



Agenda Item

A

Meeting: IAASB Consultative Advisory Group

Meeting Location: Brussels

Meeting Date: March 6–7, 2012

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

Held on September 12-13, 2011

Prague, Czech Republic

Marked to Show Proposed Changes from Representatives

PRESENT

Members

Linda de Beer	Chairman
Kristian Koktvedgaard (September 12)	BUSINESSEUROPE
Matthew Waldron	CFA Institute
Federico Diomeda	European Federation of Accountants and Auditors for SMEs
Jean-Luc Peyret	European Financial Executives Institutes
Hilde Blomme	Fédération des Experts Comptables Européens
Philip Johnson	Fédération des Experts Comptables Européens
Robert Roussey	Information Systems Audit and Control Association
Margie Bastolla	Institute of Internal Auditors
Michael Stewart	International Accounting Standards Board
Sam Gutterman	International Actuarial Association
Pat Sucher	International Association of Insurance Supervisors
George White	International Bar Association
Bengt Hallqvist	International Corporate Governance Network
Markus Grund	International Organization of Securities Commissions
Nigel James	International Organization of Securities Commissions
Koichiro Kuramochi	International Organization of Securities Commissions
Filip Cassel	International Organization of Supreme Audit Institutions
Frank Bollman	International Valuation Standards Council
Hayanari Uchino	Japan Securities Dealers Association
Gaylen Hansen	National Association of State Boards of Accountancy
David Morris	North American Financial Executives Institutes
Dominique Pannier	Organization for Economic Cooperation and Development
Simon Bradbury	World Bank
Thomas Krantz	World Federation of Exchanges

Observers

Martin Baumann*
 Giancarlo Attolini

U.S. Public Company Accounting Oversight Board
 IFAC Small and Medium Practices Committee, Deputy Chair

IAASB

Prof. Arnold Schilder
 Diana Hillier
 Phil Cowperthwaite (September 12)
 John Fogarty (September 13)+
 Cédric Gélard (September 12)
 Jon Grant (September 12)
 Daniel Montgomery (September 12)
 Jim Sylph
 James Gunn
 Kathleen Healy
 Brett James

Chairman
 Deputy Chair
 Member
 IAASB Task Force Chair
 Member
 Member
 Member
 IFAC Executive Director, Professional Standards
 IAASB Technical Director
 IAASB Senior Technical Manager
 IAASB Technical Manager

IESBA

Richard Fleck
 Jan Munro

IESBA CAG Chairman
 IESBA Deputy Director

Public Interest Oversight Board

Chandu Bhave

APOLOGIES

Members

Han Fang
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 Marc Pickeur
 Jan Robberecht
 Marie Lang
 Gerald Edwards
 Elena Lobanova
 Dr. Obaid Saif Hamad Ali Al Zaabi
 Paul Koster
 Norio Igarashi
 Ajith Ratnayake
 Yoseph Asmelash

Asian Financial Executives Institutes
 Asian Financial Executives Institutes
 Associação Brasileira de Instituições Financeiras de Desenvolvimento
 Basel Committee on Banking Supervision
 European Commission
 European Federation of Accountants and Auditors for SMEs
 Financial Stability Board
 Graduate School of Financial Management
 Gulf States Regulatory Authorities
 Gulf States Regulatory Authorities
 Japanese Financial Services Agency
 Sri Lanka Accounting and Auditing Standards Monitoring Board
 United Nations Conference on Trade and Development

* Views expressed by PCAOB representatives represent their views and do not necessarily reflect the view of the PCAOB Board or other Board members or staff.

+ Via teleconference

September 12, 2011¹

Welcome and Approval of Minutes of Previous Meeting (Item A)

To APPROVE the minutes of the March 2011 CAG public session.

OPENING REMARKS

Ms. de Beer welcomed the Representatives, including Mr. Grund, a new International Organization of Securities Commissions (IOSCO) Representative replacing Ms. Sucher, who is now representing the International Association of Insurance Supervisors (IAIS) and Mr. Stewart, the new International Accounting Standards Board (IASB) Representative. She noted that two alternates were present at the meeting: Mr. Amir Jusuf, representing the Asian Financial Executives Insitutes on behalf of Dr. Manabat and Mr. Matt Gamble, representing the Gulf States Regulatory Authorities on behalf of Mr. Koster. She also welcomed Mr. Bhavé as the Representative of the Public Interest Oversight Board (PIOB); and the International Ethics Standards Board for Accountants (IESBA) CAG Chairman, Mr. Fleck, as well as Mr. Sylph.

MINUTES OF THE PREVIOUS MEETING

Messrs. Fleck and Hafeman proposed changes to the minutes of the March 2011 meeting to more accurately reflect comments on Agenda Items B (Definition of a Professional Accountant) and M (Auditor Reporting); and the recorded PIOB observer remarks, respectively. The minutes were approved as amended.

Report Backs (Item B)

To REPORT BACK on September 2010 and March 2011 discussions on proposed International Standard on Assurance Engagements (ISAE) 3420 and the IAASB-IASB Liaison initiative.

ISAE 3420²

Ms. de Beer drew attention to matters noted in the report back in the CAG agenda material. Mr. Gunn noted that the CAG had discussed the project on several occasions, including a review of significant comments received on exposure at its March 2011 meeting. He reported that at its March 2011 meeting the IAASB was supportive of the direction proposed by the Task Force and would be asked to approve the final standard at its upcoming September 2011 meeting. He noted that all substantive issues that have been considered by the IAASB were raised with the CAG at its March 2011 meeting, and that at the September 2011 IAASB meeting the primary matters which the Task Force will be asking the IAASB to consider are refinement of an element of reporting and further guidance addressing certain scenarios that are commonly encountered in respect of whether the underlying financial information used in compiling the pro forma financial information has been audited or reviewed.

¹ The minutes present the discussions in the order that they were taken. This may not be the same as that indicated on the agenda.

² Proposed ISAE 3420, *Assurance Engagements to Report on Pro Forma Financial Information Included in a Prospectus*

IAASB – IASB Liaison Initiative

Ms. de Beer drew attention to matters noted in the report back in the CAG agenda material. Ms. Hillier noted that, in addition to the matters described in the, the IAASB wants to communicate with the IASB regarding the results of the IAASB's discussion paper (DP) on disclosures.³ Prof. Schilder noted that many commentators suggested that the IAASB and IASB should be looking at disclosures from a holistic perspective, and both Boards are interested in further exploring this.

The Representatives commented as follows:

- Mr. Stewart was supportive of the continued liaison. He noted the IASB's plans to soon publish another exposure draft (ED) on revenue recognition and that the IASB would appreciate further comments from the IAASB Working Group (WG).
- Mr. Bradbury asked whether IAASB representatives had been able yet to liaise with the new leadership of the IASB. Ms. Hillier noted the intent to do so and suggested that sharing the feedback on the disclosures DP would be an opportune time to do so.
- Ms. Sucher noted that the IASB had recently published a paper on its future agenda. She pointed out that, within the paper there was no mention of the IASB working with the IAASB. She was of the view that, given the weight the IAASB is putting on the initiative, that this would have been appropriate. She questioned whether the IAASB intends to comment on the IASB paper. Ms. Hillier responded that the IAASB would discuss this at its upcoming meeting to consider whether a response would be appropriate.

Audit Quality (Item C)

To DISCUSS matters relating to audit quality highlighted by the Task Force or brought forward by CAG Representatives, including a draft consultation paper (IAASB approval planned for March 2012).

Mr. Grant introduced the topic, noting that the CAG had provided important direction to the project at previous meetings. He noted that the project was at an early stage. A draft paper had been discussed at the June IAASB meeting but the IAASB had not discussed or approved the current draft paper. The IAASB had agreed that the Task Force should circulate the current version of the paper to the CAG and a number of other stakeholders in order to obtain views at an early stage to help shape the Framework on a collaborative basis. Mr. Grant then outlined the approach taken by the Task Force in discussing audit quality, including a proposed diagram of the audit quality framework and highlighted the importance of the interactions between stakeholders, input factors and the differing perspectives of the components of audit quality.

The Representatives and Observers commented as follows:

- Mr. Hallqvist commented that the paper appears to have been developed in the context of the one-tier board structures that are common in the United States (U.S.) and the United Kingdom (U.K.). He noted that two-tier board structures more clearly separate owner representatives from management, and therefore create fewer conflicts of interest in the governance structure. Mr. Grant

³ *The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications*, issued January 2011.

Ms. Hillier also noted the responses on consultation would be discussed with the CAG at its March 2012 meeting.

responded that, while the Task Force did not intend to focus on one-tier board structures, he did not believe the issues were different as the independence of audit committees and the open interactions between those charged with governance and the auditor are equally important for both types of board structures. Mr. Grant noted that two-tier boards may encourage greater investor involvement that may assist auditors. Prof. Schilder agreed, noting that audit committees led by strong, independent chairs are necessary, as well as an open forum for challenging and sharing information.

- Mr. Diomeda suggested that the paper is too long for small and medium sized practices (SMPs) to easily use, and that the framework is too long for incorporation into requirements. He asked if there would also be a quality framework for other assurance engagements, such as review and compilation engagements. Mr. Grant noted that the Task Force has not yet resolved the level of detail to be provided in the final document. Mr. Grant also noted that one option was to produce a list of factors in bullet point form, with associated guidance, and questioned whether this would encourage use of the framework. He highlighted that the Task Force also needed to consider what else could accompany the framework; for example, the threats and safeguards for each stakeholder could be separately identified. Mr. Grant commented that the Task Force had considered the inclusion of assurance engagements, but believed it was first necessary to focus on audit.
- Mr. Hallqvist noted that who nominates the auditor is also important and that it is preferred that an independent audit committee be responsible for doing so. He also noted that cost is rarely the key issue for audit committees.
- Mr. Attolini noted that the IFAC SMP Committee supports the audit quality project and that the development of tools to address audit quality was important. He believed the IAASB is aware of the need to ensure that the final audit quality framework addressed SMP needs. He commented that SMPs share many issues with larger audit practices, though some issues are different, such as the involvement of those charged with governance in management, in many cases the performance of the audit directly by the partner without additional staff and the importance of lenders as stakeholders. He noted that ISQC 1⁴ is fully scalable for smaller entities and using ISQC 1 to support audit quality in SMPs is important.
- Mr. Krantz asked how the audit quality framework would differ if prepared a decade ago. Mr. Grant responded that audit quality is still about knowledgeable and skilled people doing the right thing, although the wider environment has changed as business is more complex and there have been changes in technology, regulation and within the firms themselves. Mr. Grant also noted there was some desire to go back to the foundational basics of the auditing profession, including greater focus on professional skepticism. Mr. Kuramochi noted that the evolution of accounting standards over the last decade has also had an impact on auditing, including increasing the importance of professional skepticism. Prof. Schilder noted that a decade ago there were no clarified ISAs, audit regulators, International Financial Reporting Standards (IFRS), or corporate governance codes and that in the future there will be more integrated reporting.

⁴ International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

- Ms. Bastolla suggested the need for more emphasis on internal auditors, particularly regarding the work done on controls, risk, compliance and attainment of financial and other objectives. She also noted that the paper should mention the auditor's interactions with internal auditors, and internal auditors' interactions with those charged with governance. Mr. Grant agreed.
- Mr. Cassel commented that a stronger emphasis on professional skepticism was needed. He noted that, while the paper is based on all stakeholders pursuing common goals, not all stakeholders have common goals all the times, which poses challenges to audit quality and increases the importance of professional skepticism. Mr. Grant noted that the Task Force will consider whether further material on professional skepticism is needed.
- Mr. Morris noted that the Task Force survey seemed to equate audit quality to audit efficiency, and that the paper needs to have a greater focus on audit quality. Mr. Grant noted that the relationship between audit quality and cost was acknowledged in the paper and that it was a significant issue for audit committees. Mr. White agreed with Mr. Morris, noting that the core objectives of the paper seem to be to (i) minimize risk of audit failure and (ii) reduce errors in audit reporting. However, this was not clear. Mr. Hansen noted that the paper could define audit failures more clearly. Mr. Johnson agreed with Mr. White, noting that investors are looking for assurance on the quality of financial reporting, rather than stopping all audit failures, of which there are few in practice. Mr. Johnson explained that the Fédération des Experts Comptables Européens (FEE) response to the European Commission (EC) Green Paper noted that inputs are good and useful, but the big issue is the desired goals, such as the three-way dialogue between management, the auditor and regulators. Ms. de Beer suggested that the focus on audit quality could be made more clear at the start of the paper. Mr. Grant responded that the quality of individual audits is covered by ISAs so the purpose of the audit quality framework paper was on the broader environment. Prof. Schilder agreed that the output of the audit process is important, as that is what users see, and that the paper should more clearly delineate between efficiency and effectiveness.
- Mr. Kuramochi noted that IOSCO supports the IAASB's focus on audit quality. He noted that a recent article in the Financial Times, titled "Auditors under fire over Greek debt," reported that auditors have not enforced a consistent approach across all their clients. Mr. Kuramochi added that he did not believe that this related to audit quality, but accepted that it may affect perceptions of audit quality. He noted that even within the same firm there are variances in approach, which may have implications for ISQC 1. He asked if, given the notion that an audit is an audit, it would be reasonable for the public to expect the same outcome if the same auditing and ethics standards have been applied to an audit. Mr. Grant noted his personal view that ISAs are only one element of audit quality and, while they provide a structure, define the process, and steer judgments, they do not automatically provide a consistent audit approach within a country or even within a firm due to differences in individual circumstances. Mr. Gunn added that contextual factors are also important, as highlighted in the Greek debt issue. Prof. Schilder noted that judgment is essential to auditing.
- Mr. Koktvedgaard expressed concern that the paper was too ambitious, lacked boundaries and continued to confuse audit quality with audit risk. He added that he believed that it should be possible to have a very high-quality audit at a client where internal controls are weak. He noted that the paper identified weak internal controls as a risk to audit quality, when it actually affects audit risk. He further added that other matters are relevant, including the environment, quality of the accounting standards and quality of an entity's governance. He noted that the audit profession asks

users to trust the audit opinion, but this mechanism fails to distinguish between good audits and bad audits, as all result in an audit opinion. Mr. Hansen expressed the view that the paper was trying to cover too much, and should be restricted to matters within the control of the auditor. Mr. Grant noted that the Task Force had tried to deal with this point by not addressing the quality of an individual engagement but, rather focusing on systemic factors. Mr. Koktvedgaard noted that an implication of the paper was that the higher the level of quality within the company, the fewer procedures auditors need to do.

- Mr. Gutterman supported the paper's emphasis on culture. He noted that culture and relationships are the most significant factors affecting audit quality, such as the relationship between management and auditor and the auditor's willingness to challenge management. He suggested that the paper should give more emphasis to the need to engage experts when appropriate and further delineate the relationship with the various regulators involved, including audit regulators, capital market regulators and business regulators.
- Mr. Jusuf noted that deadlines have an impact on audit quality and asked how this was reflected in the paper. Mr. Grant explained that the paper has some discussion on the topic, particularly about not pressuring the auditor for information too quickly, although short deadlines are a response to market demands. He noted that the Task Force would consider whether more could be added on the topic.
- Mr. Hansen did not support the application of a threats and safeguards approach and asked if this was the default position considered by the Task Force. He also asked if the goal was to establish minimum standards of audit quality. Mr. Grant noted the Task Force's aim to paint a bigger picture to stimulate debate amongst stakeholders; the IAASB already has standards to direct and assist auditors in playing their roles, so the IAASB is looking at a more holistic approach that covers the role of other parties such as audit committees, investors, and regulators.
- Mr. Johnson noted that auditor reporting overlaps with issues of audit quality, as he sees the concerns more on an information gap rather than an expectations gap. In his view, better information on the audit will improve investor perceptions.
- Ms. Sucher noted that the definition of audit quality should be made more prominent in the paper. She suggested that there be greater coverage of the role of, and relations with, prudential regulators, and that paragraphs 31-32 of Agenda Item C-1 were overly focused on how regulators can assist auditors rather than presenting a more balanced perspective. She disagreed with paragraph 62, noting that there is more auditor judgment the higher the estimation uncertainty.
- Mr. Baumann agreed with the concerns expressed by others, and did not believe the paper was on target yet. He noted that the paper still did not deal with assessment or measurement of audit quality by audit committees. He also noted that the paper is more concerned with financial reporting quality. He agreed with Mr. Koktvedgaard that audit quality should be high regardless of the quality of governance or management, and also noted that regulators expect audits to be conducted in accordance with auditing standards. He expressed concern that the paper does a disservice to auditors by implying that audit quality will not be high if those other factors are not high-quality. In this regard, he highlighted that the wording of certain paragraphs was problematic, and made the following observations in relation to Agenda Item C-1, as examples thereof:

- Paragraph 21 – an effective audit can be done irrespective of whether there is cooperation by, or open dialogue with management, such as by expanding the scope of audit or using additional resources.
- Paragraph 40 – auditors should perform high quality audits irrespective of user involvement.
- Paragraph 49 – the paper appears to allow auditors to point to overly complex related party transactions as an excuse for audit failures.
- Paragraph 62 – the paper gives the impression that there is too much judgment involved in applying requirements of the financial reporting framework, and therefore it is difficult to do a high-quality audit, whereas he believes that auditors should be able to perform high-quality audits regardless of the complexity of the financial reporting framework.
- Mr. Roussey agreed that high-quality audits can be performed in adverse circumstances, and noted that other factors help auditors perform better audits. He recommended that the paper explain how these factors help the financial reporting process and help auditors perform better audits, such as pointing out that it is easier to perform a good audit in better environment than in a bad one. Mr. Roussey agreed with Mr. Baumann's comment about financial reporting quality.
- Mr. Grant asked whether the focus on the broader, holistic issues rather than the quality of individual audits has come through clearly enough and noted that the Task Force would agree with Mr. Baumann in relation to an individual audit. Mr. Baumann expressed the view that the practice of auditing should be able to accomplish its objectives and that the paper mixes individual engagements and broader perspectives. Mr. Baumann also disagreed with paragraph 6 regarding the comment that audit quality cannot be accurately measured. Prof. Schilder questioned whether the paper should include an assessment element as this may be more achievable than measurement of audit quality.
- Mr. James asked if the survey of stakeholder perceptions had, guided respondents towards a particular view of audit quality rather than taking the approach of a broader, more open survey that seeks views on audit quality. He asked if a roundtable would help to obtain additional perspectives. Mr. Grant acknowledged that there were a number of ways in which views could have been obtained. He observed that, while they helped the Task Force, the survey findings were not determinative, and further interactions with stakeholders was planned over coming months, including the issuance of a consultation paper.
- Mr. Pannier noted that the paper was too lengthy, and needed to be better organized to give a sense of relative priority. He supported including a section dealing with matters within the control of the auditor first, then other matters, and that the survey elements should be integrated into each section. Prof. Schilder noted that, as the project is in an early phase a longer paper is needed, but a shorter paper containing questions that an audit committee could ask could also be developed.
- Mr. Waldron noted that relationships and auditor rotation may also form part of audit quality.
- Mr. Roussey expressed the view that the paper would benefit from a greater focus on professionalism, as he would like to see auditing go back to being a profession rather than competitive business. He noted that the paper could assist this by covering the auditor's responsibilities in the financial reporting process, such as the need to perform the audit in the public interest and how the auditor adds to the credibility of financial reporting. He also asked if the paper

could cover the issue of moving the audit from being viewed as a commodity for which the focus is on obtaining the lowest price. Mr. Roussey recommended that the paper cover the challenges caused by overly principles-based and overly rules-based accounting frameworks. He noted that the U.S. went to rules-based accounting to give auditors rules to follow and enforce with clients, instead of having difficult discussions over principles. He suggested the major international firms should be asked to adopt the audit quality framework in some way.

- Mr. Hallqvist expressed the view that there are cost limitations in audits, and that auditing firms should decline work if the fees are too low, or time is too limited, in order to ensure audit quality. He noted that some companies are very greedy about fees and firms should decline rather than accept such engagements.

REPORT BACK

Ms. De Beer drew attention to matters noted in the report back in the CAG agenda material.

CONCLUSION

Ms. de Beer summarized by noting that the comments from the Representatives and Observers indicated that further refinement of the paper was needed, including revisiting the level of detail and ensuring the focus is on audit quality rather than financial reporting quality or other areas.

Mr. Grant reminded the CAG that the project was at an early stage and thanked the CAG for their very helpful observations, some of which, he noted were consistent with previous CAG meetings. He expressed concern about Mr. Baumann's comment regarding the paper doing a disservice to auditors. He emphasized that the Task Force was trying to describe the different elements of audit quality with a view to improving it, and agreed with Mr. Roussey that professionalism on the part of the auditors is fundamental. He also agreed that there needed to be further discussion about the decision to not focus on individual audits. He acknowledged the comments regarding the length of the paper and explained that this was also a concern of IAASB that the Task Force would try to address when the project was a little more advanced. Prof. Schilder thanked the Representatives and Observers for their comments.

ISA Implementation Monitoring (Item D)

To RECEIVE an update on plans for the second phase of the IAASB's project to monitor the implementation of the clarified ISAs (IAASB approval planned for September 2011).

Mr. Grant introduced the topic, noting the Phase 2 plan was being presented to the IAASB for approval at its upcoming meeting. He drew the Representatives' attention to the Appendix of the agenda material, which highlighted the main discussions and meetings with stakeholders to date. In relation to small- and medium-sized entities (SMEs), he noted that a survey was done in 13 countries, developed to monitor three years of implementation of the clarified standards (including the year preceding implementation), relating to the implementation of the clarified ISAs for smaller audits.

Mr. Grant explained the challenge in structuring the post-implementation review and outlined the proposals of Phase 2, which included the aim of a clear, appropriate and practical approach. He noted that the plan acknowledges that there are others not directly targeted, who may have information that

would be useful to the IAASB. The views of the CAG in this regard would be helpful. He noted that information on Phase 2 would be made available on the IAASB website.

The Representatives and Observers commented as follows:

- Mr. Krantz offered the assistance of the World Federation of Exchanges (WFE) to gather additional information.
- Ms. Blomme expressed overall support for the project and agreed that, at the primary level, the stakeholders to be consulted in Phase 2 seemed appropriate. At the secondary level, Ms. Blomme suggested that preparers might also be usefully involved. She also noted that, in Europe there is a difference between standard setters and the policymakers to adopt the clarified ISAs. This may affect who is considered to be a stakeholder for purpose of these consultations.
- Mr. Diomeda supported the approach of gathering information from smaller firms. To this end, he suggested that more countries in Europe could be surveyed and offered the assistance of the European Federation of Accountants and Auditors (EFAA) for SMEs. Mr. Grant noted that further input from EFAA would be useful since extending the current survey (which has been in progress for 18 months already) would not necessarily be efficient.
- Mr. Attolini commented specifically that the SMP Committee is pleased with the manner in which the IAASB includes SME considerations in many of its projects. He supported this project as a means to understand problems and difficulties that might arise in the application of the clarified ISAs. He cautioned, however, that it may still be too early to get a full picture on a wider introduction of the clarified ISAs as the standards have not yet been translated in many jurisdictions, noting that Europe only began its translation activities in 2011. In his view, this might delay the impact of introduction of the ISAs, but he believed that discussion with translating countries who had not been using the ISAs prior to the Clarity Project could be a useful longer-term initiative of the IAASB.
- Mr. Stewart, whose role at the IASB includes developing post-implementation reviews, suggested the IAASB could make use of quality reviews done by others, such as regulators and firms in other countries, to see what lessons have been learned and understand whether the goals of the clarified ISAs have been achieved. In his view, this was likely to be more efficient than reperforming quality reviews, which can be challenging due to confidentiality and resource issues. Mr. Grant agreed that the goal is to obtain as much independent input as possible, including self-assessment information by the firms and to continue engagement with audit inspection bodies. He explained that in the U.K., and likely Canada and South Africa, audit inspectors are aiming to perform root cause analyses based on their findings, to determine whether there are problems with the auditing standards themselves.
- Mr. Kuramochi noted IOSCO's support for the project as a follow-on from the IAASB's standard-setting activities. He cautioned that the IAASB should be careful not to increase the expectations gap by implying that use of the clarified ISAs would lead to a consistent outcome of audits.
- In relation to the question of effectiveness of the clarified ISAs, Mr. Kuramochi raised IOSCO's view that further exploration of whether experts and specialists have been appropriately involved in audits is necessary. It was suggested that, because of the changes in financial reporting frameworks, such expertise is likely needed to enhance audit quality. He was of the view that, while actuaries and other experts may be required to have specific qualifications, this is not necessarily

the case for valuation specialists dealing with financial instruments. Mr. Bollman offered the assistance of the International Valuation Standards Council (IVSC) in this regard. He explained that, while there is not an accreditation in place for financial instrument experts, the IVSC's standards are aimed at providing a recognized platform/set of standards for experts to use when valuing financial instruments.

- Mr. Gutterman was of the view that a focus on ISA 620,⁵ in particular to ask experts whether they believe they have been utilized appropriately, would be a useful assessment to determine whether effectiveness has improved over time.
- Mr. Kuramochi also specifically noted ISA 540⁶ should be monitored, due to the increasing use of estimates in financial reporting frameworks. Mr. Grant agreed, citing current concerns with the financial reporting frameworks, financial instruments and the application of professional skepticism. He explained that he has asked IFIAR to report on audit inspection findings in relation to estimates in order to assist the IAASB.

Mr. Grant thanked the Representatives and Observers for their comments. In relation to the suggestion that the monitoring was premature, he explained the IAASB's attempt to balance timeliness with a need to gather information, in light of the time that it would take to change any standards if such action was considered necessary. He agreed that the topic would continue to be on the IAASB's agenda for the foreseeable future. Ms. de Beer noted she would convey the CAG's support for the Phase 2 plan at the upcoming IAASB meeting.

Professional Skepticism (Item E)

To EXPLORE and SHARE viewpoints on the topic of professional skepticism in the context of audits of financial statements.

Ms. de Beer introduced the topic, noting professional skepticism was not a current project on the IAASB agenda, although it is linked to the audit quality project. This was raised in the March 2011 private session of the CAG as important and hence the paper on this agenda. She explained that the objective of the discussion was for the CAG to consider issues relating to professional skepticism. The agenda material illustrated how professional skepticism is currently addressed in the ISAs. She noted that the CAG does not run its own separate projects, so it would therefore be necessary for the CAG to offer advice to the IAASB as to whether and how this matter should feed into projects on the IAASB's agenda. Mr. Gunn commented that, while he was not privy to the CAG's discussions in its private session when it was determined this topic should be discussed, he sensed that the need for the discussion came about because of the financial press, regulatory dialogue and results from audit inspections. In his view, there are many questions about how professional skepticism can be best evidenced, documented, reviewed and understood, and the agenda material was also meant to stimulate thinking in this regard.

⁵ ISA 620, *Using the Work of an Auditor's Expert*

⁶ ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

The Representatives and Observers commented as follows:

- Mr. Baumann thought the agenda material was a good thought piece, and that professional skepticism is a matter of incredible importance, as evidenced by the number of authorities who are raising questions on it. He questioned why so many people, including regulators, feel skepticism is lacking in audits if the ISAs and U.S. Public Company Accounting Oversight Board (PCAOB) standards lay it out as clearly as he thinks they do. He suggested that it may be necessary within the standards to more clearly articulate what the threats to the practical application of professional skepticism are, including the concepts of client service and long-term client relationships, and whether this negatively affects professional skepticism to the point where the engagement team simply accepts the fact that management is honest and prepares the financial statements accurately. Mr. Baumann also noted that the PCAOB has issued a concept release on independence and objectivity, exploring the long-term relationships between auditors and entities.
- Mr. Fleck agreed that there is a link between the relationship that an audit firm has with a company and its management and the rigor in which professional skepticism is exercised. He explained that U.K. bodies are looking to stimulate increased discussion between stakeholder groups, in particular investors and auditors, with a focus on changing the relationship between auditors and management and clarifying who investors look to for information about the entity. In addition, the U.K. is considering whether auditors should be permitted to accept non-audit engagements without specific approval from those charged with governance.
- When asked by Prof. Schilder to expand on why inspectors have cited a lack of professional skepticism, Mr. Baumann explained the view that auditors had not significantly challenged management's judgments, and did not obtain sufficient appropriate audit evidence, including alternate sources of evidence. He questioned what the root cause of this may be, suggesting it may be the tone at the top of the firm, for example if the firm encourages maintaining client relationship compared with getting to the right answer. Representing an audit regulator view, Mr. Gamble agreed that auditors did not seem to be challenging management and overuse the management representation letter as a means of audit evidence. He cited a lack of evidence in the audit file demonstrating that auditors are challenging management's judgments. Ms. Sucher explained that prudential regulators had been surprised that auditors had accepted particular valuations and disclosures. Mr. Koltvedgaard was of the view that regulators are partly to blame, for their checklist-based approach to inspections.
- Mr. Gamble expressed a personal view that an accounting profession does not exist, because there is no accountability to shareholders, but only to management. In his view, auditing seems to be driven by cost.
- Mr. Gunn questioned whether there have been indications of non-compliance with the standards. He explained that the ISAs address the concept of sufficient appropriate audit evidence and suggested that, in the absence of non-compliance, regulators and inspectors may desire a change in the role of the auditor. Ms. Sucher noted that debate exists even among audit firms as to what is meant by professional skepticism. Mr. Fleck agreed. Ms. Sucher also believed that the concept of presumptive doubt could be explored further.
- Mr. Fleck explained that the U.K. Auditing Practices Board (APB) has the benefit of confidential reporting from the U.K. Audit Inspection Unit (AIU) about issues that have been noted in

inspections. He cited examples of differential valuations of the same assets, statements simply indicating agreement with management, and firm policies of not retaining notes that lead up to the audit conclusions, which may otherwise provide evidence of the debate that goes into forming these conclusions. In his view, lack of documentation taints the conclusion, as inspectors do not have visibility into the auditor's thought process. He also noted that none of the competency frameworks of the major firms discusses professional skepticism. The APB hopes to publish a discussion paper in December exploring (i) the definition of professional skepticism; and (ii) whether there are gaps in the ISAs, for example in relation to misstatements and errors. In addition, further work is planned to determine whether more is needed in the context of ISQC 1 on what competencies auditors now need given changes to the accounting standards and the complexity of international business.

- Further, in relation to the ISAs, Ms. Sucher was of the view that, although there is a robust discussion about professional skepticism in ISA 200⁷ and the topic is also addressed in ISA 540, more may be needed in other ISAs to explain how professional skepticism affects the auditor's risk assessment and the identification of significant risks. She noted that many regulators believe there is not enough in the ISAs, although the concept is addressed in ISA 700,⁸ to explain the auditor's need to stand back in the context of disclosures in the financial statements. Finally, she noted that more could be explored as to how much the auditor communicates with those charged with governance. Mr. Baumann believed that while the standards could be more descriptive, the perception of a lack of professional skepticism may persist. Mr. Gamble agreed.
- Mr. James believed the issue was how professional skepticism is applied in practice, rather than how it is defined. He noted that one of the main attributes that should be emphasized is independence of mind. Mr. Peyret was of the view that this was particularly important in circumstances when matters that may not be significant for a group audit would have implications for statutory reporting.
- Mr. Kuramochi raised the concern that, because audit fees are limited, auditors may be under pressure to ignore concerns in order to meet budget. In his view, due to the reduction in audit fees after the financial crisis, auditing has become more checklist-based which may not be conducive to exercising professional skepticism appropriately. Mr. Roussey agreed, citing an example where new staff added to budgetary pressures could lead to a failure to develop new staff. He also noted that changing ways of communication, for example by e-mail, did not allow for staff to appropriately interact with the client. He suggested outsourcing of work, either to member firms or other firms in other countries, could also lead to issues.
- Mr. Krantz suggested the agenda material could be promulgated as training material for auditors and encouraged the IAASB to explore whether the material could be published as non-authoritative guidance. He expressed the view that, while most audits go well and the auditor should not begin with a negative relationship with management, professional skepticism is essential to the role of the auditor.

⁷ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

⁸ ISA 700, *Forming an Opinion and Reporting on Financial Statements*

- Mr. Diomeda commented that the concept of professional skepticism needed to be linked to the auditor's character and behavior, which requires the auditor to be properly trained and would also require feedback after inspection. Mr. Diomeda noted that professional skepticism is closely linked to professional judgment. In his view, auditors could benefit from case study examples to illustrate best practices. Mr. Hansen explained that culture may also affect the application of professional skepticism. He believed that training on a regular basis to re-emphasize professional skepticism is the primary solution. Mr. Johnson agreed.
- Mr. Pannier believed it would be useful to understand what the incentives are that are driving auditors' performance assessments in order to understand how professional skepticism was considered within the audit firms.
- Mr. Cassel was of the view that the function of audit was to increase confidence, but that the auditor's communication and reporting do not necessarily effectively do so. He cited the example of academics and lawyers, whose reporting format often allows for them to describe things that support their conclusion but also highlight other important matters to which they want to draw attention. He suggested that it was not necessary for the IAASB to undertake a specific project on professional skepticism but to be mindful of the topic when revising the ISAs and in the context of the auditor reporting project.
- Mr. Koltvedgaard believed that exploring the concept of professional skepticism should be done in the context of the audit quality project, and acknowledged there were also links to the auditor reporting project. In his view, if education of the profession is needed, this should be done by the International Accounting Education Standards Board (IAESB) or by the International Federation of Accountants (IFAC).
- Mr. Johnson did not believe there was a lack of professional skepticism in audits, nor that the audit is driven by fees and costs. Ms. Hillier agreed, citing a disconnect between the perception of a lack of professional skepticism and her experience within an audit firm by those dealing with a difficult and complex world. She suggested that further dialogue is necessary to understand the perceived issues. Mr. Johnson acknowledged that auditors have for some time limited the amount of documentation in the audit file due to the litigious environment. In his view many discussions challenging management take place during the course of the year and clients often come to auditors seeking advice, although this may not be documented well. He suggested that reaction from the firms would be helpful to respond to the concern that auditors are not appropriately challenging management.
- Mr. Gutterman explained his view that this is a process of curiosity, being skeptical and to challenge. He believed that it was important for the auditor not only to be skeptical about the outcome of management's process, but also the basis of the outcome. He provided the example of the requirement in ISA 540 for the auditor to challenge the assumptions underlying an accounting estimate, explaining that being professionally skeptical would mean determining whether management was using a reputable industry-based model and considering whether management had been doing things the same way for years.
- Mr. Morris noted that most preparers are examined both by auditors and other regulatory bodies. He suggested exploring what an auditor does compared to what a regulator does would be helpful

in understanding whether the level of skepticism differs and whether the auditor's level of skepticism is appropriate.

Mr. Gunn welcomed these differing views and suggested the IAASB Steering Committee would consider them further. He cautioned that, before embarking on definitive actions, the IAASB would need to debate what the best way is to stimulate or articulate professional skepticism and how best to understand the expectations of regulators in this regard. Prof. Schilder agreed, noting he was grateful for the open discussion and the suggestion that further discussions with others were necessary, in particular through ongoing outreach with regulators such as IFIAR and the European Audit Inspection Group (EAIG). He noted the views that there were links with audit quality, auditor reporting and the IAESB and IFAC. Ms. de Beer suggested that enhanced understanding related to the concept of professional skepticism would be helpful, and agreed that the topic of professional skepticism may not be a separate project, but a point of emphasis in other IAASB projects.

The Auditor's Responsibilities Relating to Other Information in Documents Containing or Accompanying Audited Financial Statements and the Auditor's Report Thereon – ISA 720 (Item F)

To DISCUSS matters highlighted by the Task Force or brought forward by CAG Representatives (IAASB approval of exposure draft planned for September 2011).

Mr. Gélard introduced the topic, noting the CAG had discussed the project at its March and September 2010 meetings, as well as March 2011. He noted that the IAASB would be asked to approve the exposure draft at its upcoming September meeting.

REPORT BACK

Mr. Gélard drew attention to matters noted in the report back in the CAG agenda material.

SCOPE OF ISA 720

Mr. Gélard explained that feedback received indicated that, in the minds of readers, there continues to be ambiguity as to which "accompanying documents" are intended to be within or outside of the scope of proposed revised ISA 720. He explained that the Task Force was putting forth two proposed options for the IAASB's consideration as to how the nature and purpose of the documents should be articulated in the standard, to assist auditors in determining to which documents their responsibilities relate.⁹

The Representatives and Observers commented as follows:

⁹ These two options were characterized in the agenda material as Option A and Option B. Option A proposed that the other information "is prepared to accompany audited financial statements and the auditor's report thereon, and: (i) has a primary purpose of providing commentary to enhance the intended users' understanding of the entity and its environment; and (ii) its subject matter is within the auditor's understanding of the entity and its environment acquired during the course of the audit." Option B proposed that the other information "Is prepared to accompany audited financial statements and the auditor's report thereon, and has a primary purpose of providing commentary to enhance the intended users' understanding of the audited financial statements and the financial reporting process."

- Mr. James suggested that further consideration may need to be given to the timing of availability of the information, in light of law or regulation that may require auditors to have some responsibility for other information that may not meet the definition included in the proposed revised ISA, because of the time at which it is available. Mr. Gélard noted that the prior wording had been revised as to documents that are “intended to be made available to the intended users along with, *or at about the same time as*, the initial release, typically annually, of the audited financial statements and the auditor’s report thereon” to address this issue. He also confirmed that this indication of timing would be the same regardless of whether Option A or Option B is chosen for the ED.
- Mr. James noted that some IOSCO members were unsure whether expanding the extant ISA to cover those documents in either Option A or Option B would improve audit quality, as the auditor may not wish to be associated with some of the documents contemplated under both options. Mr. Gélard noted that, to mitigate this concern, application material had been specifically drafted to exclude documents of which the auditor may not have any knowledge.
- Mr. Roussey questioned how the proposed revised ISA addresses documents filed on the company’s website. Mr. Gélard explained that the application material notes that documents within the scope of the ISA may be made available to the intended users in the form of printed hardcopy, or electronically, including by posting on the entity’s website. Although the auditor is not expected to search the entity’s website for documents that are within the scope of the ISA, a document that meets the criteria in explained in the definition section of the proposed revised ISA is within the scope of the ISA, irrespective of the manner in which it is made available to the intended users.
- Mr. Koktvedgaard supported the proposed revised ISA, and requested clarification as to whether an auditor would be required to follow ISA 720 in opining on the financial statements. Mr. Gélard explained that this would be the case.
- Mr. Morris suggested that, regardless of the option chosen, the Task Force should consider whether inserting the phrase “that the auditor is aware of” in relation to the auditor’s responsibilities for other information. In his view, in today’s environment when public companies file various documents at the same time as the financial statements, there may be information the auditor is not aware of and, if the auditor is associated with it, it may be increasing the expectations gap. Mr. Gélard noted that, while there is a requirement in the proposed revised ISA for the auditor to make appropriate arrangements with management or those charged with governance to obtain, prior to the date of the auditor’s report, documents that are within the scope of the ISA, there may be more that could be done to respond to this concern. Prof. Schilder noted that there is always a risk that matters are not brought to the auditor’s attention. In his view, in the future this concern might be mitigated by the auditor reporting on the ISA 720 responsibilities and the documents the auditor has read. Mr. White supported this suggestion.
- Ms. de Beer noted the clear link between this debate on the consideration of the two options and the auditor reporting project.

With respect to a preference for Option A or Option B, the Representatives commented as follows:

- Messrs. Roussey and Waldron and Ms. Sucher preferred Option A for the following reasons:
 - Ms. Sucher believed the suggestion of scoping in “subject matter [that] is within the auditor’s understanding of the entity and its environment acquired during the course of the audit” was a

useful way forward. In her view, Option B may be perceived as narrowing the scope of extant ISA 720 if readers do not believe annual reports are included in the scope of the revised ISA. Mr. Gélard clarified that this was not the intention of the Task Force in proposing either option and that annual reports would remain in the scope of the proposed revised ISA.

- Mr. Waldron was of the view that the broader scope of Option A was keeping in line with the objective at the onset of the project to enhance the auditor's value-add in this area. He believed investors would find the auditor's involvement with additional information more useful, and reiterated the view that their responsibilities for this information should also be described in the auditor's report. Mr. Roussey supported Mr. Waldron's point, although he noted that this may create additional legal issues for the auditor.
- Messrs. Koktvedgaard and White and Ms. Blomme preferred Option B for the following reasons:
 - Mr. Koktvedgaard was of the view that preparers would favor Option B as it appropriately and clearly narrows the auditor's focus. He acknowledged, however, that legislation may require auditors to review other documents.
 - Mr. White believed Option B would be better understood by users in the context of the auditor's report, because of the primary purpose of these documents. He also felt that Option B appropriately recognizes the core competencies of the auditor and places boundaries on the risk of liability on the auditor.
 - Ms. Blomme agreed there were some merits in Option A in light of the request to auditors to extend their role. In her view, since the information covered by Option B naturally follows out of the audit process, this option would be preferred. In her view, it would be more clear that the auditor has not provided separate assurance on the other information if Option B is selected. Prof. Schilder noted that requests for assurance on certain other information that might be scoped into the ISA under Option A are also being explored in the auditor reporting project.
- Ms. Sucher inquired as to whether the intent of either or the proposed options would be to cover Pillar 3 information (required banking disclosures) that currently may be published at the same time as the bank's annual report. In her view, she would presume it would be covered under Option A, but it was less clear whether it would be covered under Option B. Mr. Gélard agreed with her presumption and noted further consideration may be needed on the matter. Ms. Sucher noted her communications with credit rating agencies had indicated that they use Pillar 3 information to understand the banks' audited financial statements.
- Mr. White suggested that it should specifically be clarified in the application material whether presentations to credit ratings agencies fall into the scope of the proposed revised ISA. Mr. Gélard noted that, while the intent of the proposed revised ISA was to say that the intended users of the other information would be the same intended users as the audited financial statements, the Task Force would consider the matter further.

OTHER MATTERS

The Representatives and Observers commented as follows:

- Ms. Sucher agreed with the suggestion that both options considered should be included in the ED. Ms. de Beer agreed and noted that CAG generally seemed to support this, as well as the proposal to include a question in the ED to ask respondents for their view on whether the scope of proposed revised ISA 720 has been clearly defined, including whether it has been appropriately circumscribed.
- Ms. Sucher did not support the proposed changes to the requirement in paragraph 12 of the ISA as a result of the March 2011 IAASB meeting in relation to financial data included in the other information. In her view, this was a weakening of a requirement that she supported for the auditor to perform procedures on this financial information, as the application material now describes the procedures as a matter of professional judgment. Mr. Gélard explained that the Task Force's intention was not to weaken the requirement, but rather introduce the ability for the auditor to test management's reconciliation. In his view, such judgment would be made with consideration for the likely material effect of an inconsistency in the financial data on the credibility of the financial statements. He also noted that the amendment of the requirement and the corresponding application material was made to take care of the practicalities of the work done.

Compilation Engagements – International Standard on Related Services (ISRS) 4410 (Item G)

To DISCUSS significant comments on the exposure draft of proposed ISRS 4410 and the Task Force's recommendations (IAASB approval of final standard planned for December 2011).

Mr. Cowperthwaite introduced the topic, noting that the draft ISRS 4410¹⁰ will be presented to the IAASB for approval in December. He highlighted that compilation engagements did not provide assurance, though users may take assurance. However, the involvement of professional accountants is in the public interest, even though management still takes responsibility for the information.

REPORT BACK

Mr. Cowperthwaite drew attention to matters noted in the report back in the CAG agenda material.

SCOPE

Mr. Cowperthwaite asked the Representatives for views on the proposed scope of ISRS 4410, which requires the professional accountant to comply with the ISRS if the professional accountant asserts compliance. He noted that many respondents supported this scope. However some believed that this enabled practitioners to opt out of the standard. The respondents' comments also showed that some jurisdictions understood compilations well, whereas other jurisdictions were less familiar with this type of engagement.

The Representatives and Observers commented as follows:

- Mr. Koltvedgaard commented that most people involved in management would not know about ISRS 4410, and would expect the professional accountant to follow a standard if one is available, so such engagements should be covered by the standard. He suggested that the IAASB's focus

¹⁰ International Standard on Related Services (ISRS) 4410, *Compilation Engagements*

should be on enhancing quality in compilation engagements, meaning application of the ISRS should be mandatory. Mr. Cowperthwaite responded that new application material indicates that, if the professional accountant is performing an engagement that is close to that envisaged by ISRS 4410, the professional accountant should consider reporting in accordance with the ISRS. Mr. Cowperthwaite also noted that there are engagements that are similar to compilations but the nature of the subject matter information prevents the professional accountant from complying with the ISRS, therefore mandatory application would not be advisable. Mr. Stewart noted that a requirement may limit the provision of different but similar services.

- Mr. Koktvedgaard asked what such a report could cover as users may think that the provision of a report means that a standard was followed. He questioned whether this leaves an expectations gap.
- Ms. Blomme asked if the professional accountant could use any part of the standard, without using all of it. Mr. Cowperthwaite confirmed this understanding, but noted that if the professional accountant states that he complies with ISRS 4410, the professional accountant has to comply with the whole ISRS. Mr. Cowperthwaite noted that this matter could arise, for example, when compiling non-financial information.
- Ms. Blomme commented that she found that it to better understand the scope in the ED than the currently proposed version, where it is now some of the material currently included in the application material (A3) could usefully be included in the introductory paragraphs 1 and 2. She added that, in respect of the scope, extant ISRS 4410 is clearer as far as what is not covered by the standard.

REPORT

Mr. Cowperthwaite highlighted that many responses noted that the proposed compilation reports are too similar to assurance reports. He explained that the Task Force has amended the language in the “long form” report in response, but that many of the elements of the proposed report were necessary to provide clarity of the scope and respective responsibilities, as well as important caveats regarding the nature of the engagement. He also noted that the Task Force has developed a “short form” report, but did not believe it could be used in many circumstances as it would not convey key information.

The Representatives and Observers commented as follows:

- Mr. Roussey supported the long form report, but also noted that the term “compiled” may not be well understood by users, and “assisted you in the preparation of the accompanying financial statements” may be better as it mirrors the language in the second paragraph. Mr. Cowperthwaite noted that the Task Force had explored this, but that discussions with FEE had previously indicated that such language undersold the level of service provided.
- Mr. Diomeda did not support retaining the caveats in the report as he believed they would confuse users. He believed that the report language needed to be positive as it is not a mandatory engagement and should avoid the debate around language in audit and review reports. Further, he did not support the proposal that the content of the report cannot be changed by the practitioner. Mr. Cowperthwaite noted that review reports also had caveats.

- Mr. Grund asked if the practitioner could state they have partly or materially complied with the ISRS. Mr. Cowperthwaite explained that the practitioner could add to the wording in the report but cannot remove any required material.
- Mr. Baumann supported the long form report as it clearly states it is not an assurance engagement. He noted that the ISRS should not use the term “assisting with preparation” as this would include the setting of accounting policies, making journal entries and other matters.
- Mr. Hansen also supported the long form report as he believed that the longer report is clearer about the practitioner’s involvement, which is necessary as users may not otherwise understand who is responsible for the financial statements.
- Mr. Attolini noted that the SMP Committee was still finalizing their comment letter. His personal view was that the long form report is clearer and would avoid underselling the practitioner’s involvement. He explained that the SMP Committee has some data from quick poll of SMPs who were asked two specific questions about which services are most important to SMPs. He noted that 700 responses were received, and that accounting and compilation makes up 40% of revenue, whereas audit and assurance is around 30%, and that 38% said that accounting and compilation was the fastest growing source of revenue. He believed that the ISRS will be helpful in those countries that already use compilation services, as well as those countries requesting compilation engagements.
- Mr. Jusuf supported the long form report, but suggested that the references to audit opinions or review conclusions were redundant and would not help users. Mr. Cowperthwaite noted that respondents thought these words were important and that there had also been specific comment from some respondents supporting the inclusion of “[this] is not an assurance engagement.”
- Ms. Blomme agreed with Mr. Diomeda and Mr. Attolini. She believed that some of the material in the first paragraph of the long form report could be in the paragraph regarding management’s responsibility.
- Mr. Koktvedgaard asked if it was possible for a practitioner to select only parts of the standard when performing a compilation. He was of the view that the proposals in the second paragraph of the long form report are focused on assistance, not compilation, and combining the first and second sentences of that paragraph would make this, as well as management’s responsibility for the information, more clear. He also asked if it was possible to add further material to the report in respect of another engagement performed at the same time. Mr. Cowperthwaite responded that the practitioner can select only some elements of the ISRS, but cannot assert compliance with ISRS 4410 unless they have complied with the whole ISRS. He also explained that the practitioner is able to add material to the report to cover an additional service.

ASSOCIATION WITH FALSE OR MISLEADING INFORMATION

Mr. Cowperthwaite explained that the practitioner may find an issue with the information, even though the practitioner is not seeking out such issues. The ED used the term “material misstatements,” however, respondents found this term confusing. The Task Force proposes to link the ISRS to Section 110 of the IESBA Code¹¹ about association with materially false or misleading information, which explains that

¹¹ Code of Ethics for Professional Accountants

practitioners may have to resign to avoid association with such information. However, he noted that some may find that “false and misleading” also lacks clarity and the link to management’s, and by implication the compiler’s, responsibility to produce information that is free of material misstatement, is lost.

The Representatives and Observers commented as follows:

- Ms. Blomme did not support the change as she believed that, as management have to produce information free of material misstatement, the practitioner should be held to the same standard. Mr. Diomeda expressed surprise at the change in term, but noted that there are no criteria to determine if one is better than the other. Messrs. Attolini, Diomeda, and Jusuf believe that “material misstatement” may be better understood. Mr. Roussey believed that the “materially misstated” should be used to link with the concept in audits and reviews. Mr. Cowperthwaite noted that the Task Force has tried to ensure that the practitioner is not taking responsibility for the information. He also noted that the IESBA Code requires the practitioner to be objective, which is not possible if they are also responsible for it.
- Mr. Stewart noted that this issue suggested that the information was being compared against a benchmark. Mr. Cowperthwaite explained that the compiler must be sufficiently knowledgeable to be able to do the engagement including being knowledgeable about the applicable framework, but that materiality is not always explained in all frameworks. Mr. Cowperthwaite noted that, regardless of what the framework includes, the practitioner must comply with the Code of Ethics regarding “materially false or misleading” information. Ms. Blomme noted that, as the engagement occurs in the context of an applicable financial reporting framework, it would be difficult to not use the same benchmark of “material misstatement.” Mr. Cowperthwaite noted that the concept of an applicable financial reporting framework covers any basis of preparation that is acceptable in the circumstances, so the concept of a “material misstatement” may not exist in every framework.
- Mr. Morris noted that it is possible that the framework could be specific to the entity, so a concept such as “free from material obvious errors” may be useful in all engagements. Mr. Cowperthwaite explained that “obvious” had been explored by the Task Force previously.
- Mr. Koktvedgaard asked why this requirement was not included in the report, as it may be useful to users to know that the practitioner is obliged to take action if they come across an issue. Mr. Cowperthwaite responded by noting that the ISRS did not permit the issuing of a report if the materially false and misleading information was corrected, so Mr. Koktvedgaard’s suggestion may raise questions, but noted that he would raise the suggestion with the Task Force.

Mr. Cowperthwaite thanked the Representatives and Observers for their comments.

Auditor Reporting (Item H)

To EXPLORE and SHARE viewpoints on the topic of auditor reporting and to REPORT BACK on March 2011 discussions.

Ms. de Beer introduced the topic, noting the purpose of the session was to advance the CAG discussions while the IAASB’s consultation paper was out for public comment. She noted that the March 2012 CAG meeting would include a detailed discussion of the responses received on consultation and the proposed way forward. Ms. de Beer welcomed Mr. Montgomery, joining by teleconference, and then introduced the

panelists, Mr. Kuramochi of IOSCO, Mr. Waldron of CFA Institute, and Mr. Koktvedgaard of BUSINESSEUROPE.

Mr. Kuramochi explained IOSCO's emphasis on consultation with auditors, investors, issuers and audit committee members and suggested it was important for the IAASB to consider conducting roundtables similar to those being planned by the PCAOB. Doing so would raise public awareness about the project, in particular for issuers and audit committees. While IOSCO noted divergent views on auditor reporting, its consultations indicated that investors are more focused on the auditor's report rather than requesting assurance on other matters such as management's discussion and analysis (MD&A). He also explained that, while auditors believe different investors may need different information, in most cases investors believe the nature of information they need is consistent.

Mr. Kuramochi offered his personal view that it was firstly necessary to understand investor needs in relation to assurance on MD&A, preliminary announcements and forward-looking information. Some jurisdictions already have standards in place to address assurance on MD&A that are not widely used. He suggested that IOSCO's findings that some investors want auditor discussion and analysis (AD&A), was principally because MD&A had become boilerplate. He recommended the need to further consider of the scope of information on which assurance may be requested (for example, key performance indicators, intellectual property information, environmental information) and the level of assurance that could be provided. Mr. Kuramochi also suggested confidentiality, cost and timing are critical areas to be explored.

Mr. Waldron, providing an investor view, explaining that, while it is preferable to have a global solution, what is more important is to have a high-quality auditor's report, that is not boilerplate and which can be used by investors and other users. He noted that investors wanted a similar standard of reporting for all companies regardless of size or industry, as investors make comparisons between listed and non-listed entities and the auditor's report needs to continue to allow for them to do so. Mr. Waldron noted that currently investors would like to understand the auditor's procedures in relation to other information, including MD&A and preliminary announcements. For example, he suggested that the auditor might comment on his responsibilities relating to other information, and provide views on significant accounting judgments and critical accounting policies that are described in MD&A. While investors may request more assurance in the future, the expectation regarding timing of this information, particularly preliminary announcements, is likely to outweigh the need for assurance. Finally, Mr. Waldron commented that a "big bang approach" to change would be preferred by investors.

Mr. Koktvedgaard, representing a preparer view, explained that auditor reporting depends on the audience, with the auditor having more flexibility when reporting internally to management and the audit committee of an entity. In his view, the auditor's primary focus should be on the financial statements, but could perhaps include an opinion on whether the narrative sections of an entity's annual report are in accordance with the financial statements. He was against the suggestion that auditors should report directly on the quality of an entity's internal control or the conservatism or aggressiveness of its accounting policies, as users should be able to read the accounting policies and decide for themselves. Mr. Koktvedgaard supported a long-form auditor's report to those charged with governance, who would then sign off that they had received it, as this ensures direct communication by the auditor and the entity's board of directors.

Mr. Koktvedgaard stressed that the external report should enable users to easily identify an effective audit, by including a clear binary conclusion, and direct language describing the auditor's work and

responsibilities, which could include commentary on key audit risks, significant audit procedures and changes in audit risk assessments. He also suggested it would be useful for the auditor to attend the entity's annual general meeting, with the onus on users to raise questions to the auditor. He further suggested that any required reporting to regulators should be done separately, for example by an agreed-upon procedures engagement, rather than as part of the audit.

In summary, Mr. Koktvedgaard was of the view that requests for increased reporting relate to perceptions that audit quality or reporting quality is low. To resolve those requests, he believed transparency and consistency of language in audit reporting is important. He cited a Danish study of users that noted that an entity's description of its expected performance, including uncertainties and assumptions, were key focus areas for users. Finally, he noted that entities also would likely support a "big bang approach," as any potential changes in auditor reporting would not be as dramatic compared to changes in accounting standards.

The Representatives and Observers commented as follows:

- Mr. Hallqvist appreciated the acknowledgment of the panelists of non-listed companies, and suggested the IAASB should focus on this important group. From his experience, he indicated that many audit committees rely extensively on the auditor's management letter in discharging their responsibilities. His personal view was that involving internal audit in the resolution of the auditor's management letter comments was useful.
- Mr. Morris suggested that, should certain proposals noted in the consultations by the IAASB and PCAOB be taken forward, it may be necessary for different audit reporting standards to apply, while the nature of the audit would be the same. Mr. Johnson did not support this view.
- Mr. Johnson supported the points raised by Mr. Koktvedgaard, noting the need for entities to be the primary party providing disclosure as requested, for example on the sustainability of the business. In his view, the role of the auditor is to opine on information being provided by the entity, rather than providing it directly to users. He suggested the interaction between the financial reporting standards and the audit reporting standards may need to be further explored. In relation to the suggestion that key audit risks and other information could be provided in the auditor's report, Mr. Johnson was of the view that this information could be provided by the auditor to the audit committee as a means of closing the information gap. In his view, it would be undesirable to have a proliferation of Emphasis of Matter (EOM) paragraphs or non-standard reporting that is not clear to users.
- Mr. Krantz was of the view that users would pay greater attention to auditors' reports if they were more substantial and better articulated what auditors do. Mr. Koktvedgaard agreed, believing that it would not be necessary to broaden the audit if the audit was better described.
- Mr. Hansen cautioned that more information from the auditor and increasing the length of the auditor's report, for example by including an AD&A, would not necessarily be more useful to the entity. In his view, it was preferable for the audited entity to provide original disclosure vs. an AD&A analysis.
- Mr. Pannier believed that investors collectively are interested in forward-looking information about the sustainability of entities as a matter of public trust.
- Mr. Attolini shared findings from a recent SMP quick poll, noting that 70% of respondents perceived an expectations gap, with half of these respondents believing it could be addressed by changing

auditor reporting. In addition, nearly 70% of respondents believed there was an information gap, with 38% of the view that it could be addressed by changing auditor reporting and 25% disagreeing. Mr. Attolini noted that, in the SME environment, management and those charged with governance are often the same, and this would need to be considered in exploring changes to auditor reporting.

- Mr. Johnson cautioned that, for some areas on which assurance is requested, care must be taken to evaluate these requests and consider what the auditor could opine on. In his view, there may be different levels of assurance and commenting on the auditor's procedures in a reasonable assurance audit report would not be appropriate.
- Mr. James questioned how the IAASB was coordinating its efforts with other regulators. Mr. Montgomery noted the WG and IAASB are looking for every opportunity to have continuing dialogue with regulators as well as standard setters and other parties with ongoing initiatives. He noted representatives from the IAASB had met with the PCAOB to establish a foundation for further dialogue in the hopes of sharing feedback after the consultation periods have ended. Prof. Schilder agreed, noting the meeting in July with the PCAOB was constructive and he hoped that progress could be made in a common dialogue. In his view, there were many similarities in the PCAOB concept release and the IAASB consultation paper.
- Prof. Schilder noted that the IAASB paper also discussed the possibility of enhanced corporate governance reporting models and a larger role for audit committees, highlighting a model proposed by the U.K. Financial Reporting Council (FRC). Mr. Fleck explained that the FRC's work on effective company stewardship had a similar goal of bridging the information gap, and he was encouraged by the fact that there is a willingness of stakeholders to recognize that there may be different ways of delivering the information requested by users.

Mr. Montgomery thanked the panelists, Representatives, and Observers for their useful and insightful comments. He noted that the comments raised were largely reflective of previous comments on auditor reporting and consistent with different points of view that have already been expressed. For this reason, Mr. Montgomery explained that it will be challenging for the IAASB to find solutions to address these complicated issues, with no one solution alone likely to be able to do so. In his view, it will be necessary for the IAASB to think about whether there is a holistic solution that will address the needs of stakeholders, particularly investors, while also being mindful of the underlying principles of division of responsibility between management and auditors, auditor confidentiality, audit quality, and investor clarity.

Mr. Baumann reported on the issuance of the PCAOB's concept release on auditor reporting in June 2011, which was a result of extensive outreach to investors, auditors, preparers, audit committees and regulators, during which divergent views were expressed. He explained that the concept release did not take a position but rather asked for feedback on four specific areas and solicited views on other potential solutions: AD&A (focused on providing commentary on significant judgments and estimates made by management); required use of EOM paragraphs to emphasize the most critical elements in the financial statements; clarifying technical language; and increasing auditor association with MD&A, press releases and other information. Mr. Baumann noted that a roundtable would be held on September 15, with 35 participants meeting with the PCAOB and other regulators. He explained that the U.S. Center for Audit Quality (CAQ) had formed a WG consisting of representatives from the Big 4 and other accounting firms. In their letter to the PCAOB, this group had proposed changes to the auditor's report in response to investor needs, and endorsed the use of EOM paragraphs and auditor association with the critical

accounting estimates information included in MD&A, due to the perception that entities were not including adequate information about the judgments and sensitivities in the financial statements and how change in estimates could impact the entity in the future. Mr. Baumann also reported the American Accounting Association, representing the views of academics, also supported the increased use of EOM paragraphs and cited both benefits and risks with the AD&A proposals.

Regarding the suggestion for the IAASB to organize roundtables, Mr. Sylph emphasized that the IAASB looks to the CAG as its source for perspectives from investors, regulators, and preparers, explaining that it is difficult to get an international view (as compared to the national view sought by the PCAOB). He suggested that time could be allocated during the March 2012 CAG meeting to invite other stakeholders to attend and share perspectives from different marketplaces.

REPORT BACK

Ms. de Beer drew attention to matters noted in the report back in the CAG agenda material.

SEPTEMBER 13, 2011

IAASB Future Strategy and Work Program 2012–2014 (Item K)

To REVIEW a summary of significant comments on the IAASB Strategy and Work Program Consultation Paper and the proposed final Strategy and Work Program (IAASB approval planned for December 2011).

Prof. Schilder introduced the topic, noting that the purpose of the session was to hear the CAG's views as to whether the Steering Committee (the Task Force for the project) had struck the appropriate balance in selecting and prioritizing projects. He explained that the IAASB would discuss the draft strategy and work plan and its upcoming meeting, with the intent to approve it at its December 2011 meeting.

Prof. Schilder noted that responses on consultation indicated significant support for the IAASB to continue its efforts on its current work program, in particular the projects on auditor reporting, audit quality, and disclosures, before commencing new projects. In addition, he noted strong support for the IAASB spending time and effort on the adoption and implementation of the clarified ISAs, through partnership and outreach with those who can assist in doing so. He highlighted a few points in relation to the proposed strategy and work program that had previously been of specific interest to the CAG Representatives, including the potential ISA revision projects as a result of findings from the ISA Implementation Monitoring project; the formation of a Strategy Working Group to further explore developments relating to integrated reporting, internal control, corporate governance and other matters that may impact the longer-term agenda of the IAASB; banking guidance; audit guidance for other financial institutions; a publication on proportionality of ISQC 1; and revision of the standard addressing agreed-upon procedures. Prof. Schilder also reiterated the intent to continue the significant outreach and communication activities on as wide a basis as possible, in particular stressing the importance of dialogue with regulators, including IFIAR.

The Representatives and Observers commented as follows:

- Messrs. Grund, Pannier and Uchino and Ms. Blomme noted their organizations strongly supported the proposed strategy and work program and believed it was a well-balanced approach.
- Mr. Attolini noted that the SMP Committee was very supportive of the plan, and appreciated how the IAASB has taken SMP comments into account in formulating it. In his view, this was the first strategic cycle in which there had been great attention on the needs of SMEs and SMPs, a trend he hoped to see continue. In particular, he supported the revisions of ISRS 4410, ISRE 2400,¹² ISAE 3000¹³ and ISRS 4400,¹⁴ as well as communicating on the proportionality of ISQC 1 as key projects for SMEs and SMPs. Mr. Diomeda agreed. Prof. Schilder thanked Messrs. Attolini and Diomeda for the support, noting that, in addition to the representation on the IAASB of smaller practices (through Board member Phil Cowperthwaite), the cooperation with the SMP Committee and its staff is

¹² International Standard on Review Engagements (ISRE) 2400, *Engagements to Review Financial Statements*

¹³ ISAE 3000, *Assurance Engagements Other than Audits or Reviews of Historical Financial Statements*

¹⁴ ISRS 4400, *Engagements to Perform Agreed-upon Procedures Regarding Financial Information*

appropriate. He noted that informal feedback from IAASB members suggested it may be appropriate to have a more explicit liaison with the SMP Committee next year.

- Mr. Uchino noted the Japanese Securities Dealers Association (JSDA) supported the IAASB actively engaging with stakeholders, and volunteered their broad network of issuers and investors to be used by the IAASB to help enhance capital markets.
- Mr. Gutterman, supported by Ms. Sucher, suggested the wording in relation to the project to consider whether to develop audit guidance for other financial institutions could be improved. In his view, the description seemed to imply that, in addressing issues related to banks, the IAASB would have adequately addressed financial industry issues and only residual issues might remain. In his view, the need for auditing guidance on insurance in particular is directly linked to the completion of the IASB's standard on insurance contracts, so he supported the 2013 timing. He believed that different individuals would be interacting with auditors and supervisors. Their organizations would likely be willing to devote resources to determine what the best way forward would be. Mr. Gunn explained that the intent was to acknowledge that as the IAASB explores new areas, such as banking guidance, it would be important to take stock of what it learns from such projects before undertaking new ones, in particular as difficulties in adopting international industry-specific guidance have been raised by national standard setters.
- Mr. Uchino noted the expectation that the IAASB would promote the fundamentals of the clarified ISAs, including professional judgment and professional skepticism, over the next few years with a strong mind and passion. Mr. Gamble was of the view that bedding down the acceptance of the clarified ISAs, through monitoring and outreach, should be the IAASB's priority. He noted the need for this in particular regions, like the Middle East, where there are no strong member bodies. He explained that the Dubai Financial Services Authority (DFSA) was hosting a two-day audit conference, the theme of which is professional skepticism, so there may be a need for similar conferences elsewhere. Prof. Schilder agreed that the emphasis on adoption and implementation has been a key theme of the outreach conducted by the IAASB leadership team. He welcomed further opportunity to assist organizations planning similar events, noting that the proposed program had taken into account time needed for such activities.
- Mr. Baumann suggested, in light of the discussion on Item E, it may be appropriate to highlight the IAASB's planned actions to respond to challenges relating to the application of professional skepticism within the proposed program. Mr. Pannier agreed.
- Mr. Uchino was also of the view that the IAASB should work to enhance the capability of auditors and preparers to deal with rapidly changing accounting standards, and supported the work program having flexibility to do so. In particular, he suggested an area of emphasis should be the application of ISA 540. Ms. Sucher agreed, citing her concern that as changes come along to accounting standards, questions may arise as to the consistent application of both accounting and auditing standards. She specifically noted that it was unclear whether ISA 540 was sufficiently robust to deal with the accounting standards dealing with loan loss provisioning and financial instruments in light of the increased subjectivity and use of management judgments. In her view, the timing was more likely 2015, due to the implementation date of the accounting standards. While there is flexibility in the work program, she believed this concern was important to raise. Mr. Baumann noted the PCAOB has been discussing the volume and extent of change in the accounting standards with the

U.S. Financial Accounting Standards Board (FASB), as some of its Standards Advisory Group (SAG) members had raised similar concerns, and also intends to comment on the auditability of the accounting standards and determine whether related auditing guidance is needed. Prof. Schilder noted that the provisions within the plan for 2 future projects to revise the ISAs were intended to recognize the possibility of this. The current discussion of amendments to ISA 540 as a result of the development of IAPN 1000¹⁵ touched on the debate whether to focus on amendments currently seen as necessary, or to continue to ask questions about whether there was a need for further refinements. In his view, the ongoing IAASB/IASB liaison project would be helpful in this regard.

- Mr. Baumann highlighted that possible need for additional audit procedures for systemically important financial institutions (SIFIs) has been suggested by some regulators. While the PCAOB has not formed a view as to whether this may be necessary, he suggested that it may be an area for exploration together with the IAASB to align any future efforts in this regard. Prof. Schilder agreed, noting that SIFI audits had previously been included in the scope of IAPS 1004¹⁶ and 1006,¹⁷ but further dialogue would be helpful.
- Mr. Stewart supported the IAASB commenting on the IASB's standards. To Ms. Sucher's point, he questioned how the future work program dealt with response to significant standards. Prof. Schilder acknowledged that the annual presentation by the IASB to the IAASB was helpful to understand possible implications of future standards. In the future the liaison effort may need to become more intense (for example on matters like disclosures) to further explore these issues. Ms. Hillier noted that the objective of considering the IASB's standards was to identify if there were areas where audit guidance may be needed. However, she noted that the ISAs are designed to be framework neutral and not intended to be work programs that prescribe specific procedures in relation to accounting standards.
- Mr. Krantz suggested refinement was needed within the auditing literature to define what a "market" price is, to assist with the audit of valuation. In his view, the fact that there are many kinds of markets (for example, organized and non-organized, regulated and non-regulated) calls for auditors to be alerted to this in seeking to verify a company's accounts. Prof. Schilder explained that this issue was addressed in IAPN 1000. The Task Force recommended adding additional guidance in ISA 540 relating to pricing services to address the broader discussion of how pricing information is determined. Mr. Gunn explained that accounting guidance is primarily responsible for describing what is mean by the term "price," but that such discussion illustrates the linkage between the accounting standards and their auditability. Mr. Gutterman agreed.
- Mr. Hallqvist was of the view that the IAASB should do further work on inherent limitations, in light of lawsuits against auditors who would likely ~~to~~ use inherent limitations as a defense against audit failures. Prof. Schilder suggested this matter could be explored further in discussions with the International Corporate Governance Network (ICGN) at its upcoming meeting. He indicated that he

¹⁵ International Auditing Practice Note (IAPN) 1000, *Special Considerations in Auditing Financial Instruments*

¹⁶ International Auditing Practice Statement (IAPS) 1004, *The Relationship between Banking Supervisors and Banks' External Auditors*

¹⁷ IAPS 1006, *Audits of the Financial Statements of Banks*

had previously responded to correspondence from ICGN to understand what was driving the concern. Ms. Blomme mentioned that FEE had done work in this area and would gladly share its publications with [Mr. Hallqvist and](#) Prof. Schilder.

- Mr. Diomeda suggested it might be useful for the IAASB, in finalizing ISAE 3000, to look at some of the fundamental principles of assurance. He noted the IAASB had proposed some changes to the Assurance Framework.¹⁸ Prof. Schilder explained the IAASB had discussed the need to bring together key principles in working to finalize ISAE 3000, ISAE 3410,¹⁹ ISRE 2400 and ISRS 4410. Ms. Blomme expressed a concern that the EDs of these standards did not appear entirely consistent with one another or previously issued material on terminology concepts, as highlighted in FEE's comment letters. She suggested it was important to resolve these differences in finalizing the individual standards. Mr. Gunn explained that the IAASB intends to take advantage of what it learns in developing these standards to see how the Assurance Framework is used, although he noted that there are differing views as to the utility of the framework itself and how prominent it should be.
- Ms. Blomme noted that FEE was not convinced it was necessary to perform work about the implementation of ISAE 3402,²⁰ as they did not believe there had been major concerns since it was issued. Prof. Schilder explained that the IAASB had committed to doing so when the standard was issued, but that such an exercise may be relatively simple to understand whether users were experiencing any serious difficulties in applying the standard.
- Mr. Grund suggested the project on preliminary announcements could be commenced earlier as it appeared to be easy to address due to its narrow scope. Prof. Schilder noted this was identified as a key priority by IOSCO, who supported research in this area. However, in his view, such research was needed to determine whether it would be an easy project.
- Mr. Pannier questioned whether the work program allowed for the possibility of additional actions by the IAASB, if necessary, in response to the EC's Green Paper results, anticipated in November. Prof. Schilder explained his view that developments relating to the ISAs in Europe have been positive – and that the question relates to how, rather than whether, the ISAs would be adopted in Europe. He commented that 21 of the 27 member states have already adopted the clarified ISAs and others, such as France, Germany, Italy and Spain, appear to be close and have transposed the requirements into their national standards. Ms. de Beer commented that the point was raised in the private session that both the accounting and auditing profession need to be able to react more quickly to external developments. In her view, it is difficult for standard-setting by its nature to be able to do so, but the proposed program appears to have room if further actions are necessary. Prof. Schilder supported this view, noting that the planned Strategy Working Group is meant to help the IAASB look forward.

REPORT BACK

Prof. Schilder drew attention to matters noted in the report back in the CAG agenda material.

¹⁸ *International Framework for Assurance Engagements*

¹⁹ *Proposed ISAE 3410, Assurance Engagements on Greenhouse Gas Statements*

²⁰ *ISAE 3402, Assurance Reports on Controls at a Service Organization*

Prof. Schilder thanked the Representatives and Observers for the helpful discussion and their strong encouragement.

Using the Work of Internal Auditors – ISA 610 (Item L)

To DISCUSS significant comments on the exposure draft of proposed ISA 610 and the Task Force's recommendations (IAASB approval of final standard planned for December 2011).

Ms. Hillier introduced the topic, noting that there were many responses supporting the ED, but that there were significant comments from the regulators who believed that the ED did not have sufficient safeguards around the use of internal audit. She noted that the IESBA has also been involved, and will discuss the matter further at their October meeting, as many of the issues also relate to the IESBA Code. She noted that, overall, respondents had expressed support for the auditor to use of internal audit when their work is robust work and has been appropriately supervised by the auditor.

DIRECT ASSISTANCE

Ms. Hillier reported that respondents had mixed views on the desirability of direct assistance, but that there was recognition that the ISAs need to address the issue as some jurisdictions permit it. She noted that the Task Force has reviewed and strengthened the requirements in light of the comments received, and that the Task Force has referred the definition of the “engagement team” to the IESBA for further consideration. She noted that respondents had commented that formalizing the arrangements will help deal with independence and confidentiality threats. Such arrangements would include written agreement from (i) the entity to not interfere with the work performed by internal audit on behalf of the auditor and (ii) internal audit regarding confidentiality and the need to alert the auditor if a threat to objectivity arises.

USING THE WORK OF THE INTERNAL AUDIT FUNCTION

Ms. Hillier noted that the IAASB's discussions at its June 2011 meeting supported the direction the Task Force had taken in response to comments, but believed that requirements around the need to stand back and consider if the auditor is overusing internal audit, and the need to be satisfied with work of internal audit, could be clarified.

The Representatives and Observers commented as follows:

- Ms. Bastolla noted that the proposals seemed very clear and are more indicative of actual practice. She supported the inclusion in the application material of more comprehensive information about the role of internal audit, particularly in supporting the governance function. She noted some challenges with regulators regarding direct assistance, but believed that the controls over use of direct assistance are appropriate. She also noted that the Institute of Internal Auditors (IIA) has no evidence that direct assistance is prevalent in practice.
- Mr. Attolini noted that the SMP committee had not submitted a comment letter to the ED. He asked that the requirements in the ISA be examined to ensure that there is no unnecessary burden imposed on SMPs. He suggested the ISA should include a clear statement that there is no further obligation for the external auditor if he is not using internal audit. Mr. Diomeda and Ms. Blomme supported Mr. Attolini's comment and suggested that the ED was clearer. Ms. Hillier noted that the

Task Force would consider the paragraph again, but also noted that the IAASB had previously commented that it was overcomplicated.

- Mr. Attolini noted that there was a suggestion that the requirements for using work of internal audit are more stringent than for the use of direct assistance. Ms. Hillier responded by noting that that this was not intended. Ms. Blomme noted that the auditor's obligations may be more explicit for direct assistance than for use of internal audit.
- Mr. Hallqvist noted that, as chair of several audit committees, he always requires internal audit to report to the audit committee, and invited external auditors to participate in some meetings that the audit committee has with internal auditors. He noted that the internal audit function is often the secretary to audit committee, which fosters good synchronization between auditors.
- Mr. Fleck suggested structuring the ISA in such a way that jurisdictions that prohibit direct assistance can do so and will continue to comply with the ISAs. He noted that the U.K. had not particularly considered the issue prior to the revision of ISA 610 and may choose to prohibit it. Ms. Hillier noted that the ISA acknowledges that direct assistance may be prohibited, but that it was important that group auditors were aware that it exists so they can instruct component auditors.
- Ms. Blomme supported the inclusion of direct assistance, as this was used in many jurisdictions, and noted that the revised draft standard is balanced and responsive to the comments received.
- Mr. Hansen expressed the view that the final ISA should require the external auditor to consider internal audit reports, as these may indicate material weaknesses in internal control. He asked about the use of direct assistance by internal auditors on significant risks, and whether a reporting obligation on the extent of reliance placed on internal audit would change any conclusions regarding the use of internal audit. Ms. Hillier noted that risk assessments are addressed in ISA 315,²¹ and that a recent draft of revised ISA 610 discussed with the IAASB prohibited using the work of internal audit for significant risks. However, it was suggested that internal auditors' work may be useful for parts of significant risks, and the revised ISA may be unduly restrictive. She noted that the new wording limits use of direct assistance by reference to the amount of judgment required.
- Ms. Bastolla was unsure about prohibiting the auditor to use the work of internal audit when the function had already performed specific work. She questioned whether this applied to the entire function or just the individuals involved. Ms. Hillier noted that this relates to individuals providing assistance only, to avoid self-review threats.
- Ms. Bastolla noted that judgments were always involved in internal audit work. Ms. Hillier agreed, and noted that this was recognized in the proposals.
- Mr. Roussey supported ISA 610, noting that information systems auditors are a part of internal audit and that it is important to have these people available to the external auditor.
- Mr. Pannier supported the Task Force's approach. He noted that this reinforced the importance of internal audit, was in the public interest and reinforced audit quality. He also supported the inclusion of direct assistance.

²¹ ISA 315, *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

- In relation to the limitations regarding direct assistance, Ms. Sucher preferred the language prohibiting internal auditors to perform procedures that “are designed to respond to a significant risk of material misstatement” (former paragraph 28(a) of the proposed ISA) rather than those that “relate to higher assessed risks of material misstatement and require judgment in performing the relevant audit procedures or evaluating the audit evidence gathered” (paragraph 28(b)). Also, she was of the view that the reference to judgment was not needed, and it was also unclear how “judgment” could be measured in this case as judgment was relevant in so many audit procedures.
- Mr. Baumann noted that direct assistance is specifically mentioned and permitted in the U.S. He also noted that it was not a topic under review, but that it may be put under review based on the outcome in the ISAs. He noted that the comments questioning the use of direct assistance calls into question the use of internal audit in its entirety, as it was difficult to conclude that the auditor could use internal audit if direct supervision of their work is not sufficient. He gave the example of two identical companies, in one the auditor is unable to use internal audit to provide direct assistance, in the second internal audit has performed their own work (without direct supervision by the external auditor), that the auditor is able to rely on and hence reduce the extent of the external audit procedures. Ms. Sucher noted that she understood Mr. Baumann’s perspective, but that the auditor is considering the robustness of the function rather than individual. She also noted that there was some anecdotal evidence about boards trying to get external audit to rely more on internal audit to cut costs. Mr. Fleck disagreed with Mr. Baumann, and expressed the view that the auditor is not relying on internal audit, but instead taking it as one piece of evidence that is considered by the auditor in determining how much other work to do.
- Ms. Sucher asked if ISA 610 would be re-exposed. Ms. Hillier explained that the IAASB would decide about re-exposure in December when the standard was planned to be approved.
- Ms. Bastolla noted that what distinguished internal audit from other monitoring controls is the set of internal audit standards and a disciplined approach. Mr. James noted that there was no definition for a “systematic and disciplined approach.” Ms. Hillier noted that the application material contained the considerations in assessing whether internal audit had a systematic and discipline approach.

REPORT BACK

Ms. Hillier drew attention to matters noted in the report back in the CAG agenda material.

Ms. Hillier thanked the Representatives and Observers for their comments.

Integrated Reporting (Item N)

To RECEIVE a presentation on the topic.

Ms. de Beer introduced Mr. Paul Druckman, Chief Executive Officer of the International Integrated Reporting Committee (IIRC), and explained that the IIRC had a day prior issued its Discussion Paper (DP), *Towards Integrated Reporting – Communicating Value in the 21st Century*.²² Mr. Druckman gave a

²² A printed copy of the DP was distributed during the meeting, and the electronic version can be accessed at: theiirc.org/wp-content/uploads/2011/09/IR-Discussion-Paper-2011_spreads.pdf.

presentation, using the slides in Agenda Item N, focusing on the key elements of integrated reporting (IR), including the six different kinds of capital on which it is based, and highlighting the short-term, medium-term and longer-term challenges in moving towards IR. He explained that some jurisdictions, such as South Africa, have been more aggressively moving towards IR as a means of meeting the needs of stakeholders to understand the value of a company. Further, Mr. Druckman noted that regulatory frameworks in some countries may need to adapt to embrace IR. As an initial basis, the IIRC has identified 50 companies from around the world to participate in a pilot program to experiment with implementing a system to allow for IR.

The Representatives and Observers commented as follows:

- Mr. Krantz supported the use of IR as a business tool for management and responsive to the needs of the capital markets. He noted the Board of the WFE has been impressed with the speed at which IR has been accepted.
- Mr. Peyret asked Mr. Druckman how IR envisaged presenting financial and non-financial information, citing the complexities in software systems used at a legal entity level. In his view, it would likely be difficult for this software to be integrated and companies would need to start from the bottom up to prepare integrated reports. Mr. Druckman replied that it would depend on how an entity develops its strategy, and that IR would not replace financial accounts but rather bridge the financial accounts with other information on different types of capital that affect business value, thereby providing an better overall picture of the entity.
- Mr. Waldron asked how best organizations like the CFA Institute could contribute during the comment period. Mr. Druckman explained that the purpose of the DP was to discuss the “whys” of integrated reporting, so it would be helpful to hear from organization as to whether there are any fatal flaws with the principles explained in the DP. In his view, the next step will be how to move forward with IR, including in relation to assurance.
- Mr. Grund questioned whether the IIRC envisioned that assurance would be provided on the separate components of IR. Mr. Druckman explained that innovation would be necessary, explaining that currently there is assurance on the separate components (silos) of information, mostly on the data. In his view, it will be necessary to first understand what assurance investors and other stakeholders would want on an integrated report, although he suggested that assurance on the silos may continue to be appropriate, with additional assurance on the process to prepare the integrated report. He believed that the auditing profession will need to be involved in coming up with the answer. Ms. de Beer noted that it will be difficult for practitioners to opine on a company's strategy, and the company may need to first identify how they intend to measure themselves in order for assurance to be provided.
- Mr. Roussey suggested work done previously by Robert Elliott on a broader assurance framework might be useful in relation to IR, and that XBRL may be a means for delivery of IR. Ms. de Beer and Mr. Krantz noted that IAASB will need to monitor developments in IR to ensure it is in a position to respond as necessary. Mr. Sylph noted that the American Institute of Certified Public Accountants' (AICPA) Special Committee on Assurance Services (on which Mr. Elliot was participating) had influenced the IAASB's development of its Assurance Framework. He also noted that Michael Nugent, formerly an IAASB staff member, is now working with the IIRC, and brings direct

knowledge of the Assurance Framework to the role. Mr. Druckman noted Mr. Nugent served as the primary editor of the DP.

- Mr. Roussey also questioned whether the financial information category within IR would include financial information beyond the financial statements, for example other regulatory reporting, including proxy statements.
- Mr. Attolini, supported by Mr. Diomeda, noted the project was relevant to SMEs and suggested there may be scope for the IIRC to include SMEs in the pilot project to ensure that any approach to IR is fully scalable for SMEs and for non-listed entities. Mr. Druckman noted that roundtables conducted by the IIRC had highlighted SME issues, and consideration would need to be given to SME issues before issuing an exposure draft of an IR framework.
- Mr. Kuramochi questioned the relationship between IR and accounting standards, and suggested the IIRC would need to consider how to address the fact that IFRS is not used everywhere. Mr. Druckman agreed, but noted that IR is not meant to replace financial reporting. Ms. de Beer believed that IR should be framework neutral so financial reporting frameworks other than IFRS could be accommodated.

Ms. de Beer thanked Mr. Druckman for coming to speak with the CAG on a topic that was clearly of interest to them.

Auditing Financial Instruments, and Status and Authority of International Auditing Practice Statements (IAPSS) (Item O)

To DISCUSS significant comments on the exposure draft of proposed IAPS 1000 and proposals relating to the status and authority of IAPSS and the Task Force's recommendations (IAASB approval of final guidance and statement of status and authority planned for September 2011).

STATUS AND AUTHORITY OF IAPSS

Mr. Fogarty introduced the topic and noted that the respondents to the proposals in the ED had not been satisfied by the proposed status and authority of IAPSS. He noted that some respondents wanted IAPSS to have stronger obligations attaching to their use, while others felt it would be more appropriate if IAPSS had no obligations attaching to them in order to enable them to include helpful educational and practical guidance. Mr. Gunn noted that the overall message from the comments was that the authority of IAPSS needed to be completely clear.

Mr. Fogarty noted the Task Force's view that, if there is a deficiency in practice, authoritative guidance is the only option. However, if the objective is to help influence practice, then educational material is preferable. He noted that the IAASB may see a need for both in different circumstances. Mr. Fogarty explained that the proposal for approval at the IAASB's September meeting was to create a new type of document, titled International Auditing Practice Notes (IAPNs), to influence practice. Such material would be able to be timely, educational and illustrative and could be more detailed and comprehensive than application material in the ISAs. However, he noted that a necessary part of this package of proposals was that the IAASB would need to amend the ISAs if changes to auditing practice were needed.

Mr. Fogarty highlighted that the proposals included the establishment of IAPNs as well as the withdrawal of the category of IAPSS. He noted that the withdrawal of IAPSS was seen as appropriate by the majority

of the Working Group members, but that some believed that re-exposure in relation to the withdrawal of the category of IAPs was needed, for the reasons explained in the CAG's meeting material.

The Representatives and Observers commented as follows:

- Mr. Gutterman explained that the CAG Working Group expressed general unease with the proposal for the guidance to be non-authoritative, but that no better solution than that proposed by the Working Group was identified.
- Ms. Sucher noted that she understood the difficulties encountered by the IAASB, and understood the logic of keeping all application material in the ISAs. She was unsure about the IAASB's willingness to make changes to standards if inconsistent practice eventuated. She noted that the proposals would result in the ISAs getting longer, but that this would not be of great concern. She asked how the IAASB proposed to approach the audit of insurance contracts and any revision of IAPS 1004 and IAPS 1006. Prof. Schilder responded that the IAASB had had some initial discussions with the Basel Committee on Banking Supervision, but that it was too early to decide what would be done in that space. Prof. Schilder also noted that some found the current authority of IAPs confusing, and that they posed no obligations beyond those in the ISAs. He explained that the IAASB was now more open about amending the ISAs. Mr. Fogarty added that IAPs were not always adopted by jurisdictions adopting the ISAs so the IAASB must include all application material inside the ISAs. He explained that the IAASB accepted that making additions to ISAs was a necessary consequence of keeping all authoritative material in the ISAs and that the IAASB at its June 2011 meeting was supportive of making proposed amendments to ISA 500²³ and ISA 540 as a result of the development of IAPN 1000.
- Mr. Morris asked if the IAASB would be asked to approve IAPN 1000 if it voted to withdraw IAPs and re-expose this decision. Mr. Fogarty explained that re-exposure of IAPNs does not affect the approval of IAPN 1000. Ms. de Beer noted that the CAG has commented on a number of occasions that the material in IAPN 1000 is urgently needed.
- Ms. Blomme supported the need to issue IAPN 1000, and noted the difficulty in having educational material and authoritative material in a single document. She asked about the due process for IAPNs, and what would happen to the extant IAPs. Prof. Schilder noted that the IAASB has not decided on any future IAPNs, and will determine the development process for IAPNs when the IAASB approves the respective project proposals. He also noted that consultation on the content of any new IAPN would probably be needed but that the IAASB also needs the ability to respond on a timely basis. In relation to the extant IAPs, Prof. Schilder noted that they are outdated and would be withdrawn, as consulted on during exposure. Ms. Blomme noted in her view that the [change from withdrawal of IAPs to IAPNs, making them non-authoritative, did not would](#) need to be re-exposed [as this was not proposed in the Exposure Draft](#).
- Mr. Bradbury explained that he found the proposal to re-expose the removal of the IAPS vehicle, but not exposure the creation of IAPNs, difficult to understand. He asked how the IAASB would respond if there was an overwhelming response to retain IAPs. In relation to the new IAPN, Mr. Gunn responded by noting the urgent need to get IAPN 1000 out for this reporting season. In

²³ ISA 500, *Audit Evidence*

relation to the removal of IAPs, he noted that it is not clear what the IAASB could do if there was overwhelming support for retaining the IAPs. However, this was the main issue raised in the exposure draft and respondents flagged concerns with the existing status. The IAASB does not have a different solution to describe material outside of the ISAs.

- Mr. Roussey noted that he found paragraphs 20 and 21 of the draft Preface²⁴ confusing as it did not appear that the IAASB's purpose in issuing IAPNs included assistance in interpreting ISAs. He also questioned the reference to "practice statements" in paragraph 20, and asked whether the reference to tailoring IAPNs to address particular national standards implied that ISAs could be modified. Mr. Roussey proposed that the first line of paragraph 20 should state that "IAPNs provide practical assistance in the form of background material and educational material." Mr. Fogarty responded that the proposals were an attempt to highlight the importance of IAPNs without making them authoritative, but noted that the Working Group will look again at the wording of these paragraphs.
- Mr. James asked about the due process for creating a new vehicle for the IAASB's material, and whether the IAASB can create a new category of pronouncements without exposing the proposals. Ms. de Beer and Prof. Schilder noted that the Preface has been through an extensive due process and the current proposals are in response to comments received on exposure, and that both IAPN 1000 and the Preface in this instance will go to the PIOB for its approval of due process applied. Ms. Hillier added that changing from IAPs to IAPNs was intended to help clarify the status of the material, but she did not believe practitioners would approach the material differently. Mr. Fogarty and Mr. Gunn noted that the IAASB's Terms of Reference already provide for the IAASB to issue non-authoritative documents.
- Mr. Gutterman highlighted that the International Actuarial Association (IAA) is also addressing the status of its pronouncements at the moment, and that it was also calling its category of non-authoritative documents "notes."

IAPN 1000 AND RELATED AMENDMENTS TO ISA 500 AND ISA 540

Mr. Fogarty explained that Agenda Items O2 and O3 illustrate the application of the IAPN proposals. He highlighted that the proposed amendments to ISA 500 and ISA 540 addressed a matter of substantial confusion in practice – that is, whether third-party pricing sources are management experts. He explained that third-party pricing sources were not management's experts in the way the IAASB traditionally thought of experts, but that many of the audit procedures would be similar. Mr. Fogarty also explained that responses on exposure of the amendments to ISA 500 and ISA 540 may identify other matters included in IAPN 1000 that may be usefully added to the ISAs.

The Representatives and Observers commented as follows:

- Mr. Baumann explained that he understood that IAPN 1000 would be non-authoritative, and in his view there is useful guidance in IAPN 1000. He expressed concern with the proposed amendments to ISA 500 and ISA 540, in particular that these were premature, as the issue is only starting to be debated, e.g. the PCAOB's Pricing Sources Task Force has just commenced exploring the issues

²⁴ *Preface to the International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements*

and considering responses. He believed that the proposed amendment indicating that pricing sources are not management experts would result in a significant weakening of the ISAs. Mr. Baumann explained that paragraph 13(c) of extant ISA 540 allows testing the operating effectiveness of controls over how management made the accounting estimate with appropriate substantive procedures as an audit procedure. He expressed the view that paragraph 13(c) of ISA 540, in combination with the proposed changes to ISA 500, is weaker than the extant ISA. He added that the PCAOB continues to develop an understanding of the processes of the third-party pricing sources, and drew a parallel with the recent responses to the actions of the credit rating agencies leading up to the financial crisis. He added that it was important to gain further understanding of the controls that third-party pricing sources have in place. Mr. Fogarty noted that the due process for the amendments would be the same as any amendment to the ISAs, meaning that the proposals would need to be exposed and approved by the IAASB and the PIOB. Mr. Fogarty noted that the IAPN 1000 Task Force had benefited from the involvement of a staff member of the PCAOB on the Task Force and his own involvement with the PCAOB's Pricing Sources Task Force. He also noted that the proposals were intended to clarify the existing situation rather than leave it unclear as it may be if referring only to the provisions regarding management's experts. He welcomed further input from the PCAOB and the wider community during the exposure process. Mr. Baumann was of the view that, under the current PCAOB and ISA requirements, the auditor would need to understand the valuation process for a sample of financial instruments. The proposed amendment would end this practice and create a significant difference with the PCOAB standards and more importantly, a significant gap in the audit procedures required by the ISAs.

- Ms. Sucher expressed the view that determining whether a third-party pricing source is an expert or not based on whether prices are “available to other customers” is a weak test. She noted that this implied that a consensus pricing service with only five customers, after the elimination of the highest and lowest estimate received from those customers, would qualify. She also noted that the material on indicative prices and executable prices in proposed paragraph A69b of ISA 540 was insufficient. Mr. Gutterman agreed with Ms. Sucher regarding the weakness of the test of whether a third-party pricing source is an expert. He noted that merely having multiple users of the pricing source would have unintended consequences, as this applies to many other models including those used by actuaries. Mr. Fogarty noted that the proposed amendments to ISA 500 and ISA 540 are about third-party pricing sources that develop prices only to sell to customers but are not trying to provide executable prices. He noted that the key issue is that prices obtained from third-party pricing sources are not like other evidence, and that the IAPN and ISA 540 are clear on the need for the auditor to understand how the pricing service develops the prices.
- Mr. Gutterman noted the view of the CAG Working Group that IAPN 1000 contains good material but needs further work. He supported the explanation that a model comprises a methodology, assumptions and data. However, he noted there was no further mention of data throughout IAPN 1000 and that the IAPN sometimes confuses terminology regarding assumptions and inputs. He highlighted the use of the term “independence” in Appendix 1 and that it needed to be made clear that this was not the same as auditor independence. He also expressed the view that remaining references to “complex” financial instruments should be removed.

- Mr. Bollmann supported the content of IAPN 1000. He noted that models can be constructed in a highly technical manner and, accordingly, the skills and experience of the person operating the model are critical considerations.
- Ms. Sucher supported the material in the IAPN regarding the fair value hierarchy, in light of the sovereign debt crisis. She also noted that the IAPN contained useful material on existence and completeness and on example procedures on an asset backed security. She acknowledged that the IAPN needed to be framework-neutral but expressed disappointment that the IAASB had not included material on day 1 profits and hedge accounting, as there was some evidence in the U.K. that these accounting issues are not being approached by auditors in a consistent manner.

REPORT BACK

Mr. Fogarty drew attention to matters noted in the report back in the CAG agenda material.

Mr. Fogarty thanked the Representatives for their views.

Awareness Raising (Item M)

To RECEIVE updates from CAG Member Organizations about relevant initiatives.

IVSC

Mr. Bollman presented on the role of the IVSC. He explained that the IVSC develops International Valuation Standards (IVSs) and is the voice of the valuation profession. He noted that the IVSC has existed for 30 years and described the development and structure of the organization. He highlighted that the IVSC publications have no bright line between standards and guidance so joint projects have been undertaken to develop both at the same time. He added that:

- The objective of the IVSs is to create greater confidence in valuations.
- The IVSC's authority derives from the adoption of their standards by others, who are then responsible for any enforcement.
- Upcoming projects include technical information papers and further development of the profession.

NATIONAL ASSOCIATION OF STATE BOARDS OF ACCOUNTANCY (NASBA)

Mr. Hansen presented on the role of NASBA, noting that in the U.S. state laws establish certification requirements for professional accountants, and state boards of accountancy are members of NASBA. As such, NASBA has 55 jurisdictions including territories as members, who collectively regulate over 650,000 CPAs. Approximately 10,000 people a year travel to the U.S. to undertake the CPA exam. He also noted that the U.S. has two levels of regulation with federal regulators, that is, the Securities and Exchange Commission (SEC) and PCAOB regulating public company audits and NASBA regulating audits of private organizations. He further explained that the AICPA is a voluntary membership organization with approximately 350,000 members. Linda Biek, Director of Governmental and International Relationships at NASBA, provided additional context on NASBA's work and its interest in the work of the IAASB, using the presentation included as Agenda Item M.3.

Ms. de Beer informed the CAG that the awareness-raising session for the Organization for Economic Cooperation and Development (OECD), in the interest of time, would stand over to a future meeting.

PIOB Remarks

Mr. Bhave thanked Ms. de Beer and the Representatives for a very informative two-day session, noting that the discussions had been detailed and frank. He explained that the PIOB is actively monitoring the work on audit quality, IAPSS, internal audit and compilation engagements. He was also pleased to note that the CAG had made progress on the issue of rotation and would report this progress to the PIOB.

In response to the request at the previous CAG meeting for the CAG to have better insight into the activities and deliberations of the PIOB, Mr. Bhave encouraged those interested in the PIOB's activities to visit its website (www.ipiob.org) to obtain the PIOB's annual reports from the past six years, as well as summaries of decisions taken, which are published after every quarterly meeting.

Closing

Mr. Sylph gave apologies for Prof. Schilder and Ms. Hillier, who had to depart during the discussion of Agenda Item O. He explained that both would be fully briefed on the issues debated after their departure.

Ms. de Beer thanked the Representatives and Observers for their significant level of input and their ability to consult with their organizations in a short period of time. She also thanked the IFAC Staff for their efforts.

Ms. de Beer closed the meeting.