



Meeting: IAASB Consultative Advisory Group
Meeting Location: Brussels
Meeting Date: March 6–7, 2012

Agenda Item E.6

Project Updates: ISAE 3000, Audit Quality and ISA 720

Objective of Agenda Item

1. The objective of this Agenda Item is to brief the CAG on the status of the projects regarding ISAE 3000, Audit Quality and ISA 720.

Background

2. These three projects, along with the Disclosures project have been temporarily deferred by the IAASB to permit sufficient board and staff resources to be devoted to the Auditor Reporting project. Further information about the IAASB's decision to defer these projects is contained in Agenda Item D. The Disclosures project is the subject of a separate agenda item (see Agenda Item D.5).

Assurance Engagements Other than Audits or Reviews of Historical Financial– Proposed ISAE 3000 (Revised)

3. ISAE 3000 was last discussed by the CAG in September 2010.¹ The IAASB debated the issues raised by the project at its September 2010, December 2010 and March 2011 meetings and issued an Exposure Draft in April 2011. Fifty-seven comment letters were received prior to the closing of the comment period in September 2011.
4. The Task Force has met by teleconference twice since the receipt of the comment letters. This has not been sufficient to enable a full analysis and discussion of all the comment letters. Therefore, the ISAE 3000 Task Force focused its limited time on identifying significant themes from the comment letters on matters that may affect the approval of ISRE 2400 and ISAE 3410 as these projects were not deferred as they were already close to completion. Given the overlapping nature of many of the issues encountered across the three projects this focus is necessary to inform the IAASB of any significant issues that would affect the approval of ISRE 2400 or ISAE 3410,
5. During these meetings, the Task Force identified the following key themes:
 - Broad support for the definitions of reasonable assurance (RA) and limited assurance (LA), although commentators suggested, amongst other responses, that the definition of RA should be linked to a “high but not absolute level of assurance” and the definition of LA was too dependent on user needs.

¹ See http://www.ifac.org/sites/default/files/meetings/files/5695_0.pdf

- Broad support for the requirements and application material relative to RA and LA, albeit with certain commentators suggesting changes such as amendments to the trigger point for performing additional procedures, further application material relative to LA or to “a level of assurance that is meaningful to the intended users”.
 - The majority of respondents supported the requirement to include a summary of the work performed as the basis for the practitioner’s conclusion; and² the inclusion of a statement that LA engagements involve more limited procedures than an RA engagement and consequently they do not enable the practitioner to obtain the assurance necessary to become aware of all significant matters that might be identified in a reasonable assurance engagement.³ Concerns were expressed in various ways including that the summary misleads users to thinking that LA is a higher level of assurance than RA due to the more explicit listing of procedures, the risk of inconsistent summaries of work, and suggestions that a description of the risks considered would be more meaningful than outlining the responses to those risks (i.e. the procedures).
6. The ISAE 3000 Task Force does not see any particular impediment to the approval of ISAE 3410 or ISRE 2400 as a result of the comment analysis conducted to date. ISAE 3410, as presented in Agenda Item C, is based on extant ISAE 3000 and ISRE 2400 does not fall under the umbrella of ISAE 3000. Further, because ISAE 3000, is an umbrella standard for 3000 level engagements, it needs to be sufficiently broad to permit application to a wide variety of subject matters.

Way Forward

7. The IAASB is scheduled to discuss a full analysis of comments received on exposure and a draft ISAE 3000 at its September 2012 meeting.

Audit Quality (AQ)

Highlights of September 2011 IAASB CAG Discussion

8. At the September 2011 meeting, CAG representatives considered a draft paper (“CAG Draft”) that set out a possible international AQ framework (“Framework”) developed by the IAASB’s AQ Task Force. Amongst other matters, the paper dealt with four fundamental aspects of AQ, namely contextual factors, interactions amongst key stakeholders, inputs, and outputs. It also covered stakeholder perspectives of AQ.
9. Many CAG Representatives were supportive of the Task Force’s work and the project’s general direction; indeed, one Representative commented that such a paper was needed many years ago.
10. Another Representative raised a concern that the paper was not adequately focused on matters that auditors themselves could influence and that over-emphasis on contextual factors could be read as excusing poor quality audits. A number of Representatives agreed that the paper needed to make it clear that a high quality audit needs to be performed even in adverse circumstances.

² Only three respondents did not support this contention.

³ Only five respondents did not support this contention.

11. Representatives also raised a number of other matters for the Task Force's further consideration, including:
- Reconsidering whether to cover AQ at an engagement level
 - Giving more emphasis to audit effectiveness (as opposed to audit efficiency);
 - Adding more on the role of internal auditors and experts;
 - Considering whether further emphasis was needed on professional skepticism; and
 - Reconsidering the length and packaging of the paper.

Activities since the September 2011 IAASB CAG Meeting

12. Since then, the Task Force has had the opportunity to further engage with key stakeholder groups on the CAG Draft, including the Forum of Firms at its AQ Symposium in October 2011, and IOSCO and the World Bank in November 2011. In addition, the Task Force received informal comments on the CAG draft from the International Ethics Standards Board for Accountants (IESBA), the International Accounting Education Standards Board (IAESB), the IFAC Small and Medium Practices (SMP) Committee, Canadian stakeholders, the ICGN, and some academics.
13. These discussions indicated considerable support for, and interest in, the project. The discussions also generated some new ideas and comments for the Task Force's further consideration.

December 2011 IAASB Meeting

14. At its December 2011 meeting, the IAASB considered the main comments received from stakeholders on the CAG Draft during the above outreach and the Task Force's proposals in response to them, including an illustrative reorganization of the Framework into separate engagement, firm and country levels in response to a view from a number of stakeholders that the Framework did not focus sufficiently on factors that auditors can control. IAASB members broadly supported the proposed reorganization and provided a number of detailed comments for the Task Force's further consideration.
15. The IAASB also considered an expanded introductory section to the Framework paper developed by the Task Force in response to feedback received from the CAG and other stakeholders. In this regard, the Task Force had felt that the CAG Draft did not sufficiently explain the complexities associated with AQ. The Task Force therefore proposed to describe in the expanded introductory section of the paper some of the characteristics of audit that make evaluating AQ difficult. While IAASB members agreed that there would be value in doing so, some expressed concern that the proposed material may appear defensive. IAASB members provided various suggestions to the Task Force in reconsidering the messaging in the proposed material so that it may take a more neutral tone.
16. Finally, the IAASB provided the Task Force with further input and direction on addressing the impact on AQ that the requirements of the applicable financial reporting framework may have from an auditability perspective.

Way Forward

17. A draft Framework paper is scheduled to be presented at the September 2012 meetings of the IAASB CAG and the IAASB.

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

Highlights of September 2011 IAASB CAG Discussion

18. At its September 2011 meeting, the CAG discussed this project,⁴ which was originally planned for exposure at the September 2011 IAASB meeting. The CAG's comments principally related to two main areas. These areas, and the IAASB's further consideration thereon at its September and December 2011 meetings, are described below.

Scope of the ISA

19. At their respective September 2011 meetings, the CAG and the IAASB were presented with two proposed options were for their consideration as to how the nature and purpose of the documents to be considered "other information" should be articulated in the standard, to assist auditors in determining to which documents their responsibilities relate.⁵ The CAG had mixed views as to which option would be preferable for a number of reasons, and recognized that law or regulation may prescribe additional auditor responsibilities for other information (see Item F of Agenda Item A). The IAASB, however, expressed overwhelming support for extending the scope of the ISA only to such "accompanying" documents that have a primary purpose of providing commentary to enhance the intended users' understanding of the audited financial statements and the financial reporting process (Option B).
20. Further in discussing the objective of the auditor under revised ISA 720, the IAASB iterated its support for requiring the auditor to respond to matters in the other information that are inconsistent with the auditor's understanding of the entity and its environment acquired during the course of the audit; a widening of the auditor's objective under extant ISA 720 intended to address the risk of auditor association with such other information. Further refinements of the proposed requirements to align with the scope of the ISA and the proposed concept of a "material inconsistency"⁶ within other information are anticipated in advance of the CAG and IAASB's September 2012 discussions.

⁴ The September 2011 discussion was the fourth time the CAG had discussed the project since its inception.

⁵ 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."

⁶ The December 2011 IAASB agenda material explained that a matter(s) in the other information may be inconsistent with the auditor's understanding of the entity and its environment (including the audited financial statements) in the following ways:

The Auditor's Work Effort

21. Subsequent to the CAG's consideration of the proposed standard, the Task Force considered it necessary to strengthen proposals regarding the actions that the auditor should take to safeguard the credibility of the audited financial statements when an inconsistency in the financial data is identified that would have a material effect on such credibility. The Task Force believes that auditors need to give consideration to the nature of financial data in the other information in order to determine the procedures to be performed. In particular, other information may contain financial data that are directly extracted from and intended to be the same as those in the audited financial statements. Where this is the case, auditors should compare such financial data with the equivalent in the audited financial statements. Financial data may also be directly reconcilable to the audited financial statements. This is the case when the components of the reconciliation can be agreed directly to the corresponding financial data in the audited financial statements (for example, non-GAAP measures). Where this is the case, auditors should obtain management's reconciliation of such data and compare the components of the reconciliation to the audited financial statements.
22. The IAASB was generally supportive of the Task Force's proposed direction on this issue, but agreed to give further consideration to how to bring about greater clarity to the proposed requirement to alleviate some concerns regarding auditors' ability to consistently apply such a requirement in practice.
23. Related, both the CAG's and IAASB's previous discussions have acknowledged that there may be merit in describing the auditor's responsibilities for other information, and possibly reporting on such information, in the auditor's report. This matter is further explored in Agenda Item K.2 in relation to the Auditor Reporting project.

Way Forward

24. It is anticipated that a revised draft of the proposed standard will be presented to the IAASB for approval at its September 2012 meeting. The CAG will receive a more detailed report back on the discussions at its September 2011 meeting at its September 2012 meeting before the proposed standard is issued as an exposure draft.

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- A statement that the auditor considers to be incorrect, unreasonable or inappropriate; or a statement presented in a way that omits or obscures information that the auditor considers is necessary to properly understand subject(s) addressed in the other information.