mr. Pacter noted that many and varied financial reporting frameworks exist around the world. He presumed that the proposed IFRS for SMEs will be an acceptable financial reporting framework under proposed ISA 200 (Revised and Redrafted), and that the auditor will be able to express a fair presentation opinion on financial statements prepared in accordance with the proposed IFRS for SMEs under proposed ISA 700 (Redrafted). The Representatives commented as follows on the proposed IFRS for SMEs:

- Mr. Peyret was of the view that an SME with a small financial reporting department will not be able to implement the proposed IFRS for SME. He noted that it is an issue of the threshold (that is, the criteria for determining whether an entity is an SME). Mr. Pacter explained that the proposed IFRS for SMEs does not prescribe a threshold – it is to be determined by the jurisdiction. He did not agree that implementation of the proposed IFRS for SMEs will require several employees.
- Mr. Johnson noted that participants in the FEE SME Conference had requested that the proposed IFRS for SMEs be self-contained (as opposed to nearly self-contained). He was of the view that an IFRS for SMEs that contains cross-references to full IFRSs may be misinterpreted by preparers and auditors of SME financial statements.

Mr. Sylph noted that the proposed IFRS for SMEs does not affect the possible actions to address the needs of SMEs and their auditors (C.1 and C.2 in the proposed consultation paper). The possible actions are proposed irrespective of the financial reporting framework applied in preparing SME financial statements. Representatives commented as follows on the possible actions:

- Mr. Diomeda noted that the Basis for Possible Actions section does not contain information about the possible actions to address the needs of SMEs and their auditors. Mr. Kellas explained that relevant information is provided in the Proposed Strategy section. He agreed that the Basis for Possible Actions section should also address the matter.
- Ms. Todd McEnally, Ms. Wood and Messrs. Hegarty, Koktvedgaard, Ratnayake and Roussey explicitly supported the possible action to explore, in consultation with other interested parties, the concept of an alternative assurance service for SMEs and, if considered appropriate, commence a project to develop a standard for such a service if different from International Standards on Review Engagements (ISRE) 2400, "Engagements to Review Financial Statements."
- Ms. Todd McEnally and Messrs. Johnson and Rabine emphasized the importance of not diluting the audit. Mr. Rabine referred to a project of the European Commission that is aimed at reducing the administrative burden of SMEs by 25%. An alternative assurance service was considered as part of this project; however, the Member States did not support this. Messrs. Johnson and Rabine were of the view that such a service should be based on market demand. Mr. Johnson also referred to a project of the Institute of Chartered Accountants in England and Wales (ICAEW) to study the needs of users of SME financial statements. He suggested that any proposed IAASB project run parallel with that project.
- Mr. Diomeda noted that it was suggested at the previous IAASB CAG meeting that a small group of Representatives conduct a study of the needs of users of SME financial statements.

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He asked whether the proposed consultation paper should suggest that the IAASB CAG should conduct such a study. Mr. Damant noted that, at the time, it was agreed that the proposal to conduct a study should be delayed until the finalization of the IAASB Strategy and Work Program for 2009 – 2011.

Clarity Project (Agenda Item F)

To NOTE how the IAASB has considered the CAG Representatives' comments and to RECEIVE an update on the Clarity project.

REPORT BACK

Mr. Kellas referred the Representatives to the report back in the IAASB CAG Paper. In particular, he noted that the IAASB had acknowledged the concerns of the Representatives about the phrase “aim to achieve” in proposed ISA 200 (Revised and Redrafted) and had clarified the obligation accordingly. With regard to the description in proposed ISA 200 (Revised and Redrafted) of the inherent limitations of an audit, Mr. Kellas noted that, although the IAASB accepts that more could be said about the subject from a technical perspective, it believes that the proposed ISA strikes an appropriate balance between content and readability. The IAASB will consider the comments it receives on the exposure draft of the proposed ISA. The Representatives did not have comments on the report backs of proposed ISA 200 (Revised and Redrafted), proposed ISA 700 (Redrafted), proposed International Standard on Quality Assurance (ISQC) 1 (Redrafted), “Quality Control for Firms that Perform Audits and Reviews of Financial Statements, Other Assurance and Related Services Engagements,” proposed ISA 220 (Redrafted), “Quality Control for an Audit of Financial Statements,” proposed ISA 250 (Redrafted), “The Auditor’s Responsibilities Relating to Laws and Regulations in an Audit of Financial Statements,” proposed ISA 500 (Redrafted), “Considering the Relevance and Reliability of Audit Evidence” and proposed ISA 210 (Redrafted), “Agreeing the Terms of Audit Engagements.” Mr. Damant noted that he was pleased with the IAASB’s consideration of the matters raised by the Representatives.

UPDATE

Mr. Kellas provided an update of the clarity project. Mr. Damant noted that the Clarity Implementation Progress against Plan (From October 2006) in Appendix I and the IAASB Program for Rest of 2007 and 2008 in Appendix II were very helpful. He suggested that updated versions are presented at future IAASB CAG meetings.

PRESENTATION BY IAASB CAG WORKING GROUP

Mr. Johnson made a presentation on behalf of the IAASB CAG Working Group monitoring the project. He noted that it was the view of the Working Group that, at some point after the new ISAs have been used in actual audits, it will be necessary to conduct a review to determine whether the Clarity project has been successful. Before this judgment can be made, the Working Group believes it is critical to determine how the success of the Clarity project is to be measured. In this regard, the Working Group made the following observations:

- Particular attention should be paid to how the approach of objectives and requirements in the new ISAs operates in practice to guide and support high-quality audits.

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- Auditor judgment will always be critical in conducting a high-quality audit. Therefore, at a minimum, the following questions should be answered: (1) Do the ISAs allow for the appropriate exercise of auditor judgment? (2) Do the ISAs establish sufficient accountability for auditor judgment?
- The role and use of application material will become more evident in practice as the ISAs are enforced and used and, therefore, should be considered as part of the review.

Other questions that the Working Group has identified as relevant to judging the success of the Clarity project are as follow:

- How have the clarity redrafted ISAs contributed to higher-quality audits, and how much can be expected from the application of the ISAs.
- What can be learned from the experience of the Clarity project?

The Working Group was of the view that determining what a high-quality audit is, is key to judging the success of the Clarity project. It suggested that, as a first step, it may be useful for the IAASB CAG to discuss the following: (1) What is audit quality? (2) Have the clarity redrafted ISAs contributed to the fulfillment of this objective?

The Working Group asked the IAASB CAG to consider whether it should undertake the proposed review and, if so, how it should be resourced. If considered outside the IAASB CAG Terms of Reference, is there value in scheduling discussions of related matters that might inform such reviews by Member Organizations or others? If conducted by the IAASB, should the Working Group deliberate whether the IAASB has applied appropriate judgment in conducting the review? Should such a review be mentioned in the proposed consultation paper on the future strategy of the IAASB?

Mr. Kellas responded that, based on the initial consultations on the future strategy of the IAASB (which included the IAASB CAG), the consultation paper proposes the development of a process for assessing the effectiveness of the implementation of new standards in order to determine whether there is any necessity for further refinement to achieve the intended effect of the new standards. He preferred such an assessment, because a review that focuses on the overall Clarity project (as suggested by the Working Group) may raise the question as to whether the IAASB will start another project. A post-implementation assessment (as proposed in the consultation paper) signifies continuing improvement and will contribute to consistency in application of the standards. The experience of the oversight bodies that monitor audit quality ought to provide an important source of information to the IAASB about how standards are being implemented in practice. Mr. Johnson noted that the Working Group was concerned that such oversight bodies may not have a benchmark against which to measure audit quality. Mr. Kellas referred to the consultation paper on audit quality issued by the Financial Reporting Council in the UK. He noted that audit quality was not defined in terms of the effective application of standards. He noted that audit quality may be best considered as a subset of a conceptual framework.

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To DISCUSS matters highlighted by the relevant Redrafting Task Force or brought forward by the Representatives.

EXPOSURE DRAFT OF PROPOSED ISA 210 (REDRAFTED), “AGREEING THE TERMS OF AUDIT ENGAGEMENTS”

The Representatives had no comments on the proposed ISA.

PROPOSED FINAL ISA 230 (REDRAFTED), “AUDIT DOCUMENTATION”

The Representatives had no comments on the proposed ISA.

PROPOSED FINAL ISA 260 (REVISED AND REDRAFTED), “COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE”

The Representatives commented as follows:

- Dr. Manabat, on behalf of the IAASB CAG Working Group, asked that the Redrafting Task Force consider whether the requirements in paragraph 8 (which deals with communication with a subgroup of those charged with governance) and paragraph 9 (which deals with circumstances when all of those charged with governance are involved in managing the entity) should be application material.
- Mr. Rabine suggested that the reference to the IFAC Code of Ethics for Professional Accountants in footnote 4 (ISA 260.13(a)) be included in the application material. He also suggested that “relevant ethical requirements” be explained by way of cross reference to proposed ISA 200 (Revised and Redrafted), where the phrase is discussed.
- Referring to ISA 260.13(b)(ii), which requires the auditor to communicate with those charged with governance of a listed entity, the safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level, Mr. Rabine noted that in some jurisdictions auditor independence is guarded by law or regulation. It is therefore not a matter of safeguards, but a matter of law or regulation.

Mr. Kellas agreed to communicate the three matters noted above for consideration by the Redrafting Task Force.

PROPOSED FINAL ISA 720 (REDRAFTED), “THE AUDITOR’S RESPONSIBILITY IN RELATION TO OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS”

The Representatives commented as follows:

- Ms. Sucher noted that IOSCO supports the objective. Mr. Rabine was of the view that the objective is an improvement to the one in the exposure draft.
- Mr. Ray noted that it is not clear what “respond appropriately” in the objective means. Mr. Kellas explained that the objective should be read with the requirements and application material. It is not possible to include in the objective all the responses that may be appropriate.

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- Mr. Rabine noted that ISA 720.11 refers to “relevant requirements in [proposed] ISA 560 (Redrafted) ...” and ISA 720.13 refers to “further appropriate action.” As a result, they are not self-standing requirements. He asked whether they meet the clarity drafting conventions.

PROPOSED ISA 560 (REDRAFTED), “SUBSEQUENT EVENTS”

The Representatives had no comments on the proposed ISA.

PROPOSED FINAL ISA 610 (REDRAFTED), “THE AUDITOR’S CONSIDERATION OF THE INTERNAL AUDIT FUNCTION”

The Representatives had no comments on the proposed ISA.

Control Deficiencies Noted in an Audit (Agenda Item G)

To DISCUSS a proposed exposure draft of the new ISA.

Mr. Ashton provided background to the project. He noted that the IAASB will conduct a first read of the proposed ISA at its September meeting.

At the April 2007 IAASB meeting, the IAASB’s discussions focused on how to define the term “material weakness” in the ISAs. The IAASB concluded that the way forward would depend on which of the three options should be chosen. The three options were included in the IAASB CAG Paper distributed for this meeting.

Given that the term “material weakness” is also used in the European Union’s Statutory Audit Directive but is undefined, the IAASB agreed that the views of the European Commission should be sought on this issue. If ISAs were to be adopted in the European Union, it would be desirable for any definition of “material weakness” established in the ISAs to be acceptable to the European Commission for the purposes of the Statutory Audit Directive. Accordingly, John Kellas wrote to the European Commission on behalf of the IAASB. Mr. Ashton noted that the European Commission’s response indicated a preference for Option 3.

Option 3 proposes that the requirement in the ISAs for the auditor to communicate material weaknesses be adjusted to a requirement for the auditor to communicate reportable weaknesses. This option would effectively mean that the term “material weakness” would not need to be defined in the ISAs. However, it would leave individual jurisdictions with the flexibility to define the term for their own purposes.

Mr. Rabine clarified that the European Commission is not driving the project. He noted that the European Commission did not support the proposal for the IAASB to commence a project to define the term “material weakness.” He noted that, if the IAASB does not put the current project to develop an ISA on communicating deficiencies in internal control on hold, the European Commission will support Option 3.

Messrs. Johnson and Ray supported Option 3. Mr. Sekiguchi noted that due process requires that the views of other stakeholders also be considered. He noted that, depending on the outcome of the deliberations, this project may have a significant effect in Japan.

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The Representatives responded as follow:

- Mr. Morris, reporting on behalf of the IAASB CAG Working Group, noted that the Working Group questioned the proposal not to define the term “material weakness.” If not defined, the PCAOB definition may be adopted, while it may not be appropriate as the scope of the audit may be different from that of a listed company in the U.S. It may also give rise to different definitions being developed by different jurisdictions.
- Mr. Roussey noted that the term “reportable deficiency” is considered in the context of communication with management and those charged with governance. However, the existence of a material weakness in internal control affects the scope of the audit (that is, nature, timing and extent of further audit procedures). He suggested that the Task Force consider whether elimination of the term “material weakness” in the ISAs may give rise to unintended consequences. Mr. Ray supported this request.
- Mr. Cassel supported the orientation of the ISA towards a communication objective. He was, however, concerned about the reference to “deficiencies in internal control that have come to the auditor’s attention during the audit.” This may give the impression that the auditor only communicates those deficiencies that he/she has stumbled across. Mr. Ashton explained that the objective and requirements do not override ISA 315 (Redrafted), “Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment.” He referred to ISA XXX.3, which reads as follows: “ISA 315 (Redrafted) requires the auditor to obtain an understanding of internal control relevant to the audit for purpose of identifying and assessing the risks of material misstatement in the financial statements. This ISA requires the auditor to communicate reportable deficiencies that have come to the auditor’s attention during the course of the audit but does not require the auditor to plan and perform specific audit procedures to search for deficiencies in internal control or to form an opinion on the effectiveness of internal control.” Mr. Johnson agreed with Mr. Ashton.
- Mr. Roussey asked why the objective refers to “deficiencies” as opposed to “reportable deficiencies.” He also suggested that the reference to “internal control” be changed to “internal control over financial reporting.” Mr. Ashton agreed to consider this.
- Mr. White was of the view that the definition of the term “reportable deficiency” is circular. He noted that it is not clear how the auditor should determine which deficiencies to report to management and those charged with governance. This may result in a large number of deficiencies being reported. Management and those charged with governance may not know how to prioritize them. Mr. Krantz was concerned that the communication of trivial mistakes may devalue the process. Mr. Ashton noted management often prefers to know about mistakes, even though they may be trivial. Messrs. Krantz and Johnson emphasized the importance of judgment in determining which deficiencies to report to management and those charged with governance. Mr. Ashton agreed to consider including something about prioritization in the ISA. He noted that it may be difficult to be specific about how to prioritize, because the nature of entities, their structures and how they make decisions vary.
- Mr. Ray agreed with the proposal to communicate reportable deficiencies to management and those charged with governance; however, he questioned the detail in which they should be communicated to those charged with governance. Dr. Manabat noted that proposed ISA 260

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(Revised and Redrafted) was very clear as to what should be communicated to those charged with governance. Mr. Roussey suggested that the auditor discuss with those charged with governance the level of detail in which the deficiencies should be communicated. Mr. Ashton agreed to consider the matter.

- Dr. Manabat noted that, in some jurisdictions, law or regulation requires the auditor to report deficiencies to regulators. Mr. Ashton suggested that this be dealt with as a supplementary requirement at the national level.
- Mr. Scicluna asked how the ISA is to be implemented in the case of SME audits. Mr. Ashton was of the view that, except for the fact that the communication of the deficiencies has to be in writing, the situation is not different from that today as ISA 315 (Redrafted) applies in the case of SME audits.
- Ms. Sucher and Messrs. Koktvedgaard and Scicluna asked whether the Task Force has considered including the requirements and guidance in proposed ISA 260 (Revised and Redrafted). Mr. Koktvedgaard noted that since the auditor obtains an understanding of internal control in accordance with ISA 315 (Redrafted), the requirements and guidance may also be well placed in ISA 315 (Redrafted). Mr. Ashton responded that a decision in this regard still has to be made. However, he was concerned that incorporation of the requirements and guidance in proposed ISA 260 (Revised and Redrafted) or ISA 315 (Redrafted) may result in something being lost. He was also concerned about the length of ISA 315 (Redrafted).

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Related Parties (Agenda Item J)

To REVIEW a summary of significant comments on the re-exposure draft of proposed ISA 550 (Revised and Redrafted) and the Task Force's recommendations.

Ms. Hillier presented the topic on behalf of Mr. Tremoliere, who was unable to attend this meeting. She noted that the significant comments on the re-exposure draft of proposed ISA 550 (Revised and Redrafted), "Related Parties" and related recommendations had not yet been discussed with the IAASB. The Representatives were asked for their input in developing the material for the December IAASB.

Ms. Hillier noted that 49 comment letters were received. Overall, there was strong support for the direction proposed in the exposure draft. The Task Force's analysis of the responses highlighted areas in which clarification may be needed, but the Task Force did not expect that the changes in response to the comments will be substantive in nature. She provided a brief overview of the significant comments.

Mr. Cassel, reporting on behalf of the IAASB CAG Working Group, noted that the Working Group is of the view that, generally, the Task Force's recommendations greatly improve the exposure draft.

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OBJECTIVES

- Mr. Cassel noted that the Working Group was of the view that an objective to conclude ((a)(II) of the proposed objective) should not precede an objective to obtain sufficient appropriate audit evidence ((b) of the proposed objective). Ms. Hillier explained that (a)(I) and (a)(II) set the parameters for the auditor's understanding referred to in (a).
- Mr. Cassel noted that the Working Group questioned the deletion of the phrase "irrespective of whether the applicable financial reporting framework establishes related party requirements." He noted that only three respondents had suggested the deletion. He was of the view that the phrase is an important reminder to the auditor.
- Mr. Cassel noted that the Working Group was also concerned about the emphasis on fraud risks ((a)(I)), as opposed to other risks. Mr. Morris expressed a similar view. Ms. Todd McNally was of the view that related party transactions are a major source of catastrophic fraud risk and should receive the utmost attention. Ms. Wood expressed a similar view. Ms. Hillier explained that the objectives need to be comprehensive enough to address compliance frameworks that do not contain disclosure requirements for related party relationships and transactions. In those circumstances, the auditor is primarily concerned about fraud risks. In that context, the Task Force considers it necessary to include the objective to identify fraud risk factors.
- Mr. Scicluna questioned the reference to a compliance framework in (a)(II)(ii). He was of the view that it is part of a larger issue, which ought to be dealt with separately. Ms. Hillier explained that the concept of compliance frameworks is introduced in proposed ISA 200 (Revised and Redrafted) and, therefore, needs to be addressed as necessary in relevant ISAs. Based on comments on the exposure draft, the Task Force is recommending that the auditor's focus be on evaluating whether the effects of the related party relationships and transactions could cause the financial statements to be misleading. Ms. Hillier emphasized that it is not intended, nor appropriate, for the ISA to impose disclosure requirements for related party relationships and transactions when the financial reporting framework does not provide for such disclosures.
- Mr. Rabine asked whether the objective to conclude whether the financial statements, in so far as they are affected by related parties and related party relationships, achieve fair presentation / are not misleading is intended to go beyond the requirements of proposed ISA 700 (Redrafted). Ms. Hillier noted that it was not intended to go beyond the requirements of proposed ISA 700 (Redrafted).
- Ms. Sucher was of the view that the objectives could be more "outcomes based." She preferred objectives that start with "to determine whether" rather than "to obtain an understanding" / "to obtain sufficient appropriate audit evidence" She noted that the objective could focus more on related party relationships and transactions. Ms. Hillier noted that Ms. Sucher's comments have implications beyond the particular ISA.

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PARTIES UNDER COMMON CONTROL

- Mr. Scicluna was of the view that the existence of parties that are under common control increases the risks of material misstatement. He was concerned that the Task Force's recommendations do not reflect an appropriate level of focus on such relationships. Ms. Hillier explained that the proposed revised definition provides for entities that are under common control (i.e., fellow subsidiaries). Where the framework does not contain disclosure requirements for related party relationships and transactions, it may be an impracticable goal for the auditor to identify the full scope of parties under common control because the entity may not have the systems and practices in place to track them. In such circumstances, it would be more practicable for the auditor to obtain an understanding of the entity's organizational structure and where "active" control and significant influence exist. Once into the audit, however, the Task Force believes that it is particularly important that the auditor probes significant transactions outside the normal course of business and explicitly explore the possible effect of common control on such transactions because there may be related fraud risk factors.
- Mr. Hegarty did not support the proposed revised definition. He noted that, in many developing nations, a shareholder, who is an individual as opposed to a company, may own a family of companies. This shareholder may influence the family of companies, while management of a company in the family may not be aware of another company in the family. Mr. Scicluna was of a similar view. Ms. Hillier asked what it is reasonable to expect of an auditor in an environment where management does not have the responsibility to identify those relationships. She noted that this will not be an issue in circumstances when the financial reporting framework requires disclosure of such relationships and transactions, as required in most well-established frameworks, such as IFRSs. The question is how best to achieve the objectives when the financial reporting framework is a compliance framework that does not contain disclosure requirements for related party relationships and transactions.
- Mr. Rabine preferred a definition that closely follows the definition in International Accounting Standard (IAS) 24, "Related Party Disclosures." Ms. Hillier explained that, in the context of an IFRSs environment such as Europe, the IAS 24 definition would be the auditor's first point of reference. The definition in the proposed ISA is relevant only when the definition in the financial reporting framework is deficient.
- Mr. Pickeur did not support the exclusion of the term "dominant influence" from the Definitions section of the exposure draft. Ms. Hillier explained that the Task Force plans to deal with the concept in the application material in the context of fraud risk factors. Ms. Sucher noted that dominant influence is the cause of recent reporting scandals and supported Mr. Pickeur's view that including the definition upfront gives important visibility to the consideration.

ENTITIES CONTROLLED OR SIGNIFICANTLY INFLUENCED BY THE STATE

- Mr. Ju noted that, in China, the accounting standards does not regard enterprises as related to each other merely because they are controlled by the state and such enterprises are then exempted from complying with the disclosure requirements for related party relationships and transactions.

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IMPLICIT ARMS' LENGTH ASSERTIONS

- Mr. Hallqvist was concerned that the proposed ISA does not address the issue of transfer pricing. Mr. Ratnayake described different circumstances in which transfer pricing may occur. Ms. Hillier noted that proposed ISA deals with explicit assertions about transactions conducted at arms' length. This should address issues of transfer pricing. Also, the proposed ISA does not scope out components (as was proposed by some respondents to the exposure draft) and, as a result, should address issues of transfer pricing. Mr. Koktvedgaard cautioned that transfer pricing is often an issue of interpretation of national tax laws and government views, which are beyond the scope of the audit of financial statements.

INHERENT LIMITATIONS

- Mr. Uchino noted that it is important to recognize the inherent limitations that exist in auditing related party relationships and transactions. Ms. Blomme also asked for additional guidance in this regard.

MATTERS TO BE TREATED AS SIGNIFICANT RISKS

- Mr. Cassel noted that the Working Group was concerned about the phrase “by default” as it is open to different interpretation by the audit and legal professions.
- Ms. Sucher supported the recommendation that related party transactions outside the normal course of business should continue to be treated as a significant risk. However, she was not sure about the recommendation not to classify assertions regarding arms' length transactions between related parties as a significant risk.

OTHER

- Mr. Koktvedgaard was of the view that the proposed ISA appears to explain how to apply other ISAs in the context of related parties and questioned whether a separate ISA is needed. Ms. Hillier explained that proposed ISA 200 (Revised and Redrafted) acknowledges that the objectives in certain ISAs may be subsets of the objectives in other ISAs. An ISA on related parties has been existence for a while. It addresses an important area and provides additional requirements and guidance to the auditor in this regard.
- Ms. Sucher noted that the link between the proposed ISA and ISA 315 (Redrafted) and ISA 330 (Redrafted), “The Auditor's Responses to Assessed Risks” is not clear. As a result, the proposed ISA appears to require less than what is required in terms of extant ISA 550. Ms. Hillier responded that, on balance, respondents to the exposure draft were of the view that the link between the ISAs has improved.
- Mr. Pickeur was also concerned that the proposed ISA appears to be more limiting than the original exposure draft. He referred to the deletion of the requirement relating to dominant influence.

Ms. Hillier agreed to bring the comments of the Representatives to the attention of the Task Force in finalizing the summary of significant comments and related recommendations for the December IAASB meeting.

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Accounting Estimates (Agenda Item K)

To REVIEW a summary of significant comments on the exposure draft of proposed ISA 540 (Revised and Redrafted) and the Task Force's recommendations.

Mr. Ashton provided a brief overview of the significant comments received on the exposure draft of proposed ISA 540 (Revised and Redrafted), “Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures” and the Task Force’s related recommendations, which will be discussed at the September IAASB meeting. It is envisaged that the final ISA will be approved at the December IAASB meeting. He noted that a significant majority of respondents expressed support for the IAASB’s decision to combine the close off document of ISA 540 (Revised) with extant ISA 545, “Auditing Fair Value Measurements and Disclosures.” The Representatives commented as follows:

ADDITIONAL APPLICATION MATERIAL

- Mr. Gutterman reported that, with the exception of one member, the IAASB CAG Working Group is satisfied with the manner in which ISAs 540 and 545 have been brought together and with the additional application material. While the text may be a little repetitious in places, this is not a significant problem and it would not be practical to try to change the structure at this stage to address it. Mr. Krantz agreed that the additional application material appears appropriate. Mr. Damant observed that the application material was not unnecessarily onerous. The additions were very much in the right direction, and the resulting text appears to have the right balance.
- Mr. Morris noted that, as the dissenting member of the Working Group, he disagrees with combining ISAs 540 and 545 because fair value estimates are more complex than, and have a different set of issues from, more straightforward accounting estimates such as provisions for litigation claims and obsolescence. He believed that putting the two topics together makes the combined ISA more complex than it needs to be.
- Ms. Blomme noted that there is a great deal of new material, which FEE has not yet reviewed in detail because of time constraints. Because of the diversity of views at FEE, she was not in a position to conclude on the appropriateness of the additional application material at this stage. Some people at FEE thought that the extent of material is too great for SME audits. Others, however, thought that, while modeling is a relevant issue, other issues such as credit risk and actuarial assumptions could also be addressed. Mr. Ashton responded that the Task Force believes that the application material has gone as far as generic guidance can go and that it will work for a good range of situations, e.g., insurance, long-term construction contracts, and extractive industries.
- Mr. Pickeur supported the additions to the paragraph dealing with matters that the auditor may consider in testing a model, which he noted were in line with the submission of the Basel Committee on Banking Supervision.
- Ms. Sucher supported the manner in which ISAs 540 and 545 have been brought together and the criteria used by the Task Force for adding new application material; in particular she agreed with the criteria that industry specific material should not be added except when used as an example. She noted that fair value and other estimates are a key risk area that regulators

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deal with, and was pleased that the Task Force has taken on board the comments in the submission of the Basel Committee on Banking Supervision in a non-industry specific way. She also noted that commentators on the exposure draft generally supported combining ISAs 540 and 545 as the issues are largely the same. Ms. McEnally agreed with this comment. She questioned whether the application material could say more about auditing disclosures, which will become more important as the accounting framework develops and changes. Mr. Damant agreed with this point.

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WORKING GROUP TO DEVELOP FURTHER GUIDANCE

- Mr. Damant sought feedback on the suggestion that the IAASB consider forming a working group to develop further guidance, such as an International Auditing Practice Statement (IAPS), if not a further ISA, in order to address concerns that the standard requires more specificity.
- Messrs. Gutterman, Hegarty, Krantz and Pickeur and Ms. McEnally and Ms. Singh explicitly supported the formation of a working group. Mr. Gutterman was of the view that it should not wait until 2009 because world financial conditions demand that it be given more immediate attention. Mr. Pickeur suggested that the working group be established by the end of this or early next year. Ms. McEnally noted the importance of establishing a diversified working group to support to the IAASB. Mr. Krantz offered the participation of an expert from the World Federation of Exchanges. Ms. Singh noted the willingness of the Institute of International Finance to help.

Mr. Damant emphasized the strong support and offers of assistance from the Representatives, which he urged the IAASB to consider seriously. He noted that the operation of a group may not require a significant amount of IAASB time in 2008.

Mr. Sylph noted that the IAASB will need to consider two practical issues: Whether the IAASB alone should draft the terms of reference for a working group, and whether the formation of a working group would take staff time away from other priority projects. Mr. Hegarty responded that perhaps a subgroup of the IAASB CAG could assist in drafting the terms of reference, and volunteered to contribute to such a group.

Mr. Kellas noted that demand for a working group had been expected given developments in the financial markets. The current difficulty is a lack of market liquidity, and it has become clear that valuations for the purpose of capital markets (not just for accounting) were considered a problem. This casts doubt on the reliability of fair values generally. However, the IAASB can only deal with audit issues, not accounting (or broader capital markets) issues. To this end, the IAASB will likely be able to “sponsor” a working group, but will need to resolve such matters as the status of output from such a group, the constituents to be represented on the group and, particularly if there is substantial involvement of specialists representing other parties on the group, the appropriate mechanisms for IAASB involvement and oversight.

APPENDIX “FAIR VALUE MEASUREMENTS AND DISCLOSURES UNDER DIFFERENT FINANCIAL REPORTING FRAMEWORKS”

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- Mr. Gutterman noted that the position of the IASB is changing, which will likely require significant revision to the appendix. He suggested that the appendix be replaced with a reference to relevant financial reporting frameworks (rather than being a summary). Alternatively, the IAASB could allow for future amendments without the need for due process. Ms. Blomme questioned whether the appendix, which deals with an accounting matter, should be in an auditing standard, particularly as the financial reporting framework is likely to be revised regularly. While she had no objection to the content of the appendix, she was of the view that it may be better placed somewhere other than in the ISA. Mr. Sekiguchi observed that the appendix is a good summary, but asked whether it may be appropriate for the proposed working group, if one is to be formed, to consider whether it should be included in the ISA. Mr. Ashton responded that the proposed working group will take time to consider the matter, and that it is desirable that the material in the appendix is available to auditors in the interim. Mr. Pickeur supported retaining the material in the appendix. Mr. Ashton noted that the Task Force will give further thought to where the material could be placed.
- Mr. Ratnayake noted the importance of estimates in the valuation of biological assets under International Accounting Standard (IAS) 41, “Agriculture,” and asked whether they should be considered in the appendix.

OTHER MATTERS

- Mr. Gutterman questioned whether use of the term “specialist” is appropriate, or whether “expert” should be used. Mr. Ashton responded that use of the term “specialist” is consistent with proposed ISA 620 (Revised and Redrafted), “Using the Work of an Auditor’s Expert” because people with accounting or auditing expertise are excluded from the definition “expert.” The intention of proposed ISA 540 (Revised and Redrafted) in this respect is to make it clear that the auditor may need to seek specialist advice, but that it will often be from an accountant, rather than from a member of another profession.
- Mr. Pickeur asked that the Task Force reconsider whether the requirement with respect to responding to the assessed risks of material misstatement (paragraph 13 of the proposed ISA) should be changed in line with the comments of the Basel Committee on Banking Supervision.
- Mr. Krantz asked about the possibility of aggregating ranges of values. Mr. Ashton responded that footnote disclosure of ranges is gaining favor in accounting circles, rather than aggregation of ranges of values. Mr. Damant noted that for complex financial instruments, complex note disclosure of information such as ranges is needed.
- Mr. Pickeur enquired whether the IAASB is considering re-exposure. Mr. Ashton responded that, in the Task Force’s view, re-exposure is not necessary because the exposure draft was changed mainly to add application material. The basic requirements were not changed.

Mr. Damant noted that, if future guidance is issued as practice statements rather than ISAs, it may not be recognized in all jurisdictions in which the auditing standards have legislative backing. Mr. Kellas responded that, regardless of their legal status, if practice statements are developed, the additional guidance should be welcomed by auditors. Mr. Damant suggested that the proposed working group consider the form in which any additional guidance should be issued.

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Assurance Engagements on Carbon Emissions Information (Agenda Item L)

To REVIEW a proposed project to be considered by the IAASB in December 2007.

Mr. Nugent provided a brief overview of the proposed project. He also noted another potential project to review a recently issued Dutch assurance standard on sustainability reporting to determine whether it provides an appropriate basis for an international pronouncement. The Representatives commented as follows:

- Mr. Krantz expressed his strong support for the project. He explained that the notes to entities' financial statements and other reports often include disclosures about sustainability issues that should be assured. He also noted that some members of the World Federation of Exchanges have set up energy exchanges.
- Ms. Blomme commented that FEE had often encouraged the IAASB to commence a project on assurance on sustainability reporting but was conscious that the Clarity project needed to be the first priority. Given that the Clarity project is scheduled for completion in 2008, she noted that now is an opportune time to commence a sustainability project. FEE would prefer that the broader project (i.e., reviewing the Dutch standard) be commenced, but accepted that a project on emissions may be an easier starting point as it is more narrowly focused, and could draw upon directives/guidance/protocols drawn up for the European Emissions Trading Scheme. If the emissions project is commenced, FEE would still like the broader project to be undertaken in time.
- Mr. Cassel noted that he is very much in favor of the proposed project. He noted that some members of INTOSAI may prefer the broader project to be undertaken.
- Mr. Damant noted that he preferred any project to be focused on a topic such as, in this case, emissions, because it would be difficult to draw a boundary around the broader topic of assurance on sustainability reporting in general. He also noted, however, that from a financial analysis point of view, if a company has environmental issues, they should be disclosed.

Service Organizations (Agenda Item M)

To DISCUSS a proposed exposure draft of the new International Standards on Assurance Engagements (ISAE) 3402.

Mr. Tucker provided a brief overview of the project to develop ISAE 3402, "Assurance Reports on a Service Organization's Controls," noting its connection with proposed ISA 402 (Revised and Redrafted), "Audit Considerations Relating to an Entity Using a Third Party Service Organization." Mr. Nugent provided a brief overview of the key issues. Representatives commented as follows:

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ASSERTION-BASED ENGAGEMENTS

- Mr. Roussey supported the approach in proposed ISAE 3402 that the service organization should take responsibility for the description and make published assertions about the fair presentation of that description, the proper design of controls, and the operating effectiveness of controls. Ms. Blomme also supported the assertion-based approach.
- Mr. Sekiguchi asked whether this approach will result in a different level of assurance. Mr. Tucker responded that the level of assurance would be the same, i.e., “reasonable assurance,” which matches the evidence requirements of proposed ISA 402.

WORDING OF THE SERVICE AUDITOR’S REPORT

- Mr. Roussey supported the approach in proposed ISAE 3402 that the auditor’s report should be worded in terms of the underlying subject matter, rather than in terms of the service organization’s assertions. Ms. Blomme also supported the wording of the service auditor’s report.
- Mr. Scicluna asked whether the issue of a “dirty assertion” could arise for all conclusions within the service auditor’s report. A “dirty assertion” is where the service organization correctly asserts that, e.g., controls are not operating effectively; and the auditor’s opinion states that this assertion is correct. Messrs. Tucker and Nugent explained that, under the proposed approach, any modification is explained in one paragraph, which includes the explanation of its effects. The opinion paragraph, which includes all three opinions, is then introduced with a single “except for” (or other relevantly worded caveat).
- Mr. Morris asked why this model of expressing modifications is being used, noting that it differs from the USA and Canadian model. Mr. Tucker responded that, where the reason for a modification is related to more than one of the opinions, which is often the case, the USA and Canadian model can present unnecessary difficulties for the service auditor in trying to separately explain the effect on each of the three opinions, and the result can be unnecessarily confusing for the reader. He also noted that the proposal would provide the same information to users that they are receiving under the present USA and Canadian model. Mr. Morris asked how this will affect convergence with the USA. Mr. Tucker responded that the Auditing Standards Board of the American Institute of Certified Public Accountants is likely to change to the IAASB model when it is approved. Mr. Ray noted that the PCAOB has not made any decisions (tentative or otherwise) on this matter as yet, and it is not a priority to do so at the moment. Mr. Sylph noted that the potential for convergence on this topic in the short-term may be only for non-SEC registrants.

OTHER MATTERS

- Ms. Blomme noted that the criteria detailed in proposed ISAE 3402 may need further work. Mr. Tucker noted that the criteria were expected to be discussed in detail at the September IAASB meeting.
- Ms. Wood noted that, in a group audit, the group engagement team cannot automatically rely on the component and that, in a sense, a service auditor’s report on that part of the system covered by the service organization is similar to a component audit. She asked how this analogy relates to proposed ISAE 3402. Mr. Tucker responded that the audit of the user

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organization is performed in accordance with proposed ISA 402, which includes relevant considerations for the user auditor, including evidence considerations in using an “ISAE 3402 report.”

- Mr. Morris asked whether the Task Force prefers Type A or Type B reports. Mr. Tucker responded that the Task Force sees only limited application for Type A reports – primarily when the service organization has not been in operation long enough to have a track record that allows for a Type B. Mr. Morris suggested that this be made clearer in proposed ISAE 3402. It was noted that ISA 402 has material to assist the user auditor with how to use Type A and Type B reports. Mr. Roussey agreed with Mr. Morris and suggested that Type A reports could perhaps be dealt with in an appendix, thus ensuring that prominence is given to Type B reports.
- Mr. Roussey suggested there could be more examples of IT controls because service organizations often use IT. He noted that a generic IT control framework could also be mentioned, perhaps in an appendix and offered assistance in this regard, should the Task Force wished to pursue this idea. Mr. Tucker responded that the Task Force has discussed whether it should attempt to develop specific controls and had decided against it, but will reconsider.

Mr. Peyret, who was unable to attend the meeting, had e-mailed comments on this item which will be passed to the Task Force. Mr. Roussey noted that these comments deal mostly with Shared Service Centers (SSCs), and asked whether the Task Force has considered whether proposed ISAE 3402 should apply to SSCs. Mr. Tucker explained that nothing precludes application of the proposed ISAE to SSCs. However, addressing SSCs directly would make the proposed ISAE unduly complicated because of the need to link it with ISA 600 (Revised and Redrafted), “Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors).” Mr. Kellas noted that the issue of SSCs has been raised in the project to revise ISA 402 and that the current draft includes an appendix on this topic for consideration by the IAASB in September. If the appendix is adopted for proposed ISA 402 (Revised and Redrafted), a corresponding appendix may be warranted in proposed ISAE 3402.

Closing

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.