



## Agenda Item

# A

**Meeting:** IAASB Consultative Advisory Group  
**Meeting Location:** New York  
**Meeting Date:** September 9–10, 2013

**Minutes of the Public Session of the Meeting of the  
INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD  
CONSULTATIVE ADVISORY GROUP (CAG)  
Held on April 8–9, 2013  
New York, U.S.A.**

**APPROVED**

### PRESENT

#### Members

|                                          |                                                                      |
|------------------------------------------|----------------------------------------------------------------------|
| Linda de Beer                            | Chairman                                                             |
| Conchita Manabat                         | Asian Financial Executives Institutes (AFEI)                         |
| Vânia Borgerth                           | Associação Brasileira de Instituições Financeiras de Desenvolvimento |
| Markus Grund                             | Basel Committee on Banking Supervision (Basel Committee)             |
| Kristian Koktvedgaard                    | BUSINESSEUROPE (BE)                                                  |
| Matthew Waldron                          | Certified Financial Analysts (CFA) Institute                         |
| Federico Diomeda                         | European Federation of Accountants and Auditors for SMEs (EFAA)      |
| Jean-Luc Peyret                          | European Financial Executives Institutes (EFEI)                      |
| Hilde Blomme                             | Fédération des Experts Comptables Européens (FEE)                    |
| Myles Thompson                           | FEE                                                                  |
| John Kuyers                              | Information Systems Audit and Control Association (ISACA)            |
| Glenn Darinzo                            | Institute of Internal Auditors (IIA)                                 |
| Michael Stewart                          | International Accounting Standards Board (IASB)                      |
| William Hines                            | International Actuarial Association (IAA)                            |
| Tom Finnell, Jr.(April 8 <sup>th</sup> ) | International Association of Insurance Supervisors (IAIS)            |
| George White                             | International Bar Association (IBA)                                  |
| Nigel James                              | International Organization of Securities Commissions (IOSCO)         |
| Koichiro Kuramochi                       | IOSCO                                                                |
| Frank Bollmann                           | International Valuation Standards Council (IVSC)                     |

|                 |                                                             |
|-----------------|-------------------------------------------------------------|
| Hayanari Uchino | Japan Securities Dealers Association (JSDA)                 |
| Gaylen Hansen   | National Association of State Boards of Accountancy (NASBA) |
| David Morris    | North American Financial Executives Institutes (NAFEI)      |
| Irina Lopez     | World Bank (WB)                                             |

**Observers**

|                 |                                                                |
|-----------------|----------------------------------------------------------------|
| Chris Hemus     | International Monetary Fund (IMF)                              |
| Martin Baumann* | U.S. Public Company Accounting Oversight Board (PCAOB)         |
| Brian Bluhm     | IFAC Small and Medium Practices Committee, Deputy Chair (SMPC) |

**IAASB**

|                                         |                                                                        |
|-----------------------------------------|------------------------------------------------------------------------|
| Prof. Arnold Schilder                   | IAASB Chairman                                                         |
| Dan Montgomery                          | IAASB Deputy Chair and Task Force (TF) Chair                           |
| Jon Grant                               | IAASB TF Chair                                                         |
| Caithlin Mc Cabe** (Agenda Item F only) | IAASB TF Chair                                                         |
| Bruce Winter                            | IAASB TF Chair                                                         |
| Jim Sylph                               | IFAC Executive Director, Professional Standards and External Relations |
| James Gunn                              | IAASB Technical Director                                               |
| Kathleen Healy                          | IAASB Deputy Director                                                  |
| Brett James                             | IAASB Senior Technical Manager                                         |
| Beverley Bahlmann (Agenda Item C only)  | IAASB Technical Manager                                                |
| Keesha Campbell (Agenda Item E only)    | IAASB Technical Manager                                                |
| Diane Jules                             | IAASB Technical Manager                                                |

**International Ethics Standards Board for Accountants (IESBA) CAG**

|               |                    |
|---------------|--------------------|
| Richard Fleck | IESBA CAG Chairman |
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**Public Interest Oversight Board** Michael Hafeman

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\* 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.

**APOLOGIES**

**Members**

|                                   |                                                                        |
|-----------------------------------|------------------------------------------------------------------------|
| Fang Han                          | AFEI                                                                   |
| Marie Lang                        | EFAA                                                                   |
| Juan Maria Arteagotia             | European Commission (EC)                                               |
| Raluca Painter                    | EC                                                                     |
| Dr. Obaid Saif Hamad Ali Al Zaabi | Gulf States Regulatory Authorities (GSRA)                              |
| Anne Molyneux                     | International Corporate Governance Network (ICGN)                      |
| Andrew Baigent                    | International Organization of Supreme Audit Institutions               |
| Jaseem Ahmed                      | Islamic Financial Services Board (IFSB)                                |
| Abdelilah Belatik                 | IFSB                                                                   |
| Ajith S. Ratnayake                | Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB) |
| Zhirong Mao                       | World Federation of Exchanges (WFE)                                    |

**Observers**

|                |                                    |
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| Norio Igarashi | Japanese Financial Services Agency |
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**April 8, 2013<sup>1</sup>**

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

*To APPROVE the minutes of the September 2012 CAG public session*

OPENING REMARKS

Ms. de Beer welcomed the Representatives and Observers, including new Representatives Mr. Myles Thompson (FEE – Representative replacing Phillip Johnson) and Tom Finnell (IAIS – Representative replacing Ms. Pat Sucher). She also noted that a new ICGN Representative has been appointed and will attend the September CAG meeting. Furthermore, Ms. de Beer welcomed Mr. Michael Hafeman from the PIOB as well as the IAASB Chair, technical staff and Board members who will be deliberating with the CAG as Task Force Chairs as well as the Prof. Annette Kohler and Mr. Arch Archambault in the public gallery.

For the benefit of new CAG Representatives, Ms. de Beer explained the numerous ways in which the CAG's comments are taken into account. She also noted the importance of the Task Force Chairs and IAASB Chairman attending the CAG. Ms. de Beer stressed the importance of having the IAASB Chair and Technical Director as well Task Force Chairs at the CAG meeting to ensure that they hear the views expressed by the CAG directly and are thus able to report to the Task Force and IAASB. In addition to this, there are a number of other mechanisms to ensure that the CAG views are considered by the Board, namely:

- First, Ms. de Beer noted that she attends all IAASB meetings and raises the most relevant points to the IAASB.
- Second, draft minutes of the CAG meetings are made available to the Task Force Chair immediately after the meeting. This, with the verbal input from the Task Force Chair who attended the CAG meeting assist in the deliberation of the Task Force when considering the CAG comments in determining an appropriate way forward.
- Finally, all comments raised by the CAG are minutes in detail and a written report back per comment is then provided by the Task Force Chair and technical staff to provide feedback on how every comment made by the CAG was considered and dealt with. These report backs form part of the CAG meeting papers.

Ms. de Beer also requested members with a keen interest in specific topics currently on the IAASB agenda to make themselves available for the related CAG Working Groups. The purpose of the CAG Working Groups is not to put out documents, but to act as an initial sounding board to the IAASB Task Force in between CAG meetings, should they wish to raise aspects of the project with stakeholders. This does not dilute in any way the discussions to be held at the CAG or the opportunity for CAG Representatives not on the specific Working Group to raise comments.

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

## MINUTES OF THE PREVIOUS MEETING

The minutes of the September 2012 meeting were approved as presented.

### Auditor Reporting (Item B)<sup>2</sup>

*To DISCUSS:*

- *The overall feedback received on the Invitation to Comment (ITC) (exposure draft (ED) planned for approval in June 2013)*
- *Proposed new ISA 701<sup>3</sup> addressing Auditor Commentary, including illustrative examples of the concept*
- *Proposed revisions to ISA 700<sup>4</sup> to operationalize the suggested revisions related to auditor reporting and the building blocks approach*
- *The proposals addressing Going Concern, including possible changes to ISA 570<sup>5</sup>*

Mr. Montgomery introduced the topic, noting the significant progress that had been made by the two drafting teams and thanked them, in particular Mr. Winter as the Chair of the ISA 700 Drafting Team. He also highlighted the contributions of Ms. Healy and Ms. Jules from the IAASB Staff, and IAASB Technical Advisors Ms. Denise Weber and Mr. Jon Rowden. He provided the CAG with an overview of how the discussions at the CAG meeting would be structured in light of the agenda material. Mr. Montgomery also noted the unprecedented level of response to the IAASB's June 2012 ITC and that there was broad support for various suggested improvements to auditor reporting. However, he explained the challenge the Board has in responding to the divergent views as to how best to proceed.

Mr. Montgomery noted the IAASB's commitment to issue an ED on Auditor Reporting in June 2013, and explained that half of the IAASB members have been participating through the two drafting teams. He explained the IAASB will meet five times in 2013 to continue rapid progress with the project.

In asking for overall comments, the Representatives and Observers commented as follows:

- Mr. Kockvedgaard, speaking on behalf of the CAG Working Group (WG) on Auditor Reporting, commended the IAASB for a tremendous job in conducting outreach throughout the project, and recognized the difficult task facing the IAASB in aligning the divergent views. Messrs. James and Kuramochi agreed.
- Mr. Kockvedgaard also noted that Agenda Item B.1 provided a very good overview of the responses to the ITC and the IAASB's discussions to date. He also recognized the significant efforts of the drafting teams and staff. Ms. de Beer and Messrs. Kuramochi and Waldron agreed that significant progress had been made to date.

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<sup>2</sup> Also discussed on April 9, 2013

<sup>3</sup> Proposed ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

<sup>4</sup> Proposed ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

<sup>5</sup> ISA 570, *Going Concern*

Mr. Montgomery drew the CAG's attention to a discussion of outreach activities and the report back included in Agenda Item B.

KEY AUDIT MATTERS (AGENDA ITEMS B.2, B.3 AND B.4)

Mr. Montgomery noted that, while most respondents to the ITC supported the concept of auditor commentary (AC), there were a number of concerns raised, most importantly about the auditor providing original information about the entity and the need to maintain the separate roles of management, those charged with governance (TCWG) and the auditor. He explained that the IAASB had concluded that AC in the auditor's report should initially only be required for audits of listed entities, in light of concerns expressed over the definition of public interest entities (PIEs). Mr. Montgomery further explained that the IAASB supported and renaming the concept of AC to "Key Audit Matters" or KAM.

*Revised Objective for KAM and New Proposed ISA 701*

Mr. Montgomery explained that the IAASB has to date had significant debate on a revised objective. The ITC was focused on "highlighting matters that are, in the auditor's judgment, likely to be most important to users' understanding of the audited financial statements or the audit." Respondents to the ITC had raised several concerns with the dual focus, in part because of the challenges of general purpose financial statements and the difficulties that may exist in the auditor determining what is most important to users' understanding of the financial statements. As a result of these concerns, Mr. Montgomery noted that the IAASB had agreed that a focus on key audit areas and significant auditor judgment may be a useful way forward, recognizing that, because of the nature of a risk-based audit, helping users understand key areas of the audit will help them understand the financial statements and the entity.

Mr. Montgomery explained that, at its February 2013 meeting, the Board firmly supported the change in title and revised objective and had agreed that the requirements and guidance related to KAM to support this objective should be in a new separate auditing standard.

In relation to the revised objective, the Representatives and Observers commented as follows:

- Mr. Waldron questioned, in light of the IAASB's decisions made at its February 2013 meeting, whether there was a possibility that the proposed objective would be reconsidered in light of the CAG's discussions. Mr. Montgomery explained that the IAASB was of the view that the revised objective, and the resulting focus on the audit that was performed, was an appropriate way forward to respond to concerns raised by respondents. However, he noted the Representatives' reactions would be welcome and be further considered by the Drafting Team. Prof. Schilder agreed, noting the IAASB has a further opportunity to improve its proposals before the June ED.
- While supporting the proposed objective, Mr. Diomeda urged the IAASB to further consider whether the final standard will reach the goal of addressing the information and expectation gaps. He cautioned that, since auditors will be free to communicate what they believe is valuable information to users, the expectation gap could be widened if users are anticipating more information from auditors than can reasonably be delivered. Messrs. Hansen, James, Waldron and Uchino agreed that ensuring users' needs are met is paramount to the success of the project.
- Mr. Uchino agreed with the application material that noted the purpose of KAM was to provide additional transparency about the auditor's work in carrying out the audit. Mr. James suggested that, because of the nature of the project, certain stakeholder views (i.e. investors) should be given

more weight. Mr. Montgomery acknowledged the challenges of KAM delivering value to users, and was of the view that practice will evolve over time. In particular, Mr. Montgomery drew the Representatives' attention to paragraphs 2–3 of Agenda Item B.3, which are intended to explain the purpose of communicating KAM and the benefit to users. He explained that the IAASB was of the view that a post-implementation review a few years after the standard is effective would be useful to ensure the intended benefits of KAM were being achieved. Prof. Schilder noted that dialogue will be needed with not only auditors to ensure they are appropriately implementing the standard, but also users and TCWG to ensure they understand the purpose of KAM and can consider auditors' reports appropriately.

- Mr. Morris, supported by Mr. Hemus, suggested that further clarity about the concept of matters that are of most significance in the audit would be useful. Specifically, they questioned whether this was from the auditor's perspective about the audit, or whether it was related to the accounting considerations, and if the objective needed to be placed in the context of the audit findings. Ms. Blomme noted a focus on the performance of the audit and the risk-based approach in the audit may help to clarify the objective. Mr. Hemus noted that the proposed objective could be seen as fairly open-ended, insofar as the auditor may wish to communicate about matters such as an inability to communicate with TCWG in an emerging market, because this was significant to the auditor. Mr. Hansen was of the view that matters determined to be KAM should be those few items that "keep the auditor awake at night." Mr. Montgomery explained the intent was to require the auditors to describe the matters that were of most significance in performing the audit of the financial statements, but that the IAASB was seeking to find a fairly condensed and succinct way to articulate the objective. He also noted that the objectives of the ISAs are aimed at auditors, and the requirements, application material and scope material need to adequately support the objective of the ISA. Ms. de Beer agreed that the objective cannot be read in isolation, and that the requirements and other material in the ISA attempt to explain that understanding the areas of most significance in the audit will help users understand the entity.
- Mr. Koktvedgaard questioned whether the auditor's consideration of KAM was in relation to the planning phase of the audit or after the audit was concluded, as well as how communication about KAM related to significant risk. Particularly, he questioned whether everything reported as KAM would have been assessed as a significant risk. Mr. Stewart was of the view that, due to the risk-based approach of an audit conducted in accordance with ISAs, such significant risks would be included in KAM, as proposed.

In relation to the proposal to develop new ISA 701, the Representatives and Observers commented as follows:

- Mr. Diomeda questioned why it was necessary to develop a new standard relating to KAM. Mr. Montgomery explained that the IAASB had considered incorporating this material in proposed ISA 700 (Revised) but had concluded that, since the discussion of KAM in the auditor's report is a new and significant change in practice, the significance of the auditor's effort might be lost if the requirements were subsumed in an existing standard. He also noted that the detailed requirements for certain other auditor reporting elements are included in standards other than proposed ISA 700 (for example, ISA 706<sup>6</sup> and proposed ISA 720 (Revised)<sup>7</sup>). Prof. Schilder further explained that the

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<sup>6</sup> ISA 706, *Emphasis of Matter and Other Matters Paragraphs in the Independent Auditor's Report*

IAASB was of the view that having a separate standard would reduce complexity and that, given the length of proposed material addressing KAMs, it would likely result in proposed ISA 700 being unbalanced, as such material is only required for listed entities.

- Mr. Waldron reiterated the view that investors would value consistency and comparability between the IAASB and PCAOB initiatives. Mr. Montgomery gave a personal view that the IAASB's thinking was reasonably consistent with the approach discussed at the PCAOB November 2012 Standing Advisory Group (SAG) meeting and subsequent discussions with the PCAOB Board members and Staff. Mr. Baumann agreed that a focus on helping investors understand the audit was not inconsistent with the PCAOB's thinking in principle. He noted the PCAOB's timeline was similar to the IAASB's but also needs to take into account coordination with the US Securities and Exchange Commission and an economic analysis now required by US legislation.

#### *Factors in Determining KAM*

Mr. Montgomery explained that the requirement in paragraph 11 of proposed ISA 701 was developed taking into account the responses to the ITC and the Board's view that the primary criterion of KAM is the nature and extent of the communication with TCWG. In many cases, he noted these may be the significant risks because they require special audit consideration, are often those that are discussed in more depth with TCWG and, in many cases, are related to more complex areas of the financial statements (e.g. complex accounting estimates) as well as the issues likely to cause the auditor to "stay awake at night." He noted that the proposed factors are intended to guide auditors in determining a small number of KAMs to discuss in the auditor's report, noting that the complexity of the matter, the nature of the judgments involved, or the difficulties in obtaining sufficient appropriate audit evidence are key aspects of the auditor's decision-making process, based on what users have said are most important to them. By the auditor pointing out such matters, users may devote more attention to understanding the related disclosures in the financial statements.

The Representatives and Observers commented as follows:

- Mr. Kuramochi suggested a need for the IAASB to ensure it is reflecting the comments made by respondents to the ITC in the ED. He was of the view that the implications of changes to the auditor's report will likely be tested with the next audit failure. Specifically, he questioned whether leaving the matters to be included in the auditor's report to the auditor's judgment was appropriate in light of the feedback from the ITC. In his view, investors would like to understand whether the auditor had performed a high-quality audit and therefore it may be appropriate for the objective to be linked to audit quality in some manner. Mr. Diomeda agreed. Mr. Montgomery explained that users and other respondents to the ITC supported the auditor using professional judgment to determine which matters to communicate in the auditor's report and did not suggest specific matters that should be required to be communicated in all cases. Prof. Schilder was of the view that the value of KAMs will likely evolve as auditors consider how best to discuss such matters in the auditor's report in a manner that does not result in standardized language.

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<sup>7</sup> Proposed ISA 720 (Revised), *The Auditor's Responsibilities for Other Information in Documents Containing or Accompanying the Audited Financial Statements and the Auditor's Report Thereon*



- Mr. Hemus expressed concern that leaving the matters to be disclosed to the auditor's professional judgment may result in a lack of comparability, for example between two similar entities. Mr. Montgomery explained that the factors in the auditor's decision-making process would be expected to be applied for both entities and it would be likely that the auditors of the two entities would have had similar communication with TCWG about these matters. He acknowledged that the proposed requirement in paragraph 16 of the proposed ISA 701 allowed for flexibility of what might be communicated on the matters in the auditor's report.
- Mr. Baumann questioned whether the requirement as drafted would limit the auditor to consider only the matters communicated with TCWG as KAMs. He was concerned that there may be other significant matters that had been discussed with management that the auditor and management agreed did not need to be discussed with TCWG. Mr. Hansen was of the view that auditors generally do not often like to admit they had difficulty in the audit, but that auditors should be required to explain to TCWG the reasons for the difficulties (for example, whether due to poor planning by the auditor or failures by management). Mr. Montgomery explained that ISA 260<sup>8</sup> requires the auditor to communicate with TCWG significant matters discussed with management and significant difficulties encountered during the audit.
- Messrs. Finnell and Hemus questioned whether auditors would be limited to a particular number of KAMs. In Mr. Finnell's view, two to three KAMs would generally be appropriate and would require the auditor, particularly of a large entity, to need to think carefully about which three matters to discuss. Mr. Diomeda was of the view that, since the selection of matters was based on the auditor's judgment, it was necessary to ensure the auditor could include as many KAMs as the auditor considered necessary in the context of the particular audit. Mr. Montgomery explained that the ITC, while noting the final decision was left to the auditor's judgment, indicated a range of two to ten matters would generally be appropriate. Respondents to the ITC noted that a fewer number was preferred, and proposed ISA 701 included application material highlighting the possibility of range of two to seven matters, as many auditors requested guidance on what would generally be appropriate in order to provide a consistent steer for the auditor's decision-making.
- Ms. Blomme was of the view that the matters included as KAMs are not all the matters that were discussed with TCWG. Mr. Stewart agreed, but was of the view that it is the nature and complexity of the matter itself, not necessarily the nature and extent of the communication with TCWG, that should drive whether a matter is a KAM. Mr. Stewart and Ms. Manabat were of the view that the approach of leveraging communication with TCWG was sensible and appropriate. Mr. Stewart noted that matters that were considered sources of estimation uncertainty should be appropriately disclosed in the financial statements in accordance with International Financial Reporting Standards (IFRS).
- Ms. Manabat was of the view that giving further transparency to significant matters communicated with TCWG was appropriate, in particular as it may result in TCWG paying greater attention to management's disclosures in the financial statements and engaging in greater dialogue with the auditor about these matters.

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<sup>8</sup> ISA 260, *Communication with Those Charged with Governance*

- Ms. Blomme and Mr. Grund agreed there would likely always be at least one KAM in the audit of a listed entity. In Ms. Blomme's view, there would likely be a negative perception if the auditor of a listed entity included a statement of "nothing to report" in the auditor's report. Mr. Winter was of the view that there may not be KAMs for certain smaller listed entities that, for example, may be dormant. While agreeing that explaining that having no KAMs to report would be expected to be relatively rare, Mr. Baumann noted that research done by the PCAOB had indicated a significant amount of dormant listed entities.
- Mr. Kuramochi was of the view that auditors generally avoid written communication about critical issues relating to fraud and other sensitive matters. Messrs. Hemus and Kuramochi questioned whether discussing such matters in the auditor's report would be appropriate. Mr. Montgomery also noted that the Drafting Team had considered whether there are some matters that should not be communicated in the auditor's report, primarily because it may be difficult to describe such matters succinctly in the auditor's report without the benefit of two-way communication. Mr. Baumann urged the Drafting Team to consider whether the proposed application material in paragraph A28 that explained such circumstances was appropriate, as some could use such guidance to avoid discussion of most matters. He raised the example of circumstances where the most significant risk in the audit is the quality of the incumbents in the key roles of the CEO and CFO, who exercise influence over the financial statements as a whole. In his view, this could result in a significant deficiency in internal entity-level controls which should be communicated as a KAM, due to the pervasive effect on the financial statements. Mr. Morris noted that there are frequently circumstances in which the auditor meets with TCWG without management present. Mr. Morris also noted that topics covered during those sessions relating to management may not be appropriate to report externally. Mr. Montgomery noted the IAASB had not yet considered the wording, but it would be important not to give too much flexibility to auditors. He suggested the auditor's description of sensitive matters could explain that the auditor had spent a significant amount of time discussing the particular matter with TCWG.
- Mr. White noted that the illustrative report included introductory language to explain the purpose of KAMs in the context of the overall audit. In his view, it would be unlikely that there were matters discussed in KAM that had not been disclosed in the financial statements, due to potential liability issues. Mr. Hemus suggested it may be useful to clarify that expectation. Prof. Schilder noted the IAASB needed to reflect on liability risks, either in circumstances when the auditor discussed a matter that was not disclosed in the financial statements, but also when the auditor decided not to disclose a particular matter that later became problematic.
- Mr. Peyret agreed that users may be more likely to question the accounting in relation to matters in the auditor's report. He was of the view that it will be necessary to educate users about the purpose of KAMs to minimize confusion. Mr. Montgomery noted that many respondents to the ITC, including preparers and auditors, had expressed concern about the auditor providing original information about the entity, and this approach sought to ensure users could find whether management had discussed the accounting implications of the matters that were highlighted by the auditor.
- Mr. Waldron noted that the CFA Institute surveys had indicated that investors would like to know more about the materiality levels applied in the audit. In his view, it would be appropriate for the IAASB to consider including guidance on whether auditors should discuss materiality in the auditor's report. Mr. Montgomery explained that only a limited number of respondents to the ITC

highlighted the need for a discussion of materiality in the auditor's report, with auditors and preparers expressing concern that users may not be able to appropriately interpret such information. He noted that the Drafting Team would give further consideration to the matter in light of the UK Financial Reporting Council's (FRC) consultation on a similar requirement.

- Mr. Hansen questioned the impact of year-to-year reporting of KAM and whether the auditor would need to update KAMs or explain why an issue noted as a KAM in the prior year was no longer considered a KAM. Mr. Montgomery explained the Drafting Team had not yet fully considered the issue, but was initially of the view that the auditor's decision-making process on KAM was based on the current year audit. In his view, certain matters may be most important in one year but could be less important in the next year, but acknowledged some may wish for auditors to address this.
- Mr. James noted recent inspection findings by the International Forum of Independent Audit Regulators (IFIAR) indicated that auditors are not consistently identifying significant deficiencies in internal controls. In light of this, he questioned how many KAMs would be noted in practice relating to significant deficiencies in internal controls.
- Mr. Koltvedgaard questioned whether it was necessary to consider matters other than those that were significant risks in determining KAMs. Mr. Montgomery explained that the Drafting Team wished to make a strong link to the consideration of significant risks identified both at the planning stage and during the audit. However, he noted that the findings from Phase II of the ISA Implementation Monitoring project had indicated that auditors may not consistently be classifying certain matters as significant risks, for example, accounting estimates with a high risk of material misstatement. Mr. Montgomery explained that the Drafting Team did not want to limit KAMs to matters classified as significant risk so that the scope could be sufficiently broad, but was of the view that it was useful to give a strong steer in proposed ISA 701 about the relationship between significant risks and KAM. Mr. Montgomery further noted the Drafting Team's proposals to strengthen communication with TCWG about significant risks through revisions to ISA 260.

### *Illustrative Examples*

Mr. Montgomery explained that the illustrative examples included in the ITC had been revised to take into account respondents' comments. In particular, he noted that respondents were of the view that the illustrative examples should provide more context about why the matter was important to the audit, rather than simply referring to the financial statements, and that this is consistent with discussions at the November 2012 PCAOB SAG meeting. Mr. Montgomery explained that, while there was some support for highlighting the auditor's procedures in relation to KAMs, the majority of respondents were of the view that it would be difficult to describe the auditor's procedures in a complex audit area in a meaningful yet succinct way. He also noted there was some support for a discussion of findings or an auditor conclusion, but respondents also raised concerns about KAMs being seen as separate assurance on individual matters.

Mr. Montgomery also noted that many respondents were of the view that the contextual language explaining why KAM were discussed in the auditor's report, how such matters were determined and how the discussion of the individual matters related to the financial statements as a whole was an essential part of the auditor's report. Mr. Montgomery highlighted, however, that it was seen to be lengthy when placed as the introduction to the section.

The Representatives and Observers commented as follows:

- Mr. Koktvedgaard noted the CAG WG had divergent views on value and appropriateness of the examples, but was of the view that the IAASB would learn more from respondents to the ED. He explained that some WG members were of the view that the examples were not necessarily beneficial but rather an enhanced explanation of the auditor's responsibilities rather than the auditor's approach to the audit, but that it was also important to consider whether the examples were harmful.
- Mr. Kuramochi noted the illustrative examples will send an important message to auditors implementing proposed ISA 701, both in terms of the topics that may be selected and the level of detail that should be included in the auditor's report. He suggested it would be useful to provide an example of a more sensitive situation.
- Mr. Waldron noted that, while the examples included new information, he was not convinced that the examples would be responsive enough to the calls from investors for more insight from auditors, in particular the auditor's views on accounting policies. Mr. Montgomery explained that the development of illustrative examples had been the most challenging to the IAASB and the Drafting Team insofar as having meaningful examples that could be implemented in practice. He acknowledged that the IAASB may not ever be able to fully meet the demands of users and investors but was seeking to improve practice, and he was of the view that the auditor saying something about matters which were significant in the audit would signal users should pay attention to those matters and further engage with management and TCWG about them. Mr. Montgomery explained the IAASB would seek to further strengthen the examples before exposure, but would need to be clear in the ED how the IAASB had arrived at the examples and why they are structured the way they are. Mr. Sylph agreed, noting that it was important for the model to be flexible enough to allow for auditors to discuss the most important matters in any particular audit so that it can evolve over time.
- Mr. Kuramochi also noted that IOSCO was of the view that a case study could be a useful analysis to determine the appropriate level of detail in the description of KAM, for example on an entity such as Enron, to determine whether users would have found value and gained insight into the potential issues facing the entity by reading KAMs. Mr. Waldron agreed. In Mr. Kuramochi's view, the true value of changes to auditor reporting will be tested with the next audit failure.
- Mr. Koktvedgaard questioned whether it was necessary to include an example of the auditor's discussion of the overall audit process, in particular the approach to tests of controls and substantive testing.
- Mr. Morris was of the view that the examples addressing goodwill and financial instruments were appropriate in light of the interaction between audit and accounting issues, and addressed topics that were likely to be considered KAMs. However, he was of the view that the example of an unusual transaction could be replaced with an example of a matter identified as a significant risk.
- Mr. Hines noted the difficulties in separating auditing from accounting issues in the descriptions of KAMs. In the financial instruments example, he was of the view that it was unclear whether the use of an entity-specific valuation model would have been required by the financial reporting framework or whether management had a choice of models. Mr. Finnell noted that the matter of valuation of

financial instruments would be a standardized disclosure for a financial institution and suggested industry-specific guidance may be appropriate.

- Mr. Diomeda questioned why the illustrative example about financial instruments included a conclusion while the other two examples did not. Mr. Thompson was of the view that the examples would be enhanced if the auditor discussed whether misstatements had been identified relating to the matter or if the auditor confirmed the auditor's view that the disclosures in the financial statements were appropriate. Ms. de Beer highlighted the concern that users may interpret such conclusions as piecemeal opinions or separate assurance on the matter.
- Mr. White suggested greater transparency about what caused the auditor to determine a particular matter as a KAM would be appropriate. Mr. Grund agreed this would be useful.
- Messrs. Diomeda and Grund questioned the need for the disclaimer in the contextual language. Mr. Morris was of the view that such language was generally important but could be further streamlined. Mr. Thompson preferred the language used in the ITC. Mr. White suggested it would be more appropriate to explain what value the user might derive from understanding KAM, and suggested that language in paragraph 2 of proposed ISA 701 could usefully be included in the auditor's report. Mr. Montgomery noted the new language was developed in response to concerns raised by preparers and auditors that it needs to be clear to users that the discussion of KAM in the auditor's report is not a comprehensive list of matters discussed with TCWG.

#### *Proposed Changes to ISA 260*

Mr. Montgomery explained that the proposed changes to ISA 260 were incremental revisions (rather than substantive changes) that the Drafting Team considered necessary to underpin the changes to auditor reporting and that the majority of revisions were to include new application material. He highlighted the proposed new requirement for the auditor to communicate significant risks with TCWG. Finally, Mr. Montgomery explained that the Drafting Team had considered whether communication with TCWG should be in writing, noting that extant ISA 260 allows for flexibility.

The Representatives and Observers commented as follows:

- Mr. Bluhm inquired whether the revised requirements in ISA 260 were intended to apply to all auditors or only auditors of listed entities who would be required to include KAMs in the auditor's report. He noted some concern from small and medium practices (SMPs) that there would be an increase in the scope of an audit. Mr. Montgomery confirmed that the requirements would apply to all audits, but that the Drafting Team did not believe there would be a significant incremental burden for auditors of small- and medium-sized entities (SMEs) to communicate about significant risks or significant unusual transactions if applicable. Mr. Bluhm suggested that this could be further clarified in the ED and views solicited to ensure such changes are appropriate. Messrs. Diomeda and Morris agreed that such revisions may only be appropriate for listed entities to mirror proposed ISA 701. Mr. Montgomery were of the view that such enhancements to ISA 260 would likely be useful in practice, even if auditors were not required to include KAMs in the auditor's report and that these communications were scalable in cases where auditors of entities other than listed entities included KAMs in the auditor's report. Mr. Koktvedgaard suggested ISA 260 could be restructured to more clearly articulate which requirements were applicable only to listed entities.

- Mr. White agreed that the proposed revisions to ISA 260 were appropriate, because an expected benefit of proposed ISA 701 is to improve communication between the auditor and TCWG. He was of the view that the communication proposed by the changes to ISA 260 are likely to already be taking place and therefore not cause a significant incremental burden, but that clarification of the need for such communication would be useful. Mr. Baumann agreed, noting that the additions would make improvements to audit quality by requiring a robust discussion of some of the most important aspects of the audit. He explained that the PCAOB had given consideration of the incremental costs in proposing its auditing standard addressing communication with TCWG and had concluded that, because there was no additional work effort, communicating what is already expected to be documented should not be overly burdensome. He noted that increased communication with TCWG could result in additional time being spent by audit committees but that such communication would enable them to better carry out their responsibilities.
- Messrs. Bluhm, Koktvedgaard, Kuramochi and White were of the view that it may be appropriate to require written communication with TCWG about those matters included as KAMs in the auditor's report. However, Mr. Koktvedgaard cautioned that this could result in a voluminous communication as the auditor would be required to communicate the audit plan to TCWG, and urged the IAASB to specifically request feedback on this matter in the ED.
- Mr. Peyret was of the view that communication should always be in writing to provide evidence of the discussions in case of disputes with the entity. Mr. Grund noted the recent guidance from the Basel Committee set out an expectation that communication with TCWG would always be in writing, but also introduced the concept of proportionality, relating to size, complexity, structure, economic significance, and the risk profile of a bank.
- Mr. Peyret also noted the need for the IAASB to consider Article 23 of the proposed European Commission (EC) legislation.
- Mr. Kuramochi suggested it may be useful to consider whether the factor in the proposed ISA 701 to consider the difficulty of the judgment involved in determining KAM was adequately aligned with ISA 260. Mr. Montgomery noted this was intended to be addressed by paragraph 16 of proposed ISA 260 (Revised), but that further application material may be useful to align the two standards.
- Mr. Diomeda suggested flexibility regarding the form of communication with TCWG was appropriate. He noted that, in SME audits, discussions with TCWG occur on a daily basis and a more stringent written requirement would be burdensome. Mr. Baumann agreed, noting that the PCAOB's auditing standard allows for similar flexibility because so much of the communication with TCWG are oral, and such communication is an iterative process depending on what management has already communicated to TCWG. Rather than requiring communication with TCWG to always be in writing, the PCAOB agreed that requiring the auditors to document the substance of their communication with TCWG would be more appropriate. Mr. Koktvedgaard suggested that the audit committee minutes could serve as a record of the communication.

*Including KAMs when the Auditor's Opinion Is Modified*

Mr. Montgomery also noted that the Drafting Team was of the view that a discussion of KAMs should be included even when the auditor expresses a qualified or adverse opinion.

- Mr. Hansen noted that adverse opinions are so rare that it may not be necessary for the IAASB to specify what is necessary in such circumstances. Mr. Koktvedgaard noted this was consistent with the views of the CAG WG.
- Mr. Hemus noted that the International Monetary Fund had received disclaimers of opinions for auditors of central banks and there may be useful information that could be communicated as KAMs in such circumstances. Ms. Lopez agreed.

#### *Documentation*

The Representatives and Observers commented as follows:

- Mr. Baumann noted the proposed documentation requirement was unclear and appeared to suggest that the auditor's rationale for the decision-making process surrounding KAM should be documented. In his view, what is important from a reviewer's perspective is what was discussed with TCWG and the engagement quality control reviewer. He suggested a focus on documenting those matters that the auditor did not consider to be KAMs would be more appropriate. Mr. Montgomery agreed that further clarification could be helpful.

#### *KAM for Audits of Entities Other than Listed Entities*

Mr. Montgomery noted that auditors of entities other than listed entities would not be precluded from discussing KAMs in the auditor's report, provided that all the requirements of proposed ISA 701 were applied. He explained that auditors of entities other than listed entities may include KAMs in the auditor's report because (i) law or regulation may require them to do so; (ii) the entity may request the auditor to do so; or (iii) the auditor may voluntarily decide to do so. The IAASB had previously determined that in such circumstances in order to promote consistency the auditor of an entity other than a listed entity would be required to apply proposed ISA 701 in its entirety.

- Mr. Hansen suggested flexibility was necessary, to enable auditors to consider whether it would be appropriate to include KAMs in the auditor's report in the context of the audit. However, he was of the view that, once an auditor of an entity other than a listed entity decided to include KAMs, such decision should not be changed each year.
- Mr. Hemus noted that practice for entities other than listed will likely evolve over time. In his view, preparers will likely want to consider whether the inclusion of KAMs on a voluntary basis is viewed as a positive approach, or whether it is seen as negative.
- Messrs. Bluhm, Hemus and Stewart and Ms. Lopez suggested agreement with management and TCWG at an early stage would be appropriate. Mr. Stewart noted the benefits of the communication of KAMs may warrant the IAASB further considering whether KAMs should be required for all entities. Messrs. Bluhm, Stewart, Thompson and Waldron agreed that when KAM is included it should be done in a similar manner as listed entities, as differential reporting is not useful.
- Mr. Diomeda suggested the auditor of an entity other than a listed entity could alert management and TCWG about the possibility of the auditor including KAMs in the auditor's report when the engagement is accepted, rather than seek explicit agreement from TCWG before including KAM in the auditor's report.

- Mr. Bluhm noted the discussion about KAM for entities other than listed entities would be further informed by the IAASB's determination about how to treat the Other Matter paragraphs going forward. Prof. Schilder agreed.

#### ISA 700 ISSUES (AGENDA ITEMS B.5, B.6 AND B.7)

Mr. Winter introduced the topic, noting there were a number of issues related to proposed ISA 700 (Revised) on which the CAG's feedback was being sought.

#### *Consistency, Relevance, and Flexibility, Including the Effect of Law, Regulation, and National Auditing Standards on Auditor Reporting*

Mr. Winter explained that, although proposed ISA 700 (Revised) prescribed the specific wording for certain sections of the auditor's report, the ordering of the elements of the revised ISA 700 auditor's report would not be mandated. He also explained that the level of flexibility with respect to law or regulation within extant ISA 700 would be maintained.

The Representatives and Observers commented as follows:

- Mr. Koktvedgaard noted that the CAG WG was of the view that the IAASB should mandate the ordering of the elements in the auditor's report. The WG members believed having consistency in the ordering of the elements in the auditor's report would be beneficial in ensuring that important information in the auditor's report is conveyed with the same level of prominence and emphasis that the IAASB intends and would avoid confusion that a different presentation may be interpreted as an issue in the audit. He was of the view that it was unnecessary to incorporate another layer of flexibility beyond allowing law or regulation to prescribe a different order. Ms. de Beer asked whether the CAG WG had views as to whether the specific wording within the sections of the auditor's report should be mandated. Mr. Koktvedgaard responded that, for most sections of the auditor's report, such as the opinion paragraph, the wording should essentially be the same, so as to maintain consistency in the information communicated to users, but that some flexibility may be needed. He noted that the only differences that should exist in the auditor's report should be because of law or regulation.
- Mr. Thompson strongly recommended that the IAASB maintain the level of flexibility that exists within extant ISA 700 so that jurisdictions can continue to have the ability to tailor requirements relating to the content and layout of the auditor's report based on specific national circumstances through law or regulation.
- Mr. Waldron was of the view that it was important to have consistency in the placement of the "pass/fail" opinion upfront in the auditor's report, but that the IAASB could allow flexibility in the placement of the other elements of the auditor's report.

#### *Explicit Statement of Compliance with Ethical Responsibilities*

In response to the proposed requirement and illustrative text relating to a statement of compliance with ethical requirements, including independence, in the auditor's report, the Representatives and Observers commented as follows:

- Mr. Koktvedgaard expressed support for the new requirement, in particular the explicit reference to independence, but suggested that proposed ISA 700 (Revised) should also require that the



auditor's report include a reference to the specific code with which the auditor is required to comply with in respect of independence. Mr. Winter explained that many different independence requirements may apply to a large multinational audit, which could result in a lengthy disclosure in the auditor's report if the auditor was required to name all sources of independence requirements. He highlighted application material that explained that the auditor may be required by law or regulation to include more specific information about compliance with ethical requirements, such as a reference to the specific independence code, in the auditors' reports. Mr. Morris further emphasized the existence of varied ethical rules and independence codes across jurisdictions and suggested that an approach similar to the one taken in dealing with different accounting frameworks could be useful, whereby in a group audit a common denominator is determined for purposes of establishing a framework for auditor reporting and reference is made to a specific ethics code in the auditor's report. Mr. Fleck agreed that an explicit reference to the source(s) of the relevant ethical requirements would be appropriate.

- Mr. Baumann suggested that, because it is not uncommon for auditors to violate and remedy independence rules during the course of an audit engagement, having a definitive statement about compliance may be misleading to users. Mr. James agreed that it would be inappropriate for the auditor to state compliance if the auditor had not complied with all relevant ethical requirements. Mr. Baumann added that, in the US, auditors would not be able to make such a statement because the existence of a violation would not constitute compliance with all of the ethical code, including independence rules. Mr. Winter responded that the IESBA *Code of Ethics for Professional Accountants* (IESBA Code) was recently revised to include provisions for dealing with breaches of independence requirements. Ms. Healy further explained that the IESBA Code adopts a safeguards and threats approach, and establishes a framework that requires auditors to identify, evaluate, and address threats to independence. In such cases, while the auditor has not complied with all independence requirements, the auditor is able to assert that the auditor is independent of the entity because TCWG have concurred with this assertion. Mr. Stewart noted that the use of the title "Independent Auditor's Report" was an implicit statement of compliance.
- Mr. Fleck agreed that the use of the phrase "compliance with" caused difficulties in the case of breaches and suggested revising the statement to parallel the statements relating to which auditing and accounting standards applied to the engagement. Mr. Baumann noted that such a statement would be interpreted differently from the one presented in the proposed illustrative auditor's report. Mr. James disagreed and suggested that, in his personal view, with respect to the IESBA Code even when there is an independence violation, auditors could still say that they were compliant, if they did what the Code calls for – which could simply be reporting the matter to TCWG.
- Mr. James added that some members of IOSCO questioned whether investors would also want to know about breaches, and suggested that those breaches also be reported in the auditor's report.
- Mr. Hines suggested that the requirement in ISA 260 for the auditor of a listed entity to communicate with those TCWG about independence should be expanded to all entities.

#### *Enhanced Descriptions of the Responsibilities of Management, TCWG, and the Auditor*

In response to requests for views on the proposed requirements and illustrative text relating to enhanced descriptions of responsibilities of management, TCWG and the auditor, the Representatives and Observers commented as follows:

- Mr. Koktvedgaard noted that there was support among WG members for the proposed requirement permitting auditors to relocate the description of the auditor’s responsibilities to a website when law or regulation permits. Ms. de Beer further probed by asking whether the IAASB should mandate the exact wording to be used on the website. Mr. Koktvedgaard suggested that the exact words to be used on the website need not be mandated. Ms. Blomme and Messrs. Bluhm and Fleck agreed. Mr. Winter responded that, while there may be merit in mandating the exact words to be included on the website, the Drafting Team had determined it would be appropriate to require that the description on the website be consistent with what would otherwise be required to be included in the auditor’s report, to allow for flexibility to describe other concepts.
- Ms. Blomme noted that a similar mechanism now exists in Europe and that, while some countries were not supportive of it when it was first adopted, many have now embraced it. Mr. Fleck agreed, explaining that, in the UK, the FRC allows auditors the option of relocating the description of auditor’s responsibilities to a website and a number of major accounting firms use this option. The UK FRC determined that the website was a viable option because investors did not want to read standardized language in every report as they were already familiar with the concepts. He noted that the UK stakeholders cited benefits of not only less standardized information in the auditor’s report, but also the flexibility to have a more detailed description of the audit on the website, though he noted that such description is close to the description that would be required to be used in the auditor’s report.
- Messrs. Hansen and Waldron expressed a contrary view, noting a preference for having the description of the auditor’s responsibilities within the auditor’s report. Mr. Waldron added that investors prefer to have all information about the audit available in one location. Mr. Hansen noted that, from a regulatory perspective, there was a preference for having all the information in the auditor’s report.
- Ms. Blomme questioned whether, if not relocated to a website, the length of the material to describe the auditor’s responsibilities was appropriate.
- Mr. Diomeda questioned the statement in the auditor’s responsibility section that explained “Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.” He noted that misstatements are considered in the aggregate so the use of the phrase “individually or in the” was redundant. Mr. Diomeda was also concerned that the phrase “could reasonably be expected to influence the economic decision so users” was difficult to understand.
- Mr. Koktvedgaard expressed preference for a short and concise description of management’s responsibilities for the financial statements in the auditor’s report. He also expressed support for having additional guidance in proposed ISA 700 (Revised) that allowed for a cross-reference to a location to where a further description of management’s responsibilities is included. Ms. Blomme suggested it may be necessary to reinstate the description of management’s responsibilities relating to going concern.

- Mr. Kocktvedgaard suggested that proposed ISA 700 (Revised) should require that the auditor's report include a statement about quality control procedures in accordance with ISQC 1.<sup>9</sup> He also questioned why the IAASB standards do not make explicit reference to other standards issued by IFAC.

#### *Disclosure of the Name of the Engagement Partner*

Mr. Winter explained the IAASB had mixed views on the appropriateness of disclosing the name of the engagement partner in the auditor's report. Mr. Winter noted that the IAASB recognized that, in exceptional circumstances, disclosure could lead to a significant security threat to the person and accordingly disclosure of the name would not be required in those circumstances. Ms. de Beer noted that the CAG had previously strongly supported such disclosure. She shared her interpretation from the IAASB's December 2012 and February 2013 meetings, indicating the active and lively discussions and deliberations already held by the IAASB on the topic, which was not as unanimously in support of such disclosure. She expressed concern that the US liability issues raised at the Board relating to disclosing the name of the engagement partner could hinder the IAASB's progress on the auditor reporting project as a whole and it would be a pity that so much progress in the public interest otherwise to be achieved by the project might run, in her personal view, the risk of being derailed by the disclosure of the name. She therefore asked that Representatives and Observers also advise her, for commenting to the IAASB, as to whether the CAG was of the view that, if this aspect of the project should become a "deal breaker", it could be delinked from the auditor reporting project for the sake of progress and then rather be addressed at the national level.

In response to Ms. de Beer's question Representatives and Observers commented as follows:

- Messrs. Grund, Hansen, Hemus, Kocktvedgaard, Stewart and Waldron expressed strong support for requiring the name of the engagement partner to be included in the auditor's report, but acknowledged that the auditor reporting project should not be compromised if the IAASB is unable to conclude on disclosing the name of the engagement partner.
- Mr. Hansen did not support the inclusion of a "harm's way exemption" and suggested that threats of such significance could raise questions about an engagement partner's independence.
- Mr. Waldron acknowledged the debates in the US about disclosing the name of the auditor's report, as well as the concerns expressed by auditors, and was of the view that other improvements to auditor reporting, in particular KAM, were of greater importance.
- Mr. Kocktvedgaard suggested that there is a public interest benefit in having the name of the engagement partner in the auditor's report. He added that it is difficult for investors to easily track information about breaches of independence, or conflicts of financial interests, if the name of the engagement partner is not disclosed in the auditor's report. Mr. Kocktvedgaard further added his view that audits are all about people and that when different engagement partners are involved in the audit, the public should know.

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<sup>9</sup> 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*

- Messrs. Hemus, Grund, and Stewart suggested that the proposed requirement also applied to entities other than listed entities. Mr. Hemus suggested that the IAASB consider making the requirement applicable to PIEs. Mr. Grund suggested the disclosure could also be required for systemically important financial institutions (SIFIs). Mr. Winter explained that the focus on listed entities was due to demand coming primarily from institutional investors (i.e. users of listed entity financial statements), and that the proposed “harm’s way” requirement was put forth as a compromise in order to align with requirements in jurisdictions, such as the EC, where disclosure of the engagement partners name is already required. Mr. Winter cited feedback from respondents to the ITC about the challenges in determining a global definition for PIEs that would be universally understood.
- Mr. Stewart added that the construct of “unless otherwise publicly available” would make retrieving the name difficult for users.
- Mr. Morris was of the view that the IAASB should determine what is best, particularly since most jurisdictions already have such a name disclosure requirement. He noted that the ISAs would not apply in the US for listed entities, but acknowledged that the US Auditing Standards Board was not supportive of a proposed requirement due to liability concerns. However, he suggested this should not preclude the IAASB from moving forward with a proposed requirement. He also suggested the proposed standard be drafted in a manner that would allow jurisdictions that adopt the revised ISA 700 to depart from having to comply with the new requirement to disclose the name of the engagement partner when law or regulation determines it necessary or permissible to do so. Mr. Winter noted an alternative would be to leave the decision to require disclosure of the name of the engagement partner to national standard-setters (NSS) in light of liability issues unique to each jurisdiction. Mr. Winter noted, however, that some may view this as the IAASB missing an opportunity to take a leadership position on enhancing transparency.

#### GOING CONCERN

Mr. Winter introduced the topic, briefing Representatives and Observers on the feedback received on auditor reporting on going concern featured in the ITC, including the interest that the EC attaches to the issue, and liaison with accounting standard setters. He noted that many respondents to the ITC raised concerns about the proposed wording in the ITC potentially raising the expectation gap. Mr. Winter outlined the following three options considered by the Drafting Team in determining an approach for auditor reporting proposals relating to going concern:

- Option A (Preferred by the Drafting Team) – Continue to pursue improvements in auditor reporting on going concern using the premise of extant ISA 570;
- Option B – Exclude going concern from the scope of the auditor reporting project, awaiting the finalization of accounting standards to inform a broader ISA 570 revision project; and
- Option C – Proceed with auditor reporting on going concern, and attempt to predict likely changes to accounting standards and factor in potential improvements to auditor reporting that could result from them.

In relation to the proposed approach to auditor reporting on going concern, the Representatives and Observers commented as follows:

- Ms. de Beer indicated that, based on her observation, the IAASB CAG's views to date have been for the IAASB to move forward on going concern in the auditor reporting project and not wait for the accounting standard setters to complete improvements to the financial reporting frameworks, as this can take a long time.
- Mr. Stewart provided an IASB staff update on the status of the IASB's going concern project. He noted that the objective of the IASB's going concern project was not to change the fundamentals of financial statement preparation using the going concern basis of accounting, but instead to clarify when a material uncertainty exists and what financial statement disclosures are needed in such circumstances. Mr. Stewart also reported that the IASB is planning to consider staff proposals on this topic in May 2013 and it will likely be at least a year before the project would be finalized. Such proposals are expected to focus on disclosing events and conditions that would likely cause an entity to fail, before considering any mitigating actions that management might take, and presenting those mitigating factors as well as a conclusion as to whether a material uncertainty exists. Mr. Baumann commented that the IASB approach in principle sounded very similar to the current approach being considered by the US Financial Accounting Standards Board (FASB). Mr. Baumann then asked about whether the IASB and FASB were planning to explore convergence as the going concern projects progressed towards completion. Mr. Stewart responded that the IASB and FASB are closely liaising, and actively monitoring each other's work.
- Ms. Blomme noted that the EC proposals related to auditor reporting were explicit about auditor reporting with respect to going concern, but remained silent in the accounting directive revision about changes to management reporting responsibilities related to going concerns. She added that there is an understanding in the European community that the EC proposals will be updated to include provisions for management to confirm that the financial statements have been prepared using the going concern basis of accounting. Ms. Blomme indicated that it was important for the auditor's report to include an explicit statement about management's responsibility with respect to going concern. She also re-emphasized FEE's support for having going concern statements in the auditor's report for audits of all entities. Mr. Winter acknowledged Ms. Blomme's comments and the importance of having a more explicit statement about management's responsibility with respect to the use of the going concern assumption in preparing the financial statements. Mr. Winter agreed that explicit statements by management about both the use of the going concern assumption and the identification of material uncertainties would provide a useful basis for auditor reporting.

In relation to the proposed illustrative wording in the auditor's report relating to going concern, the Representatives and Observers commented as follows:

- Mr. Koktvedgaard suggested that the proposed wording relating to going concern in the illustrative auditor's report and the proposed requirement should be revised to more explicitly accommodate the various accounting frameworks. Mr. White agreed, noting that the illustrative example was drafted on the basis of IFRS.
- Mr. Koktvedgaard questioned whether it was necessary to have a separate going concern section in the revised illustrative auditor's report and suggested that the IAASB allow jurisdictions the flexibility to determine the placement of additional information about going concern in the auditor's report. For example, he suggested that the IAASB consider the possibility that a jurisdiction may determine it necessary to have law or regulation that requires going concern matters be reported as KAMs in all circumstances, or have it be included as part of the overall conclusion in the opinion

section. Mr. Thompson added that, in a situation where the auditor spends a lot of time on going concern issues, it would likely also be a KAM in addition to required reporting in the going concern section. Mr. Winter acknowledged Mr. Koktvedgaard's view, noting that his suggestion had been previously explored but, in light of the strong steer received from respondents to the ITC and other stakeholders, in particular the EC, it was necessary to have statements about going concern featured prominently in the auditor's report.

- Mr. Baumann cited concerns about the wording of the going concern section, and believed that the wording would be unhelpful to users and could potentially cause more confusion rather than reducing the expectation gap. Specifically, Mr. Baumann suggested that the concepts explained in the first two sentences of the section contradicted each other and commingled the topics of the use of the going concern assumption and the basis of accounting. Mr. Stewart agreed, highlighting that there might be events and conditions that indicate that an entity might fail, before mitigating factors have been considered. Mr. Stewart noted that, if there are still material uncertainties after such mitigating factors, there is a net risk that should be disclosed. Mr. Baumann also noted that an inability to discharge liabilities does not indicate that the use of the going concern assumption is inappropriate, as entities can be in bankruptcy proceedings for many years, and that the concept of the "foreseeable future" was more closely linked to material uncertainties. Finally, Mr. Baumann was of the view that, while the statement relating to the identification of material uncertainties was more useful than the conclusion on the appropriateness of the going concern assumption, which he did not support, users will likely have difficulty understanding the nature of the auditor's disclosures unless the language is further revised.
- Mr. White expressed support for Mr. Baumann views, and asked for clarification as to whether the first paragraph of the illustrative auditor's report is framework-specific.
- Mr. Stewart also suggested editorial suggestions to the going concern section, including more closing aligning the first two sentences with the wording that exists under the accounting framework.
- Mr. Koktvedgaard questioned whether the auditor would include an Emphasis of Matter (EOM) paragraph when a material uncertainty had been identified, suggesting that the sub-heading "Disclosures about Material Uncertainties" be replaced with the more familiar term "Emphasis of Matter." Ms. Healy clarified that the extant ISA 570 allows flexibility to use a heading titled "Emphasis of Matter" or another suitable title when a material uncertainty exists and is properly disclosed in the financial statements. She noted that the Drafting Team had concluded that a more tailored heading would be appropriate and, in such circumstances, that the statement about material uncertainties should be positioned within the GC section. Mr. Koktvedgaard was of the view that using an EOM heading would appropriately draw users' attention to the fact that the auditor's report was unusual. Mr. Montgomery explained that the trigger for such disclosure would not differ from extant ISA 570, and that respondents to the ITC saw merit in including all reporting relating to going concern in a separate section prominently placed in the auditor's report.
- Mr. Waldron acknowledged the views expressed on the illustrative text relating to going concern, noting that it was a very interesting debate. He added that he agreed with elevating the importance of going concern by having a separate section about it upfront in the auditor's report. However, investors are more concerned with just having the new information available in the auditor's report.

Mr. Waldron also expressed concerns for the wording included, stating that some of it may be too standardized.

- Mr. Koktvedgaard also suggested that in the case of an adverse auditor's opinion, a going concern section would not be necessary.

Mr. Winter thanked the Representatives and Observers for their comments and feedback and indicated that he would convey their views to the IAASB and DT-700, in particular on the need to re-work the illustrative text relating to statements about going concern in the auditor's report to have them better reflect users' needs. Specific to drafting the requirements about auditor reporting on going concern, Mr. Winter also indicated that further consideration would be given to accommodating the varied accounting frameworks.

#### CLOSING

Messrs. Montgomery and Winter thanked the Representatives and Observers for their comments and noted the IAASB would further consider them as it seeks to finalize the ED for approval at its June 2013 meeting. Mr. Montgomery confirmed that he and Mr. Winter intended to solicit feedback from the CAG WG in advance of the June 2013 IAASB meeting on a select number of issues.

#### **Audit Quality (Item C)**

*To REPORT BACK on the September 2012 CAG discussions and EXPLORE Member Organizations' reactions to the proposed Audit Quality Framework (consultation paper out for public comment through May 15, 2013)*

Mr. Grant introduced the topic, noting that the purpose of the agenda item was to hear Representatives' initial responses to the questions posed in the Consultation Paper, *A Framework for Audit Quality* (the Framework). He noted that the Consultation Paper was still out for comment, with a comment deadline of May 15<sup>th</sup>. Mr. Grant highlighted that the discussion might also help Member Organizations in preparing their written responses as they hear the discussion between Representatives.

The questions posed in the Consultation Paper were:

- (a) Does the Framework cover all of the areas of audit quality that you would expect? If not, what else should be included?
- (b) Does the Framework reflect the appropriate balance in the responsibility for audit quality between the auditor (engagement team and firm), the entity (management and those charged with governance), and other stakeholders? If not, which areas of the Framework should be revised and how?
- (c) How do you intend to use the Framework? Are there changes that need to be made to the form or content of the Framework to maximize its value to you?
- (d) What are your views on the suggested Areas to Explore? Which, if any, should be given priority and by whom? Are there additional Areas to Explore?

Prof. Schilder noted that the International Corporate Governance Network (ICGN), in conjunction with the US Center for Audit Quality (CAQ), had arranged a meeting which brought together stakeholders from

various backgrounds to discuss the Framework and the interactions highlighted within it. He noted that the discussion at the meeting had been lively with different perspectives on audit quality shared by the participants.

The Representatives and Observers commented as follows:

- Mr. Hemus supported the Framework, noting that it would be useful for the entities with which the IMF works.
- Mr. Hansen noted that the test for the success of the project would be how it is used. He added that the Framework should further emphasize the role of audit firms aligning compensation with technical abilities.
- Messrs. Baumann and Stewart noted the importance of both TCWG and audit committees to audit quality. Mr. Stewart questioned whether, in conjunction with other stakeholders, standards for audit committees could be considered. Mr. Grant responded that doing so would go beyond the IAASB's remit in its Terms of Reference. He also noted that the role and regulation, if any, of audit committees was largely at the national level due to local differences. Ms. de Beer agreed that the role of audit committees is often covered in national corporate governance codes. She also noted that non-executive directors are becoming more organized via international collaborations between the institutes of directors. She highlighted that this would make it easier for the IAASB to interact with this important stakeholder group in the public interest. Prof. Schilder noted he had spoken about the relationship between audit committees and external auditors for both a WB conference and an IMF conference. He added that there was a limit to what the IAASB and IFAC could do with respect to TCWG and audit committees, thus the need for the Areas to Explore within the Framework to encourage other parties to undertake work where relevant.
- Mr. Morris noted that audit committees may be able to use the Framework, particularly if the format and structure of the Framework was amended to make it easier to apply. He did not believe that preparers would find it useful as it would be too conceptual for that audience and too heavily reflective of auditor viewpoints.
- Mr. Baumann noted that the Task Force could further explore methods of measuring audit quality to support comparisons between firms and within a firm over time. Mr. Grant responded that, while measuring audit quality could have been included as an Area to Explore, he believed that getting the Framework in place was needed before measurement of audit quality could be significantly advanced. He mentioned that the CAQ was exploring the topic of measuring audit quality. Prof. Schilder noted that the Areas to Explore include greater international harmonization in the role of audit committees with regard to the evaluation of the quality of the external audit and encouraging audit committees to provide more information to users of the financial statements on the work they have undertaken. He highlighted that the CAG's views on these areas are important as any future work may involve a variety of stakeholders. He also noted that a checklist, based on the Framework, may be a useful step towards providing a measurement tool for TCWG to assess audit quality.
- Mr. Bluhm noted that the Framework would be useful to SMEs as, while management and TCWG may be the same people, they need to be addressed in different ways regarding audit quality.
- Mr. Bluhm noted that some audit committees would find the Framework too long to use effectively, and suggested the IAASB should explore how to make the Framework shorter and more useable.



Mr. Koktvedgaard noted that TCWG's responsibilities are often set by law, so the Framework cannot alter their responsibilities. Mr. Grant agreed that there may merit in transforming the Framework into a shorter document focused on TCWG, but that the director community should take this on rather than the IAASB. Ms. de Beer noted that the Framework is not intended to be a standard.

- Mr. Koktvedgaard noted that some of the input factors, such as the knowledge and experience of the engagement partner, are only accessible to external parties if the engagement partner's name is known.
- Mr. James highlighted that while IOSCO recognizes the progress that has been made with the Framework, it still appears to be more in the nature of a description of the elements of an audit with a focus on current practice. He noted that the Framework could be more useful if it was provocative and challenged auditors to think outside of current practice. Prof. Schilder highlighted that the auditor reporting project was an example of where the IAASB was stimulating new thinking by the profession.

Mr. Grant thanked the Representatives for their comments and noted that the project would return to the CAG for further discussion in September 2013. He noted that further consideration may need to be given to future actions after the Framework is approved to support its use and further debate on the topic of audit quality.

#### **Open Session (Item D)**

*To DISCUSS relevant and emerging matters in various jurisdictions:*

- *Japan – Presentation by Mr. Kuramochi on the Proposed Additional Standard to Address Risks of Fraud in an Audit*

Ms. de Beer noted that, as part of the CAG's consultative and advisory role to the Board, it is necessary to gain an understanding of activities in various jurisdictions, as this might impact on the IAASB's future agenda and work program. She highlighted that, to this end, she asked Mr. Kuramochi from the Japanese regulator to provide the CAG with a brief outline of the work done in Japan to strengthen their fraud standard to enhance professional skepticism.

Mr. Kuramochi introduced the topic, highlighting key aspects of the new Japanese auditing standard addressing risks of fraud in a financial statement audit.<sup>10</sup> Mr. Kuramochi noted that the standard was developed because there was a view that the national standards in Japan, which were compliant with ISA, did not sufficiently address challenges that auditors faced in practice with respect to fraud. For example, he noted that certain auditors did not sufficiently exercise professional skepticism for circumstances that indicate fraud. He also noted that communication between predecessor and successor auditors about matters related to fraud was not always sufficient. Mr. Kuramochi explained that the new Japanese fraud standard added requirements for auditors to respond to the circumstances that

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<sup>10</sup> In March 2013, the Financial Services Agency (FSA), the Japanese Government issued a standard to address Risks of Fraud in an Audit. The provisional translation of the standard is available at the FSA's website at: <http://www.fsa.go.jp/en/news/2013/20130411-1.html>

indicate the possibility of fraud, such as the examples in the appendix to ISA 240<sup>11</sup> and PCAOB standards. Mr. Kuramochi added that the fraud standard also enhanced the Engagement Quality Control Review when there is a suspicion of a material misstatement due to fraud. Mr. Kuramochi clarified that the new standard would not change the scope of auditor's work with respect to fraud, if auditors were already performing sufficient work and meeting the existing objectives in the ISAs (in the case of good auditors).

The Representatives and Observers commented as follows:

- Ms. de Beer noted that the new standard would not change current practice for good auditors, but would provide a more explicit expectation from practitioners. Mr. Baumann commented that, in his view, a distinction should not be made between “good” and “bad” auditors but instead focus should be placed on the “unconscious human bias” that exists among all auditors, as is featured in the PCAOB Staff Alert on professional skepticism. Mr. Baumann expressed a view that sometimes auditors do not identify issues during an audit because of their unconscious human biases.
- Mr. Hemus asked whether findings in Japan indicate that it is rare to have auditors' reports that included a qualified opinion or a disclaimer of opinion. Mr. Kuramochi added that almost all listed entities have unqualified opinions in Japan, but added he believed that this is the practice seen all over the world, not only in Japan.
- Mr. Hines commented that within the insurance industry it is common practice to have ongoing dialogue between predecessor and successor actuaries in order to accept the engagement and suggested that the same could be done among auditors.
- Mr. Finnell noted that, though he can envision a situation where an auditor may want to resign rather than express a qualified opinion or disclaim an opinion due to fraud (because this would require disclosure of the reasons therefore), the knowledge of TCWG about the circumstances surrounding the auditor's resignation should be a mitigating factor. Mr. Kuramochi responded that in certain situations, auditors try to avoid speaking about certain issues, but acknowledged that TCWG could in fact help change practice. Mr. Darinzo agreed and added that the internal audit function has an important role to play in responding to those issues when they arise. Mr. Kuramochi acknowledged Mr. Darinzo's view and added that internal auditors because they work closely with TCWG could conduct further research and dig deeper into issues.
- Prof. Schilder, reflecting on his visit to Tokyo in the last year, complimented Mr. Kuramochi and the Financial Services Agency on finalizing the standard. He further noted that the new standard is useful in addressing some very important issues that are also being addressed by the IAASB as part of its current standard-setting initiatives, in particular as it relates to professional skepticism. Mr. Kuramochi acknowledged that it is very difficult for auditors to adequately apply professional skepticism and that the new standard provides additional guidance for that reason. The new standard notes that in normal audit situations the auditor is required to apply a certain level of professional skepticism, but would increase that level of professional skepticism by requiring the involvement of an engagement quality control reviewer with sufficient and appropriate experience, authority and other qualifications, as necessary, in order to respond to any suspicion of fraud. Mr. Kuramochi added that auditors can benefit from understanding fraud cases because regulators

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<sup>11</sup> ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

have noted that audit failures arising from fraud are similar (i.e., fraud schemes are recycled). Accordingly, knowledge of existing frauds could help auditors better identify them in the context of the specific audit engagement.

Ms. de Beer thanked Mr. Kuramochi for his presentation. She also asked Mr. Grund to provide a brief comment as to the work done by the Basel Committee on Banking Supervision (BCBS) on its consultative document, *External Audit of Banks*. Ms. de Beer reminded the CAG that Ms. Pat Sucher had previously done a presentation to the CAG in this regard.

Mr. Grund noted that the consultative document had now been published and responses from CAG Member Organizations would be particularly welcome, and reported that the comment period would be open through June 21, 2013. He highlighted that the intention of the document is to clarify the role of the external auditor in so far as the audit of banks are concerned.

Ms. de Beer commented that both these projects will have to be considered by the IAASB in order to determine to what extent it impacts their future agenda.

### **Report Backs (Item E)**

*To REPORT BACK on the following topics:*

- *Auditor Responsibilities Relating to Other Information (ISA 720) (Exposure draft approved September 2012)*
- *Disclosures (Project proposal approved September 2012)*

Mr. Gunn highlighted that the comment period for the exposure draft of proposed ISA 720 (Revised) (ED-720) had ended with 68 comment letters received to date. He noted that respondents generally supported in principle the review of extant ISA 720 and the aims of the proposals in the ED. However a significant majority of responses expressed concerns about the practicality of the proposals and their clarity.

In relation to the report back on ED-720, Mr. Hansen questioned whether further progress could be made on specifying that senior engagement team members should perform the work effort on Other Information, as this would enable more complex matters to be identified than if the work was performed by lower level team members. Mr. Gunn noted that the IAASB had considered the question in finalizing ED-720, and had decided to limit that responsibility to the engagement partner. However, guidance material in the proposed ISA addresses factors that the engagement partner may take into account when determining the appropriate individuals to read and consider the other information.

Mr. Gunn also noted that the report back on the disclosures project highlighted the Task Force's responses to previous CAG comments.

## Assurance Engagements Other than Audits or Reviews of Historical Financial Information - ISAE 3000 (Item F)

*To REPORT BACK on the September 2012 CAG discussions and DISCUSS issues identified and the way forward (IAASB approval planned for September 2013)*

Ms. Mc Cabe introduced the topic, noting that the project to revise ISAE 3000 has benefited from input from the CAG over the life of the project and that approval of a final ISAE was planned for September 2013. Ms. Mc Cabe also drew attention to the report back on comments made at previous CAG meetings.

### STRATEGIC REVIEW

Ms. Mc Cabe highlighted that the IAASB had asked the Task Force to conduct a strategic review of the project in late 2012. The purpose of the strategic review was to evaluate the way forward in light of reservations as to how much progress the Task Force could achieve. In particular, noting that the revision of ISAE 3000 was limited to applying the clarity conventions and addressing the lessons learned on implementation of extant ISAE 3000, the strategic review dealt with the Task Force's proposed approach to comments and issues outside the scope of the project. In brief, the IAASB agreed with the Task Force's recommendation to continue to aim to complete the project by September 2013 by:

- Responding to comments received on exposure that are within the scope of the project;
- Using terminology from recently released standards such as ISAE 3410<sup>12</sup> and ISRE 2400,<sup>13</sup> unless there is a significant reason to depart from such terminology;
- Refining the material addressing direct engagements;
- Addressing consequential amendments to other ISAEs and the Assurance Framework<sup>14</sup> prior to the completion of the project, recognizing that it may be difficult to make the amendments subsequent to the completion of the project; ceasing work on any illustrative reports; and
- Deferring resolution of questions raised by both respondents and members of the Task Force on the scope of ISAE 3000 with respect to historical financial information, including vis-à-vis ISA 805.<sup>15</sup>

The Representatives and Observers commented as follows:

- Ms. Borgerth noted that, while she would have preferred that conceptual issues were addressed, she understood the pressure on the IAASB agenda and that revision of the Assurance Framework is a substantial undertaking. However, she noted that including illustrative reports within the ISAE would enhance adoption of the standard, although it could limit innovation in reporting practices.
- Mr. Diomeda and Ms. Blomme supported the preparation of consequential amendments, noting that these amendments are necessary to align ISAE 3000 with other ISAEs. They also noted that

<sup>12</sup> ISAE 3410, *Assurance Engagements on Greenhouse Gas Statements*

<sup>13</sup> International Standards on Review Engagements (ISRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*

<sup>14</sup> *International Framework for Assurance Engagements*

<sup>15</sup> ISA 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*

the IAASB could collect example reports based on engagements conducted under extant ISAE 3000 to determine if such reports could be of use to practitioners. Mmes. Blomme and De Beer expressed the view that a template of an illustrative report could be used to demonstrate the differences between direct and attestation engagements. Ms. Mc Cabe responded that the Task Force did not intend to prepare any illustrative reports, but noted that examples of reports were available in ISAE 3410. She added that illustrative reports had, in the past, required significant time to reach agreement, and that it would be even more difficult with ISAE 3000 as there is not a specific underlying subject matter. However, she explained that the standard explains the headings that are required in assurance reports and illustrates some of the wording that may be appropriate in different circumstances. She also noted that the Task Force has reviewed several examples of direct reports and expanded the requirements and application material to better address the contents of these reports, which are often lengthy long-form reports. She added that drafting illustrative reports, including outlines, could delay the standard significantly. Prof. Schilder noted that he understood the desire for illustrative reports, but noted that as the underlying subject matter of direct engagements varies significantly, he did not believe that the Task Force would be able to respond to the request for illustrative reports.

#### DIRECT ENGAGEMENTS

Ms. Mc Cabe provided a presentation on direct engagements and the similarities and differences thereof with attestation engagements, the latter of which many IAASB members and CAG Representatives are more familiar with. She highlighted that there are common concepts to both types of assurance engagements. She noted that, in direct engagements, the practitioner measures or evaluates the underlying subject matter rather than another party (e.g. management) and obtains assurance over the data they use to prepare the measurement or evaluation.

Ms. Mc Cabe noted that the responses to the ED of proposed ISAE 3000 (Revised) provided a clear message that the Task Force needed to better address direct engagements by amending requirements and application material. She also noted that key paragraphs have been split into reasonable assurance (RA), limited assurance (LA), direct engagements and attestation engagements to aid practitioners' comprehension of the revised standard.

In response to previous comments by Representatives, Ms. Mc Cabe explained that the Task Force has added further application material to explain that a practitioner in a direct engagement is independent of the responsible party and the underlying subject matter. She also noted that she and IAASB staff would be meeting with IESBA representatives to discuss the possible implications for the IESBA Code. The Representatives and Observers commented as follows:

- Mr. Stewart asked whether it would meet the definition for an attestation engagement if the responsible party engaged another practitioner to do the measurement or evaluation on their behalf. Ms. Mc Cabe agreed that this could be done but added that, in this case, the responsible party still has to take responsibility for the measurement or evaluation and the suitability of the criteria. She noted that the responsible party may prefer to engage a practitioner to perform a direct engagement to avoid the need to take responsibility for these matters.
- Mr. Diomeda suggested that the ISAE and the Assurance Framework should better distinguish RA from absolute assurance, as it was sometimes difficult to explain to users and regulators the inherent limitations of assurance without a formal document to which to refer. Ms. de Beer added

that such misunderstanding could be another example of the expectation gap regarding certain subject matters, such as forward-looking information. She noted that a practical example of this was explained by Mr. Diomeda in a document on a specific Italian example, shared with the IAASB staff and Task Force Chair. She suggested that proposed ISAE 3000 (Revised) should include a health warning about performing an RA engagement if users expect absolute assurance. Ms. Mc Cabe responded that there is a need to explain the limitations of an assurance engagement and the Task Force has addressed this, but the proposed ISAE also explains circumstances where LA may not meet the needs of users. Ms. Mc Cabe also noted that the proposed ISAE precludes a practitioner performing a LA engagement if the practitioner believes that an RA engagement cannot be performed as the preconditions for an assurance engagement, such as the need for suitable criteria, are the same.

- Messrs. Koktvedgaard and Stewart questioned whether the practitioner's involvement in selecting or developing the suitable criteria in a direct engagement could affect the practitioner's independence. Ms. Mc Cabe noted that, in all assurance engagements, including attestation engagements, the practitioner has to consider the appropriateness of the criteria. Mmes. de Beer and Mc Cabe also noted that, in a direct engagement, the practitioner has to present the criteria in the assurance report and this enables users to consider whether the criteria is appropriate for their purposes. Prof. Schilder noted that direct engagement reports were often long-form reports to enable the criteria to be explained in sufficient detail to enable users to determine the assurance obtained by the practitioner.
- Mr. Koktvedgaard suggested that there may be types of measurement or evaluation that would cause the practitioner to no longer be considered independent.

#### APPLICATION BY COMPETENT PRACTITIONERS WHO ARE NOT PROFESSIONAL ACCOUNTANTS

The Representatives and Observers commented as follows:

- Mr. Diomeda supported the extension of the application of the ISAE to competent practitioners who are not professional accountants, and asked whether the Task Force position would change when the definition of a professional accountant changes. He also asked if the Task Force's proposal to require competent practitioners who are not professional accountants to state the ethical and quality control requirements they follow is an attempt to signal to users that the report was not prepared by a professional accountant. Ms. Mc Cabe responded that the definition of a professional accountant was still under review, but that it would not address the fundamental issue that non-accountants may seek to use proposed ISAE 3000 (Revised).

#### APPROACH TO LA

Ms. Mc Cabe noted that the strategic review indicated that the Task Force should develop the proposed ISAE consistent with simplified language in recently released standards such as ISAE 3410 and ISRE 2400, as opposed to pursuing more technically pure language. She highlighted that the IAASB debated the point at length and concluded that the simplified language would enable practitioners to better understand the differences between LA and RA.

## CONCLUSION

Ms. Mc Cabe thanked the Task Force for its comments. Ms. de Beer noted that proposed ISAE 3000 (Revised) would be on the September 2013 CAG agenda as it was intended to be approved at the September 2013 IAASB meeting.

**April 9, 2013**

### **IAASB Future Strategy (Item G)**

*To DISCUSS topics relevant to the IAASB's future Strategy and Work Program:*

- *Innovation, Needs and Future Opportunities (INFO) Working Group*
- *ISA Implementation Monitoring*
- *2015-2019 Strategy and Priorities*

Mr. Gunn introduced the topics, noting that the IAASB was seeking views and insights from the CAG and others on the IAASB's forward strategy as it develops its *Strategy and Work Program, 2015–2019*. He noted that, in addition to outreach with individual stakeholder groups, the IAASB's future strategy and priorities will be informed by a number of input streams, including in particular the findings from the IAASB's ISA Implementation Monitoring project, the proposed IAASB Innovation, Needs, and Future Opportunities (INFO) Working Group, and the IAASB's formal strategy consultation process.

### ISA IMPLEMENTATION MONITORING PROJECT

Mr. Grant highlighted key points from the responses received to the ISA Implementation Monitoring Project. He explained that in the comment letters received, some points were more strategic whereas others were very detailed. He also noted that the general views expressed that the IAASB had generally achieved its goals in revising the ISAs through the Clarity Project and the application of these ISAs had improved consistency between firms, although the stage of ISA adoption and national implementation efforts impacts consistency. He highlighted that the Task Force determined there were 6 key themes emerging from the responses:

- Professional skepticism;
- ISA 600<sup>16</sup> – Adequate involvement of the group auditor;
- ISA 600 – Component materiality;
- ISA 315<sup>17</sup> – Controls relevant to the audit;
- ISA 315 – Identification of significant risks; and
- ISA 220<sup>18</sup> – Engagement quality control review, including consequential amendments to ISQC 1.<sup>19</sup>

<sup>16</sup> ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

<sup>17</sup> ISA 315, *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

<sup>18</sup> ISA 220, *Quality Control for an Audit of Financial Statements*

<sup>19</sup> International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial*

The Representatives and Observers commented as follows:

- Ms. de Beer asked if an ongoing process was needed to monitor the implementation of IAASB standards after the ISA Implementation Monitoring Project was completed. Mr. Grant agreed that this would be useful, but noted that it may create an expectation that the IAASB would be able to respond to all evidence it may gather, which may make it difficult for adopting jurisdictions as there will not be a stable platform of ISAs. He suggested a more disciplined approach was necessary to take into account the time and due process that would be needed to revise existing standards or develop new ones in response.
- Mr. Peyret inquired how the IAASB monitors ISA adoption by jurisdictions, including those who translate ISAs into their national languages, to ensure that the final adopted text is in accordance with the IAASB standards. He highlighted that the ISAs should be written using language that judges would find easier to interpret in a legal context. Messrs. Grant and Gunn noted that the IAASB and IFAC have policies on modifications to the IAASB's standards<sup>20</sup> and translations<sup>21</sup> respectively. Mr. Gunn added that IFAC's translation policy is focused on achieving a faithful translation with involvement by or consultation with appropriate experts. Mr. Grant also noted that setting a primary objective of using language in ISA which was understandable in a legal context may result in a shift away from principles-based standards.
- Mr. Stewart noted that the IASB used a combination of public and private responses when conducting a post-implementation review of IFRS 8.<sup>22</sup> He asked about the level of access IAASB members had to the individual responses. Mr. Grant responded that the IAASB has been provided with access to a database that groups comments by stakeholder and themes to respect the confidentiality of respondents.
- Mr. James noted that the IOSCO response indicated that securities regulators agreed on three broad areas for improvement: professional skepticism; sufficient appropriate audit evidence; and the use of other auditors and experts. He added that he did not believe that the summary of responses gave adequate emphasis to the sufficient appropriate audit evidence point. Mr. Grant responded that the issues around sufficient appropriate audit evidence were noted by the Task Force in the context of a number of individual ISAs, rather than as an overarching theme, but that, in his view, the point had been captured in the analysis.
- Mr. Hemus asked whether firms referenced professional skepticism in their responses. Mr. Kuramochi noted that, in preparing the Japanese ED on fraud, the Japanese FSA noted that professional skepticism is a matter of judgment by every auditor. This led the Japanese FSA to propose an objective review by another person, particularly a fraud expert, to enhance the application of professional skepticism. Mr. Grant noted that, due to the regulatory emphasis, some

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*Statements, and Other Assurance and Related Service Engagements*

<sup>20</sup> *Modifications to International Standards of the IAASB: A Guide for National Standard Setters that Adopt IAASB's International Standards but Find It Necessary to Make Limited Modifications* (see [www.ifac.org/sites/default/files/publications/files/modifications-to-internatio.pdf](http://www.ifac.org/sites/default/files/publications/files/modifications-to-internatio.pdf))

<sup>21</sup> *Policy for Reproducing, or Translating and Reproducing, Publications of the International Federation of Accountants* (see [www.ifac.org/publications-resources/policy-reproducing-or-translating-and-reproducing-publications-international-](http://www.ifac.org/publications-resources/policy-reproducing-or-translating-and-reproducing-publications-international-))

<sup>22</sup> International Financial Reporting Standard (IFRS) 8, *Operating Segments*



firms had referenced professional skepticism in their responses. He added that he found the Japanese Fraud ED's progressive approach to involving experts to increase skepticism interesting.

- Mr. Koktvedgaard noted that some issues, such as professional skepticism affect more than one of the independent international standard-setting boards, making a coordinated approach necessary. He asked whether the other international standard-setting boards have similar projects to the IAASB's ISA Implementation Monitoring project.
- Mr. Hansen highlighted that outreach to regulators to get feedback on lessons learned from audit inspection findings would assist in informing the ISA Implementation Monitoring project.
- Mr. Thompson noted that, if the areas identified by the ISA Implementation Monitoring project indicated that audit quality could be improved, then these areas should be addressed quickly. For example, he suggested that the proposed changes to ISA 260 regarding the identification of significant risk could be addressed in the Auditor Reporting ED. Mr. Grant responded that the concerns with ISA 260 through the ISA Implementation Monitoring projects went beyond than the identification of significant risks, and that it may be difficult to add this to the Auditor Reporting project without it delaying that project.
- Ms. de Beer noted that the IAASB should consider whether a broader project is needed on professional skepticism and professional judgment. Mr. Grant also noted that the IAASB could review ISQC 1 to consider whether it required the right behavior at the firm level.

Ms. de Beer concluded the session by remarking that the ISA Implementation Monitoring Project illustrates the need for flexibility in the future Strategy and Work Program to respond to such findings.

#### INFO WORKING GROUP

Mr. Gunn introduced the proposed INFO Working Group terms of reference (ToR), noting that the purpose of the proposed Working Group was to assist the IAASB in assessing and considering emerging areas of assurance needs. He also noted that this approach will assist the IAASB in determining when, and if, an area of focus of the Working Group has progressed to the point where the IAASB could consider undertaking a project that would be able to be efficiently completed. He highlighted that the Working Group would initially focus on integrated reporting, but may also consider in due course sustainability reporting, corporate governance, eXtensible Business Reporting Language (XBRL) and reporting on internal controls.

- Messrs. Koktvedgaard and Kuramochi supported the establishment of the INFO Working Group. Mr. Kuramochi noted that this Working Group could investigate other potential engagements such as providing assurance on valuations or forensic work.
- Mr. Diomeda noted that the ToR should specifically take into account issues and services relevant to SMEs and small and medium sized practitioners (SMPs). Mr. Gunn agreed, noting that considerations would as appropriate take into account this constituency. He also noted that a poll conducted by the IFAC SMP Committee identified that 20% of respondents identified assurance and related services as their areas of focus for future years.
- Ms. Borgerth supported consideration of assurance on sustainability engagements, as she was of the view that assurance is fundamental to enhancing the credibility of sustainability reports.
- Mr. Hansen supported the inclusion of forward-looking information.

- Mr. Morris suggested that the Working Group should have a process similar to the ISA Implementation Monitoring Project to monitor the implementation of new assurance engagement standards. Mr. James noted that the INFO Working Group can monitor future developments, which may be a way forward for the ISA Implementation Monitoring project. Mr. Gunn responded by noting that the two projects have different focuses and objectives, and that monitoring implementation of standards would not be part of the INFO Working Group's role. However, consideration of how the IAASB monitors implementation of its standards may be a matter for the IAASB to consider as part of its future strategy. He also noted that the IAASB had already agreed to monitor the implementation of ISAE 3402<sup>23</sup> as a standalone exercise.
- Mr. Hansen noted that other professions, such as engineers, are using standards produced for professional accountants, and suggested that the INFO Working Group should consider whether outreach to these professions should be undertaken to uncover any issues that should be considered by the IAASB in monitoring areas of focus.
- Ms. Blomme preferred the transparent approach under the proposed INFO Working Group ToR, rather than the IAASB Steering Committee reviewing forward trends on a more ad hoc basis. Prof. Schilder responded that the role of the Steering Committee is quite different as it is focused on advising the Chairman. He noted that matters of substance need the transparency delivered by having a formal Working Group.
- Ms. Blomme noted that FEE had changed the role of their committee addressing financial reporting to address “corporate reporting” rather than “financial reporting” in recognition of the importance of non-financial reporting by companies. She added that further work would be needed on the assurance implications of integrated reporting but that the Integrated Reporting Framework would help in this regard.
- Mr. Koktvedgaard noted the need for coordination between the independent standard-setting boards of IFAC on topics of mutual interest, such as professional skepticism. Ms. de Beer suggested that the IAASB should, as part of its Strategy development process, formalize the liaison and cooperation between these groups to avoid unintended consequences. Prof. Schilder noted that the IAASB worked to strengthen its liaison activities with both the IESBA and the International Accounting Education Standards Board (IAESB) in recent months.

#### IAASB STRATEGY AND WORK PROGRAM, 2015–2019

Prof. Schilder noted that many of the IAASB's current projects would inform the development of the *Strategy and Work Program 2015–2019*. He also noted that the IAASB was suggesting a five-year strategic period, with a review halfway through, rather than continuing with a three-year period, as this would enable a better understanding of the IAASB's medium-term goals. He noted the preliminary view that the first two years of the work program (i.e., 2015 and 2016) would be likely to be occupied by projects continuing from the 2012–2014 plan, in particular those that had not yet commenced.

Prof. Schilder highlighted some the broad challenges for the future that he viewed as important considerations for the IAASB's future strategy. Among others, he emphasized that the Auditor Reporting and Audit Quality projects showed the need for dialogue among all stakeholders. He also noted that the

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<sup>23</sup> ISAE 3402, *Assurance Reports on Controls at a Service Organization*

ISA Implementation Monitoring project had highlighted possible improvements to a number of ISAs. Therefore, the IAASB would need to consider how best to address these in a timely fashion while still assisting jurisdictions that have recently adopted the Clarified ISAs. He added that recently developed standards, such as ISAE 3410 showed that the IAASB needed to think about application of IAASB standards to non-accountants.

Prof. Schilder noted that external factors also affect the IAASB's future strategy. He referred to the Basel Committee publication that Mr. Grund had mentioned, as well as recommendations from the European Securities and Markets Authority on the need to consider issues related to materiality. He also noted that changing technologies such as increased use of information technology and data mining would continue to affect the audit landscape.

Prof. Schilder noted that the IAASB members and staff had been working very hard to deliver the IAASB's current work program, but that this level of activity is unsustainable. He added that the Steering Committee would consider whether the IAASB could use different operating procedures or look for opportunities for partnership and collaboration with others to enable the IAASB to continue to meet the increasing demands of a wide range of stakeholders.

Mr. Gunn encouraged CAG Member Organizations to provide formal responses to the IAASB's strategy survey and other current consultations.

The Representatives and Observers commented as follows:

- Mr. Koktvedgaard supported the move to a five-year strategic period. By contrast, Mr. Bollmann questioned the usefulness of a five-year plan, suggesting this could lead to the IAASB over committing for the period. Mr. Hines asked whether the five-year strategy period for the IAASB was integrated with IFAC's strategic planning timetable. Prof. Schilder noted that the IAASB is at arm's length from IFAC, and Mr. Gunn indicated that he did not see any complications from having slightly differing periods.
- Mr. Hemus asked how the IAASB's strategic objectives related to the PIOB's role, particularly when considering capacity constraints affecting projects and the public interest. For example, he suggested the need to consider whether it is in the public interest to develop new assurance standards to meet growing demand, and noted the PIOB has an important role to play in helping the IAASB evaluate necessary trade-offs due to limited resources. He also asked what planning period the PIOB used. Mr. Hafeman noted that the PIOB sets its own strategic objectives independent of the standard-setting boards, but its mandate includes reviewing the IAASB's Strategy and Work Program and considering whether they address all public interest issues. He highlighted that the PIOB's responsibilities including recommending matters that may be need to be added to the work program from a public interest perspective or that are on the work program but need to be prioritized differently. Mr. Hafeman noted that IFAC has previously increased resources in particular areas when the PIOB had expressed concerns that resources appear to be inadequate, but that the PIOB recognized that funding is limited. He added that the PIOB supported the creation of the INFO Working Group as it will inform the IAASB's judgment on whether there are emerging developments that need to be addressed on a priority basis.
- Ms. de Beer suggested that the IAASB first needed to agree on its strategic initiatives and agenda and based on the resources required to support the execution thereof, it may need to seek additional funding to address key projects if those projects cannot be accommodated with the

resources allocated to the IAASB. Mr. Sylph noted that the broader budgeting process for resourcing the standard-setting boards happens on a three-year cycle. He also noted that additional resources are unlikely to be available in a shorter period due to the lengthy process needed to secure such resources. Therefore, in his view, moving to a 5-year strategic period could enable the IAASB to consider how it might raise additional funds if the work program continues to be increased.

- Mr. Koktvedgaard asked if the IAASB had sufficient reporting mechanism to regulators in light of the move away from self-regulation of the profession, and suggested that audit oversight bodies have an important role to play in contributing to standard setting and ensuring quality audits. He also noted that areas such as information technology and the influence of governance structures needed to be recognized in the Strategy and Work Program. In his view, these developments will lead to an expectation of auditors become more efficient, as companies had to. Prof. Schilder noted that the IAASB aimed for a continuing, constructive dialogue with regulators such as IOSCO, IFIAR, and the European Audit Inspectors Group, noting that audit inspectors provide the IAASB with feedback on how its standards are being applied in practice.
- Ms. Blomme noted that, particularly in Europe, increased regulation in relation to the audit has led to greater oversight and inspections and increased documentation. She suggested that this burden significantly affects auditors of financial statements of entities other than listed entities, and that consideration was needed as to whether the amount of time incurred relating to documentation is justified.
- Mr. Kuramochi noted that IOSCO preferred that the IAASB focus on the need for high-quality ISAs rather than other assurance services, as auditors play an indispensable role in the capital markets supporting the public interest. He noted that a failure attributed to auditing standards could adversely affect the profession, and that keeping public confidence is paramount for the audit profession. He expressed a personal view that fraud should be a focus as it is a source of audit failure and reduces public confidence. He suggested some aspects of the INFO WG may have benefits to audit quality.
- Ms. Blomme and Mr. Koktvedgaard noted that, as the thresholds for audits have increased over time, there is a need for another type of engagement to fill the gap between an audit and a review, adding that ISRE 2400 had not met this demand and more of a hybrid-type engagement may be appropriate. Ms. de Beer agreed, noting that in South Africa an audit threshold had also been implemented and as a result smaller companies require reviews, which might not adequately be addressed by ISRE 2400 (Revised). Mmes. Blomme and De Beer suggested the IAASB needed to monitor the implementation of ISRE 2400 to ensure it is meeting its objectives. Mr. Koktvedgaard noted that Denmark had introduced an enhanced form of review engagements to meet the need for a positive form of opinion with a lower work effort than an audit. Prof. Schilder noted his view that a few extra procedures added to a limited assurance engagement were unlikely to be sufficient to support a positive form opinion and that there is a risk that users may interpret this as too similar to an audit. He noted that revision of the standard on agreed upon procedures<sup>24</sup> may provide a useful

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<sup>24</sup> International Standards on Related Services (ISRSs) 4400, *Engagements to Perform Agreed-Upon Procedures Regarding Financial Information (Previously ISA 920)*

way forward, as such engagements can be address specific areas of concern in the financial statements and may form part of a hybrid engagement.

- Mr. Koktvedgaard suggested the IAASB could be more transparent about the status and planned timeline of anticipated projects, and that it might be useful to pinpoint the cost of an individual project to aide stakeholders in recommending prioritization of individual projects in light of resource constraints. Ms. de Beer noted the Steering Committee and staff undertakes these types of analysis, but was of the view that the level of detail many not always be appropriate for public consumption. Mr. Gunn noted that a project timetable is made available after each IAASB meeting. He also explained that in developing the future work program staff reviews the known items on the IAASB's work program, attempts to forecast the timing and level of effort associated with new initiatives, and the Steering Committee uses this information to evaluate the capacity for new projects.
- Ms. de Beer highlighted that three possible topics that could be included in the Strategy were building on the Japanese fraud standard, addressing assurance for audits of banks and whether the Assurance Framework needed to be revised.
- Mr. James noted that there may be lessons to be learned from the experience of accelerating the Auditor Reporting project, to address continuing concerns on resource constraints and the possibility of needing to focus on a priority issue and defer other projects.
- Ms. Blomme noted that she hoped to see documentation requirements made proportional for smaller entities. She noted that increased regulation of the profession often affects smaller firms as well as large, multinational firms.

Prof. Schilder thanked the Representatives and Observers for their comments.

## **PIOB Remarks**

### VIEWES ON CAG MEETING

Mr. Hafeman congratulated the CAG on a productive meeting, noting that the meeting was well-organized and effectively chaired. He added the CAG Representatives and Observers seem to have been given equal opportunities to comment, and have shared their views on wide range of issues related to the agenda items. He noted that although many of the topics had previously been discussed at the CAG, the additional advice provided to the IAASB was nevertheless useful, in addressing some very difficult issues, such as disclosure of the name of the engagement partner, disclosure of KAM for unlisted entities, and the auditor's responsibilities regarding going concern.

Mr. Hafeman suggested that the IAASB, in considering how to best deal with these issues within the auditor reporting ISAs, take into account what would be most responsive to the needs of the public interest. He acknowledged that ascertaining the needs of the public interest can sometimes be difficult, involve trade-offs among the interests of various stakeholders. He then suggested that the IAASB use the simple test proposed in the PIOB's eighth public report as a guide in determining what is in the public

interest<sup>25</sup> to determine whether changes in the ISA will lead to the creation of more relevant information, or enhance the ability of users to trust the information contained in financial statements.

Specific to the Auditor Reporting project, Mr. Hafeman noted that during the CAG meeting, there were a few comments from CAG Representatives implying that the IAASB could defer decisions on the content of a standard by issuing an ED with provisions that the Board is not fully comfortable with. He cautioned against doing so, noting that although input on alternatives can certainly be sought through exposure, the IAASB should be comfortable that, in the absence of objections from stakeholders, it would be satisfied with the wording of the ED becoming the final standard.

On the topic of ISAE 3000, Mr. Hafeman noted that commented on the issue of the possible use of the standard by persons other than “professional accountants.” He expressed a view that the IFAC definition of “professional accountant” is not useful in this context, so the project of the IAESB to revise the definition is important. He noted however that the revised definition will not fully resolve the issue of scope, which needs to be considered by each of the independent standard-setting boards. Accordingly, suggested that each of the independent standard-setting boards take on the issue of clearly identifying the intended audience for its standards.

#### VIEWS ON OTHER MATTERS

Mr. Hafeman indicated that the PIOB met most recently at the end of February, 2013. The PIOB agreed that the IAASB should explore, through consultation with its stakeholders, a change to the period covered by the IAASB’s future Strategy and Work Program, provided that there is an opportunity to review the Strategy during its time span.

Mr. Hafeman reported that the PIOB has made public available its response to its March 28, 2012 public consultation that sought input on the PIOB work program for 2012 and beyond. Mr. Hafeman noted that the PIOB received recommendations regarding public interest protection, the nature of independent due process oversight, oversight models, communication policy, diversification of PIOB financing, and the respective roles of the Monitoring Group (MG) and the PIOB. The MG also made public its recommendations in response to its parallel consultation.

#### **Closing Remarks**

Prof. Schilder thanked the CAG Representatives and Observers for their comments. Ms. de Beer also thanked the CAG Representatives and Observers for their high level of preparation and participation and the quality of comments provided. She also thanked the IAASB members and Staff for their contribution to making the meeting successful.

Ms. de Beer closed the meeting.

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<sup>25</sup> “So how can the accountancy profession contribute to the public interest? The PIOB believes that the accountancy profession can best do so by providing account-related information in which the public has confidence. This information will be most helpful if it is relevant to the users and is trusted by them as a faithful representation of the performance of the reported activities. Audits and other assurance services play an important role in meeting these criteria, by providing an objective and professional view in which users may have confidence.” The full PIOB report is available at: [http://ipiob.org/sites/default/files/public\\_reports/annual\\_report2012.pdf](http://ipiob.org/sites/default/files/public_reports/annual_report2012.pdf)