

**Draft Minutes of the 12th Meeting of the
INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD**

Held on September 13-17, 2004

At the Offices of the American Institute of Certified Public Accountants, New York

Voting Members

Present: John Kellas (Chairman)
Denise Esdon (Deputy Chair)
John Archambault
Philip Ashton
Roger Dassen (except morning of Sept. 13)
Denis Desautels (except Sept. 16-17)
Sukanta Dutt
Josef Ferlings
John Fogarty
Jan Bo Hansen (except Sept. 17)
Gen Ikegami
Ian Plaistowe
Roger Simnett
Roberto Tizzano
G rard Tr moli re (except Sept. 16-17)
Mowafak Al Yafi (except afternoon of
Sept. 15 and Sept. 17)

Technical Advisors

Wolfgang B hm (Mr Ferlings)
C dric G lard (Mr Tr moli re)
Jon Grant (Mr Plaistowe)
Diana Hillier (Mr Ashton)
Susan Jones (Mr Fogarty)
Richard Mifsud (Mr McPhee)
Keith Newton (Mr. Archambault)
Emilio Palma (Mr Tizzano)
Tania Sergott (Mr Hansen)
Greg Shields (Mr Desautels)
Tan Shook Kheng (Mr Dutt)
Sylvia Smith (Mr Kellas)
George Tucker (Mrs Esdon)
Hans Verkruijsse (Mr Dassen)
Yuichi Yamamoto (Mr Ikegami)

Apologies: Rog rio Gollo
Ian McPhee

Non-Voting Observers

Present: David Damant (Chairman, IAASB CAG) (for Sept 13-14)
Jennifer Rand (for Thomas Ray)
Hisashi Yamaura

IFAC Representatives and Technical Staff

Present: Ian Ball (IFAC Chief Executive) (Sept 17), ND Gupta (IFAC Board Liaison to IAASB),
Jim Sylph (Technical Director), James Gunn, Jane Mancino, Michael Nugent, Alta
Prinsloo, Ken Siong, Jan Tyl

1. Opening Remarks and Minutes

Welcome and Introductions

Mr Kellas welcomed the public observers to the meeting.

Mr Kellas noted that apologies were received from Messrs Gollo and McPhee, and that Mr Mifsud has been appointed as proxy for Mr McPhee. Mr Gollo did not appoint a proxy. Mr Kellas also noted that: Mr Hansen will not be in attendance on September 17th, with Mrs Sergott appointed as his proxy; Mr Trémolière will not be in attendance on September 16-17th, with Mr Gélard appointed as his proxy; Mr Desautels will not be in attendance on September 16-17th, with Mr Shields appointed as his proxy; and that Ms Rand will act as observer in the absence of Mr Ray.

Mr Kellas introduced and welcomed Mr Damant, Chairman of the IAASB Consultative Advisory Group (CAG). Mr Damant noted that he intends to reorganize the membership of the CAG to extend the geographic and representative coverage, and that he will work diligently to ensure that the CAG contributes positively to the development of high quality auditing and assurance standards.

Mr Kellas welcomed Mr Gupta, IFAC Board member with the role of liaison with the IAASB, and thanked him for his attendance. Mr Kellas also welcomed Mr Tyl as a new member of the IAASB staff.

Meetings of the US Public Company Accounting Oversight Board's (PCAOB) Standing Advisory Group (SAG)

Mr Kellas reported that he and Mr Sylph had attended the June and September 2004 meetings of the PCAOB SAG. He noted that the issue of reasonable assurance had arisen in relation to fraud and related parties: differing views were expressed by members of the SAG on the meaning of 'reasonable assurance' in relation to fraud detection as compared with the completeness of the identification of related parties. No indication was provided on how the PCAOB might respond to the comments or on whether the PCAOB intends to undertake a project on reasonable assurance. Mr Kellas noted also that in June the SAG urged the PCAOB to revisit its interim standards on fraud but in doing so, to consider further whether SAS 99 should be revised or whether additional fraud considerations should be addressed in specific standards such as those on estimates and related parties. At the September meeting, there was an extended discussion of fraud, as well as of issues relating to the PCAOB's interim standards on fair value, related parties and external confirmations.

First Time adoption of International Financial Reporting Standards

Mr Kellas noted that the non-authoritative document "First Time Adoption of International Financial Reporting Standards – Guidance for Auditors on Reporting Issues" was published on the IFAC website in August. He thanked all those who participated in the collaborative effort, with special mention made of Ms Hillier and Mrs Smith for their work on the initial drafts.

Minutes of Previous Meeting

Mr Ashton noted that, although no change to the minutes was required, the comment letter on the ISA 700 exposure draft anticipated from the European Commission (EC), as referred to in the minutes of the previous meeting, was not received.

Mr Ashton requested that the minutes make clear that the IAASB asked for the revised ISA 700 to be presented for approval at the December 2004 meeting, but that issue of the final standard may be subject to possible deferral pending finalization of the revisions to ISA 701 and 800. Except for this change, the minutes of the public session of the previous IAASB meeting were approved as presented.

2. IAASB Due Process Exposure Draft

Mr Kellas reported that the proposed exposure draft, “Proposed Amendments to the Preface to the International Standards on Quality Control, Auditing, Assurance and Related Services (Preface) – IAASB Due Process and Working Procedures,” was approved by ballot for issue with a due date for comments of October 15, 2004. Mr Kellas noted that Mr Plaistowe did not approve the document for issue; while Mr Plaistowe did not have difficulty with the thrust of the document, he did not think all the drafting was sufficiently clear and understandable. Mr Kellas also noted that Mr Ferlings indicated conditional approval subject to certain changes, and that Mr Gollo was not in attendance at the June meeting and therefore abstained from voting. Mr Kellas noted that staff will consider the points raised by Messrs Plaistowe and Ferlings along with comments received on exposure.

3. Clarity of IAASB Standards

Mr Kellas led a review of a draft exposure draft of a proposed policy statement and proposed consultation paper addressing the topic of improving the clarity of IAASB standards. The IAASB agreed the following with respect to the proposed policy statement:

- The proposed categories of professional requirements should be labeled “requirements” and “presumptive requirements.”
- The description of the proposed requirement for the professional accountant to “justify” departure from a presumptive requirement should be stated in terms of a requirement to “document” such departures.
- The departure from a presumptive requirement should be sufficient to achieve the objectives of the presumptive requirement, rather than the objectives of the standard. Consequently, the proposed description of explanatory material should provide also for an explanation of the objective of the professional requirements of a standard, where not otherwise self evident.
- The proposed documentation requirement should be effective for engagements for periods commencing on or after June 15, 2005.
- The proposed statement that appendices carry the same authoritative weight as the standard should be deleted, as the existing Preface subsumes appendices as part of the explanatory material of a standard. The statement that appendices are an integral part of a standard, however, should be retained.
- The proposed policy statement should be applied on a prospective basis to all exposure drafts issued on or after the date of final approval of the policy statement. The explanatory memorandum to accompany the exposure draft should explain further that final approval of the proposed policy statement could be as early as June 2005.
- The title of the proposed policy statement should be changed to “Clarifying Professional Requirements in International Standards Issued by the IAASB.”
- The explanatory memorandum to accompany the exposure draft should recognize the fact that the illustrative examples in the “Supplement to the Exposure Draft and Consultation Paper: Illustrative Examples” prepared by IAASB staff suggest there will be an increase in the number

of bold type requirements in standards when drafted under the proposals as compared with the present drafting convention, and that some believe that this increase will be significant. Respondents to the exposure draft should be asked whether the proposals will improve the quality and consistency of audits, and whether the possible anticipated increase in the number of bold type requirements raises concern over the specificity and level at which professional requirements are set.

The IAASB agreed the following with respect to the proposed consultation paper:

Understandability of IAASB Standards

- The section should provide a summary of the main findings of the Wong report “Challenges and Successes in Implementing International Standards: Achieving Convergence to IFRSs and ISAs.”
- In addition to the proposed questions, respondents to the consultation paper should be asked for their views on how concerns over the length of the standards might be resolved and on other options for improvement that should be considered by the IAASB.

Restructuring Options for Consideration

- The second restructuring option (Option B) should not refer to the need to consult on whether the term “ISA” applies to the proposed “standards section” or to the entire document, as the IAASB had previously agreed it would apply to the entire document.
- The discussion of the restructuring options in the consultation paper should make it clear that the authority of the document containing the explanatory material – whether an IAPs or a second section within an ISA – would be equivalent following either option.

Fundamental Principles Underlying an ISA Audit

- The possible principle of “Professional Judgment” should exclude reference to the fundamental principles and applicable professional requirements.
- The reference to “important matters” in the possible principle of “Documentation” is ambiguous and should be clarified.
- The possible principle of “Reporting” should exclude the statement that the auditor reports to those that have appointed the auditor, to avoid inconsistency with proposed revised ISA 700.

Practice Statements

- The discussion in the section on related considerations for Practice Statements should explain that the use of the present tense in describing actions or procedures of the professional accountant in IAPs is an issue that will require future consideration by the IAASB.

Mr Plaistowe wished it recorded that he has concern about the increase in the number of professional requirements that will arise from the application of the proposed policy statement. He urged the IAASB, when considering the responses to these proposals, to consider the need for standards to be understandable and to be drafted in such a manner that the right balance is achieved between the extent of professional requirements and the ability of auditors to apply professional judgment.

The IAASB members present voted unanimously to issue the proposed policy statement as an exposure draft and to issue the consultation paper, with a closing date for comments of December 31, 2004.

4. Documentation

Mr Dassen reminded the Board that a revised draft of the proposed revised ISA 230, based on comments received at the June meeting, had been circulated prior to this meeting for their review and comment. Mr Dassen led a review of a proposed revised exposure draft.

The IAASB noted that although the term “audit file” was used in the draft, it was not defined. Accordingly, it was agreed that it should be explained that audit documentation for a specific audit engagement is assembled in an audit file. With regard to the section dealing with documentation of new information received after the date of the auditor’s report, the IAASB agreed to delete the reference to whether the information was requested by the auditor (which was one of the factors suggested as relevant to the auditor’s consideration whether to perform audit procedures on the new information), as the example was open to misinterpretation.

The IAASB members present voted unanimously to issue the proposed revised ISA 230 as an exposure draft, with a closing date for comments of January 31, 2005.

5. Estimates

Mr Ashton led a review of the proposed revised ISA 540, “Auditing Accounting Estimates and Related Disclosures (Excluding Those Involving Fair Value Measurements and Disclosures).” The IAASB noted and agreed the following:

Reasonableness of Accounting Estimates and the Applicable Financial Reporting Framework

- The IAASB deliberated on the proposed responsibility for the auditor to determine whether accounting estimates are both in compliance with the entity’s financial reporting framework and reasonable in the circumstances. It was agreed that the concept of evaluating the reasonableness of estimates should be retained but that the responsibility should be set out in the context of the applicable financial reporting framework.

Risk Assessment Procedures, and Methods and Assumptions Used in Making Accounting Estimates

- The IAASB discussed the use of the proposed term “measurement reliability” and possible alternatives. It was agreed that it should be replaced by the term “estimation uncertainty,” and that a definition consistent with the IASB Framework should be developed.
- The task force should clarify in the explanatory material that a change in estimates, as a result of new information, is not a misstatement. The task force should also reconsider the proposed definition of, and explanatory guidance on, the term “best estimate” taking account of the fact that some financial reporting frameworks might not lead to the conclusion that the most likely outcome represents the “best estimate.”
- The explanatory material addressing circumstances affecting measurement reliability [estimation uncertainty] and the methods and assumption used in making accounting estimates should refer to management assumptions. The task force should also consider whether the proposed standard should require the auditor, as part of the risk assessment procedures, to consider the sensitivity of accounting estimates to changes in significant assumptions, and whether sensitivity of assumptions should be limited to those assumptions that are outside management’s control.
- The task force should reconsider the use of the proposed phrase “range of reasonably possible outcomes,” as it may imply a very wide range, and the positioning of the related discussion within the standard. It was suggested that the use of the phrase “ranges of outcomes” may be appropriate when addressing auditing consideration more generally in the standard, and the use of the phrase “range of probable outcomes” when addressing the narrowing and evaluation of the

range. In this regard, it was agreed that the term “probable” should be explained to mean “more likely than not.”

- Concern was expressed over the prominence given to the explanatory material on the use of ranges by management, with it being noted that the use of ranges and probabilities in developing accounting estimates may not be common practice. It was agreed that the standard should explain that, in the first instance, the auditor considers the requirements of the financial reporting framework in relation to requirements to develop ranges, and that ranges may otherwise be developed by management depending on the circumstances.

Assessment of, and Responses to, the Risks of Material Misstatement

- The standard should address the auditor’s responsibility to identify, assess and respond to the risk of material misstatement for accounting estimates at the assertion level, and not at the financial statement level, as the latter is addressed by the IAASB’s audit risk standards. The standards and guidance relating to determining the need to use the work of an expert, however, should be retained.
- The proposed requirement for the auditor to determine which, if any, of the risks identified give rise to high estimation uncertainty (and therefore are significant risks) should exclude reference to specific factors that may be considered. These considerations, however, be included in related explanatory guidance as possible indicators of significant risk. The task force was also asked to reconsider the proposed list of factors in terms of: (i) the appropriateness of including internal control considerations; and (ii) whether reference to the degree to which the estimate is highly dependent on management’s judgment and to materiality should be made.
- The standard should address estimates where reliable measurement is not possible (proposed “Category C”) separately and earlier in the document. The remaining proposed categories of accounting estimates – estimates with high measurement reliability (proposed “Category A”) and those with low measurement reliability (proposed “Category B”) – should be described in terms of those estimates that give rise to significant risks, and those that do not. Descriptive language, rather than identifying categories, should be used for drafting purposes.

Responses at the Assertion Level

- The proposed requirement for the auditor to determine whether events occurring between the period end and the date of the auditor’s report confirm the accounting estimate made should be established as a separate bold type paragraph. The standard should provide additional explanatory guidance on the consideration of subsequent events, including: (i) explanation that risk assessment is a continuous process throughout an audit, and that a subsequent event may mitigate or remove a significant risk associated with the estimate; and (ii) developing the proposed example more fully to give recognition to the possibility that a transaction may have been undertaken for fraudulent purposes.
- Alternative approaches to auditing estimates should be considered when subsequent events confirming the estimates are not expected to occur, rather than in response to when such events have not occurred.
- The task force should consider whether testing the “operating effectiveness of the process used to develop the accounting estimate” includes testing of internal control, taking account of the comparable provisions of ISA 545, “Auditing Fair Value Measurements and Disclosures.”

Responses to Significant Risks

- The task force should consider whether the proposed requirement for responses to significant risks could be summarized and cross-referred to the underlying requirements contained in the audit risk ISAs.

Auditor Developed Range of Reasonably Possible Outcomes

- The standard should emphasize the need for the auditor to encourage management to develop a range of probable outcomes, where that is appropriate, before deciding to develop such a range independently. The standard should also recognize that, in some instances, it may be impracticable for the auditor to develop a range, particularly when management has not been able to do so. The related explanatory material should avoid suggesting that the auditor's judgment is used instead of that of management in determining a best estimate.

Changes in Location of Accounting Estimates Within the Range from One Period to Another

- The standard should elaborate on what might constitute a "good reason" for changing the location of an accounting estimate within the range from one period to another, and explain that the auditor considers whether there is adequate support for such a change. The task force should explore the implications of a change in an estimate occurring as a result, for example, of a change in management who operate within a different risk profile. The standard should also explain that, even if the reasons for a change appear to be valid, a change from period to period may nevertheless possibly be an indication of bias.

Indicators of Bias

- The standard should explain that the auditor considers the term "bias" in the context of its use in the applicable financial reporting framework. For purposes of the proposed revised standard, a footnote referring to the definition, or description, of bias used in IFRSs should be made.

Evaluating Disclosure

- Concern was expressed that the proposed standards and guidance in the section "Evaluating the Disclosure of Low Measurement Reliability in the Financial Statements" were tantamount to establishing accounting standards. It was noted that the draft included no guidance on the auditor's responsibilities when disclosures are inadequate. It was agreed that the proposed section be retained in the standard, and that the implications of inadequate disclosure be included. The task force should take account of guidance in ISA 545 and the proposed revised guidance on the auditor's report and emphasis of matter paragraphs. It was also agreed that this matter should be highlighted and specifically addressed in the explanatory memorandum that would accompany the exposure draft.

Appendices

- Proposed Appendix 1 should form part of the explanatory memorandum accompanying the exposure draft. Appendix 2 should be removed in its entirety.

The IAASB asked the task force to consider its comments and present a revised standard for approval as an exposure draft at the December 2004 meeting.

6. Materiality

On behalf of Mr. Lindsell, chair of the Materiality Task Force, Mrs Esdon led a review of the proposed revised ISA 320, "Materiality in the Identification and Evaluation of Misstatements." The IAASB noted and agreed the following:

- *The applicability of the proposed standard to special purpose audit engagements.* The proposed ISA, as currently drafted, applies to the audit of a complete set of general purpose financial statements. A footnote indicates that much of the guidance in the ISA can be adapted for audits of financial information other than an audit of a complete set of general purpose financial statements. Additional guidance, as necessary, for special audit purpose engagements should be provided in ISAs developed specifically for those engagements.
- *Nature and causes of misstatements.* The proposed descriptions of different types of misstatement should remain, as they are not provided in other ISAs.
- *Definition of materiality.* It is appropriate to use the definition given in International Accounting Standard 1, "Presentation of Financial Statements." The expression that "misstatements of items are material if they could ... influence ...," however, may potentially set a very "low bar" in the evaluation of materiality; accordingly, the task force should develop the guidance further, based on relevant guidance in IAS 1.
- *Users.* The proposed ISA should provide further guidance explaining who "intended users" are and their characteristics; guidance in IAS 1, explaining the characteristics of users and the matters that could influence their economic decisions, should be used as a basis. The IAASB agreed that it is appropriate for the proposed ISA to indicate that, for a profit oriented entity, meeting the needs of investors would meet most of the needs of other users; it should, however, indicate that this statement is derived from the IASB's Framework. The proposed ISA should also provide brief guidance on the auditor's duty of care, indicating that it is ordinarily determined by law or the Courts, as it is important to clarify that the auditor does not, ordinarily, seek to meet the needs of potential investors.
- *Management's materiality.* The proposed ISA should not require the auditor, when determining materiality for the audit, to consider the materiality level, if any, used by management when preparing the financial statements. It was noted that the proposed ISA does however explain that the auditor ordinarily communicates with those charged with governance about the materiality level determined for the financial statements, and that obtaining an understanding of the views of those charged with governance and of management may help the auditor judge what might reasonably influence the economic decisions of users.
- *"Planning materiality."* To avoid giving the impression that "planning materiality" and "evaluation materiality" are different, separately determined amounts, and in light of the proposed guidance that explains that the materiality level for the financial statements remains the same amount throughout the audit (absent information that would result in a change to the materiality level as the audit progresses), it was agreed that it was not necessary to use a term such as "planning materiality."
- *Percentages applied to benchmarks.* It was agreed that more examples might better illustrate that the auditor needs to exercise judgment and may determine different percentages in different circumstances. The technical advisors to IAASB members were asked to provide the task force with details of examples/guidance that they are aware of.
- *Timing of evaluation of misstatements.* Stating the requirement for the auditor to evaluate whether misstatements are material, and then stating the requirement for the auditor to communicate them to management and request that they be corrected could lead to the auditor to readily accepting immaterial misstatements not being corrected. The task force was therefore asked to move the

requirements and guidance dealing with the evaluation of the materiality of misstatements to the later section on the evaluation of uncorrected misstatements (after communications with management). The requirements and guidance relating to the evaluation of whether the circumstances of identified misstatements may be indicative of the existence of other misstatements, however, should remain before communication to management.

- *Communication of misstatements to management.* The task force should clarify the requirements and guidance relating to the auditor encouraging management to correct all known misstatements (other than those that the auditor believes are clearly trivial), particularly in relation to ensuring that management does not “cherry pick” misstatements to correct when the auditor encourages management to take action to reduce the estimated amount of likely misstatements. In addition, the proposed ISA should explain that the auditor is to consider management’s reasons for refusing to correct such misstatements; those reasons are relevant to the auditor’s consideration of the qualitative aspects of materiality.
- *Evaluating the effect of uncorrected misstatements.* The proposed ISA should include guidance indicating that the auditor needs to allow for undetected misstatements when performing the overall evaluation. With regard to prior period misstatements, the proposed guidance should be amended to be neutral as to whether the rollover method or iron curtain method should be used. With regard to management bias, the task force was asked to clarify the auditor’s obligation(s) to consider management bias. In addition, the task force was asked to strengthen the link between management bias and the risk of material misstatement of the financial statements. It was also felt that the concept of management bias may be clearer if the examples are not limited to accounting estimates; proposals for additional examples included management’s choice of accounting policies, amortization of new classes of assets, revenue recognition, and the quality of earnings.
- *Documentation.* The proposed ISA should clarify that the auditor also has to document the qualitative aspects of materiality, tolerable error, and instances of management bias.
- *Conforming amendments to ISA 260, “Communications With Those Charged With Governance.”* The task force should liaise with the ISA 260 Task Force to determine whether it is necessary to reflect the proposed conforming amendments in the exposure draft since both projects are running parallel. The task forces were asked to consider clarifying that the auditor should not communicate tolerable error and in particular, that it should not be communicated to management.
- *Conforming amendments to ISA 580, “Management Representations.”* The task force should reconsider the deletion of certain original text, and should liaise with the ISA 580 Task Force in finalizing the proposed conforming amendments.
- *Conforming amendments to ISA 600, “Using the Work of Another Auditor.”* The reference to “a group materiality level to evaluate the effect of misstatements of the components’ financial information and the consolidation on the group financial statements” was questioned. It was asked whether this was “evaluation materiality” – a concept which has not been included in the proposed ISA 320. It was also noted that the factors indicated as having an effect on the group auditor’s determination of materiality levels for individual components affect the group auditor’s risk assessment and not the group auditor’s determination of materiality levels.

The IAASB asked the task force to consider its comments and present a revised standard for approval as an exposure draft at the December 2004 meeting.

7. Independent Auditor's Report

Mr Ashton noted that the objective of the session was to review and discuss proposed final wording of the revision to ISA 700 and related amendments, which incorporate the task force's recommended responses to comment letters received and comments provided by the IAASB at its previous meeting. He noted that comments received from public respondents on the ISA 700 Exposure Draft had been wide ranging but overall they expressed support for the direction taken. He also noted that the task force was closely monitoring developments in the ISAs 701 and 800 projects.

Mr Ashton led a review of the proposed revised ISA 700 and the related amendments to ISAs 200, 210, 560, 701 and 800. The IAASB noted and agreed the following:

THE AUDITOR'S REPORT ON FINANCIAL STATEMENTS

- *Wording Prescribed by Law or Regulation for the Auditor's Opinion.* The IAASB discussed the circumstances where wording prescribed by law or regulation for the auditor's opinion differs significantly from the phrases "give a true and fair view" and "are presented fairly, in all material respects". The task force proposed that in such circumstances, the auditor needs to consider whether an explanation would be appropriate to mitigate the risk that users might misunderstand the assurance obtained from the audit. The IAASB deliberated the issue of whether such an explanation would be better positioned in the part of the auditor's report dealing with the auditor's responsibilities or whether it should remain as an emphasis of matter paragraph as proposed by the task force. The IAASB concluded that such explanation should be placed in an emphasis of matter paragraph mainly because this treatment would more clearly highlight the explanation and serve to enhance the consistency of the auditor's report. The task force was asked to prepare an illustrative example of wording of an emphasis of matter paragraph that would be appropriate in these circumstances for the December IAASB meeting.
- *Audits Performed in Accordance with ISAs and/or National Auditing Standards.* The IAASB debated the issue of whether ISA 700 should allow greater flexibility in the wording of the auditor's report to cater for audits of entities that want to be able to report cross-border that the audit has been conducted in accordance with the ISAs but have prescribed reporting formats in their home jurisdictions. The IAASB noted that the option to use a different reporting format and wording when the auditor has conducted the audit in accordance with ISAs and national auditing standards could be used in such circumstances. In the Board's view, this provides sufficient flexibility during the transition to convergence. The IAASB confirmed its view, supported by most of the respondents to the Exposure Draft, that consistency in the auditor's report when the audit has been conducted in accordance with ISAs is important.
- *Misleading Financial Statements Resulting from Compliance with the Financial Reporting Framework.* The IAASB discussed the proposed guidance on the circumstances when compliance with a specific requirement of a framework results in misleading financial statements and when a legally-imposed financial reporting framework is not considered to be acceptable. Concern was expressed about the ability of each individual auditor to make the judgment on acceptability of the financial reporting framework, and the risk that the auditor could be held liable for failing to invoke an override if the financial reporting framework used departed in any way from the most advanced framework in the marketplace. After discussion, the IAASB asked

the task force to give further consideration to reflecting in the guidance in ISA 200 the fact that, for most frameworks for general purpose financial statements, the decision on the acceptability of the framework will be made in a jurisdiction by the profession as a whole. The task force was also requested to review the wording in ISA 700 to reinforce that it addresses entity-specific circumstances only, rather than deficiencies in the framework itself.

- *Reference to Applicable Ethical Requirements.* The IAASB discussed the issue of what was meant by “applicable” in the proposed reference in the auditor’s report to compliance with “applicable ethical requirements.” It was noted that the IFAC Code serves as a baseline and that national ethical requirements also apply where they are more restrictive. The IAASB agreed that it would be preferable in the interest of simplicity to delete the word “applicable” before “ethical requirements”.
- *Date of Approval of the Financial Statements.* The IAASB debated the proposed dual test for the date of the auditor’s report being no earlier than the date of approval of the financial statements and no earlier than the date on which sufficient appropriate audit evidence has been obtained. The IAASB concluded that it would be preferable to subsume the concept of approval of financial statements into the principle of sufficient appropriate audit evidence since approval of the financial statements is a form of evidence that those with the recognized authority have determined that a complete set of financial statements has been prepared.
- *Illustrative Auditor’s Report.* The IAASB noted that certain national standard setters would have to make changes to the illustrative auditor’s report for the requirements of local law or regulation, and debated the merits of moving the illustrative report to an appendix to facilitate this task. It was noted that because the wording in the report is reflected in the preceding bold-lettered requirements, the report is not illustrative in the same way as most other illustrative examples in other ISA appendices but rather demonstrates how all of those requirements collectively form the expected ISA audit report. It was also noted that this was not an issue that emerged in the Exposure Draft responses. The IAASB agreed that not to move the illustrative report to an appendix.
- *Effective Date.* In light of the anticipated issue of the final revised ISA in December 2004, concern was expressed that the proposed effective date of the standard for auditors’ reports dated on or after December 31, 2005 might result in some implementation difficulties for certain national standard setters. Taking account of the reasons why this effective date was originally chosen, the IAASB agreed to leave the proposed effective date unchanged pending further consultation at the forthcoming meeting of European national auditing standard setters.
- *Other Issues.* The IAASB also agreed the following:
 - To consider adding a footnote with regard to the fact that the reference to internal control in the section of the ISA dealing with management’s responsibility for the financial statements should be construed as being also a reference to books and records.
 - To add guidance to cater for circumstances where management has additional relevant responsibilities specified in the local jurisdiction, over and above management’s basic responsibility for the financial statements as addressed in the ISA.
 - To deal, within the body of the ISA, with circumstances where the auditor may have a responsibility to perform both an audit of financial statements and an audit of the effectiveness of the entity’s internal control, and to address the appropriateness of referring in

the auditor's report to the fact that the auditor's consideration of internal control is not for the purpose of expressing an opinion on the effectiveness thereof.

- Certain other editorial changes to the proposed revised ISA, including the illustrative auditor's report.

ISA 200, OBJECTIVE AND GENERAL PRINCIPLES GOVERNING AN AUDIT OF FINANCIAL STATEMENTS

In addition to editorial changes, the IAASB agreed the following:

- The wording in the section dealing with the conduct of an audit of financial statements, in particular compliance with relevant ISAs, should be conformed after the completion of the IAASB's project on clarity of standards.
- The development of a revised definition of reasonable assurance is a matter beyond the scope of this project. It was noted that IAASB staff is considering a separate project addressing the issue.
- The issue of having guidance addressing financial reporting frameworks established by law or regulation and whether such frameworks result in fair presentation of financial statements was one that would be more appropriately addressed by the accounting profession within the jurisdictions concerned and not the individual auditor.

ISAs 210, 560, 701 AND 800

Other than certain editorial changes to ISA 210, the IAASB agreed the revised drafts of ISAs 210, 560, 701 and 800 as presented.

The IAASB asked the task force to consider its comments and present a revised standard and related conforming amendments for review and final approval at the December 2004 meeting.

8. Modified Auditor's Report - Emphasis of Matter Paragraphs

Mr Hansen noted that the task force was asked to develop overarching principles that would help drive consistency in the usage of emphasis of matter paragraphs in auditor's reports, and that the task force was seeking the views of the IAASB on a proposal to do so. He presented the task force proposal to limit the use of emphasis of matter paragraphs in auditor's reports to situations that meet the following three conditions: (i) a significant uncertainty exists but is relatively unique to the entity (i.e., it is not an uncertainty common to most entities in the industry); (ii) the uncertainty is disclosed in the financial statements; and (iii) the auditor agrees with management on the accounting policy, the application of the accounting policy and the adequacy of the related disclosures.

Mr Hansen noted that the task force also proposes to establish another category of emphasis of matter paragraphs. This category, which would have the heading "Other Significant Matters," would address matters such as avoidance of auditor association with misleading information, statutory requirements and, in rare and unusual circumstances, other matters that are not contained in the financial statements.

The IAASB expressed concern that communication by way of emphasis of matters paragraphs might be too restricted under the proposal. The IAASB was of the view that the auditor should be permitted to emphasize in the auditor's report other matters, beyond just significant uncertainties, that are adequately presented and disclosed in the financial statements. The task force was asked, however, to develop explanatory guidance that cautions against the unnecessary emphasis of other matters. The task force was also asked to develop proposed headings to be used for these types of paragraphs in

the auditor's report, taking into account that such headings should relate to the matter being emphasized.

The IAASB expressed support for the proposed use of a second category of emphasis of matter paragraphs.

The IAASB asked the task force to consider its comments and present a revised standard for first read at the December 2004 IAASB meeting.

9. Special Reports

Mr Dutt presented a draft proposed revised ISA 800, "The Independent Auditor's Report on Historical Financial Information Other Than a Complete Set of General Purpose Financial Statement." He noted that the proposed ISA follows a principles-based approach, which could be applied to all types of engagements to report on the audit of historical financial information other than a complete set of general purpose financial statements, and that it was developed with reference to the proposed ISA 700 (Revised), "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements" and the "International Framework for Assurance Engagements."

The IAASB noted and agreed the following matters

- *Scope of the proposed ISA.* The proposed ISA should clarify the relationship between the proposed ISA and ISAE 3000 (Revised), "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information," and between special purpose audit engagements (providing reasonable assurance) and other assurance engagements providing moderate assurance. The task force should also consider how best to present the audit considerations not covered in other ISAs, but relevant to special purpose audit engagements, in the proposed ISA – the scope of which is the auditor's report on other historical financial information and not the audit of other historical financial information.
- *Materiality.* The guidance on materiality in the context of a special purpose audit engagement should be expanded. The task force should consider whether the auditor should deal with the matter in the engagement letter or audit opinion. In addition, the task force addressing the topic of materiality was asked to reconsider the application of the proposed revised ISA 320 to the audit of other historical financial information.
- *Applicable financial reporting framework.* The task force should reconsider the proposed standards and guidance on the auditor's consideration of the acceptability of the applicable financial reporting framework. It was noted that the auditor's consideration will be affected by the fact that the information is prepared for specific users and for a special purpose, and by the audit opinion (i.e., whether the audit opinion contains the "true and fair" / "present fairly, in all material respects" statement).
- *"True and fair" / "Present fairly, in all material respects."* The guidance on the terms used to express the audit opinion should be more flexible and indicate that, based on the auditor's professional judgment, terms most appropriate to the engagement circumstances should be used.
- *Elements of the auditor's report.* Due to the diversity of special purpose audit engagements, the ISA should specify the elements of the auditor's report, but allow flexibility in how each element is described.

- *Auditor's report in a prescribed format.* Concern was expressed about the standard and guidance on a request for the auditor to report in a prescribed a format. It was felt that the auditor may not be able to comply with either the standard on the elements of the auditor's report or the standard on reporting in a prescribed format. The task force was asked to reconsider the standard and guidance and, where appropriate, to align it with the proposed ISA 700 (Revised).
- *Restriction on distribution and use of the auditor's report.* An IAASB member was of the view that the inclusion of a paragraph in the auditor's report, restricting the distribution and use of other historical financial information prepared for a special purpose, should be mandatory. The task force was asked to: (i) revise the text to clarify that it is the distribution and use of the auditor's report, and not of the other historical financial information, that is restricted, and (ii) to delete the text dealing with the inclusion of a commentary in the engagement letter, indicating that the auditor accepts no responsibility for any loss or damage suffered by the addressee or any other reader as a result of using the other historical financial information for a purpose other than that specified, since it is a risk management and not an audit issue.

The IAASB asked the task force to accelerate the project timetable and to present a revised standard for first read at the December 2004 meeting.

10. Related Parties

Mr Plaistowe provided an overview of the project to revise ISA 550, "Related Parties." He indicated that the task force had reviewed a discussion paper issued in October 2003 by the UK Auditing Practices Board entitled "Improving the Auditing of Entities Subject to Common Control", as well as a special investigative report issued in February 2002 by a committee of the Board of Directors of Enron. Mr Plaistowe led the IAASB through a discussion of the issues identified by the task force.

- *Adopting a Definition of "Related Party."* The IAASB discussed the issue of whether ISA 550 should use related party definitions that are consistent with those in IAS 24 (Revised). The IAASB noted that the IAS 24 definitions should be used as a default for the purpose of understanding the requirements of the ISA, but that the standard should enunciate the responsibility of the entity's management to thoroughly understand and comply with the requirements of the applicable financial reporting framework.
- *Addressing Perceived Shortcomings in the Financial Reporting Framework.* The IAASB discussed the issue of whether the auditor should be encouraged to apply an override of the financial reporting framework if the auditor deems related party disclosures to be inadequate. It was noted that such an override could create difficulties for auditors since it could be illegal in a number of jurisdictions, and that it was unclear whether this would extend the auditor's responsibilities to obtain information from related parties for disclosure. The IAASB concluded that this was a difficult area but further thought should be given to: (i) considering the acceptability of the financial reporting framework as addressed in ISA 210; (ii) using the "standback" option in ISA 700 to consider whether the financial statements do give a true and fair view without further disclosures; and (iii) stating in the audit report words to the effect that the financial statements make no disclosure of related party transactions (which might be required by other financial reporting frameworks).
- *Adopting a Risk-Based Approach.* Mr Plaistowe indicated that the task force had concluded that ISA 550 needed to be revised to adopt a risk-based approach to the auditing of related party transactions. The IAASB concurred with this decision, but pointed out that the revised standard

should contain a minimum set of procedures to identify related party transactions. In addition, the revised standard should set out auditing procedures relating to understanding the entity that focus on understanding and evaluating the entity's internal control over the identification and disclosure of related party relationships and transactions.

- *Obtaining Evidence from Interested Parties.* The IAASB noted that there were inherent limitations in seeking evidence from interested parties (such as agents) to related party transactions. The IAASB agreed, however, that seeking evidence from such parties could be useful in certain circumstances, but noted that the proposed standard should clearly explain the purpose of such procedure. The IAASB also agreed that there should not be an expectation that the auditor would always obtain evidence from interested parties; the focus should, instead, be on using the procedure as a corroborative tool.
- *The Standard of Adequacy and Understandability.* The IAASB debated the issue of what should be an appropriate standard for adequacy and understandability of related party disclosures. Mr Plaistowe noted that clear guidance on this issue was lacking in IAS 24. Mr Sylph indicated that the IAASB Chairman had written to the IASB in June 2004 to request the IASB's collaboration on this project to address this and other issues, and that he was expecting a formal response in due course. It was also noted that at the PCAOB's SAG meeting held in September 2004, commentators had also advised the PCAOB to work closely with the U.S. Financial Accounting Standards Board when revising the PCAOB's interim standard on related parties. The IAASB concluded that the issue of an appropriate standard for adequacy and understandability of disclosures is a financial reporting framework matter and therefore outside of the scope of the project.

The IAASB also agreed the following:

- The revised standard should not address the disclosure of transactions between parties that are "almost related" or that involve conflicts of interest since these were issues that should be dealt with by the applicable financial reporting framework.
- The revised standard should differentiate between two types of risk factors, one relating to the identification of related party transactions, and the other relating to whether such transactions are conducted on an arm's length basis.
- The revised standard should include guidance on obtaining representations from key parties within the entity.
- The proposal for guidance on communication of related party issues with those charged with governance could be more appropriately dealt with in the appendix to the proposed revised ISA 260, "The Auditor's Communication with Those Charged with Governance."
- The revised standard should include additional guidance in the area of substantiating disclosures that assert that related party transactions were conducted at arm's length.

The IAASB asked the task force to consider its comments and present a revised standard for first read at the March 2005 meeting.

11. Communications

Mr Desautels provided an overview of the project to revise ISA 260 "Communications of Audit Matters with Those Charged with Governance" and led a review of the draft revised standard. The IAASB agreed the following matters.

- Given the significant increase in matters explicitly required to be communicated to those charged with governance, the task force should carefully reconsider the motivation for each. It was suggested that comparing the draft ISA with a modern audit committee charter could help in this process.
- The task force should consider further whether references to the engagement letter (where one exists) and the representation letter in the draft are appropriate, and to consider the extent to which the ISA should deal with representations requested of management and those charged with governance.
- While the auditor would ordinarily discuss with those charged with governance the application of materiality in the audit, the standard should explain that the actual materiality level (or tolerable error) would ordinarily not be communicated.
- The task force should reconsider whether the independence disclosures (including fees) required by the draft to be made to those charged with governance: (i) need always be in writing; and (ii) should be mandated only for particular entities (e.g., listed entities, public interest entities, or large entities). It was noted that where there is minimal separation between management and those charged with governance, as may be the case in small- and medium-sized entities, such disclosures may be unnecessary.
- The IAASB discussed whether particularly important matters that are communicated to those charged with governance orally, should always be confirmed in writing. It was noted that, in some cases, it may be contrary to legal advice to put certain matters in writing (e.g., queries related to management integrity or money laundering).
- The task force should reconsider the requirements of the draft regarding matters of governance interest that come to the attention of other auditors (including network firms) and members of the firm outside the audit team, as a number of members felt strongly that the draft requirements are too broad to be achievable in practice.
- The task force should reconsider whether some of the more significant requirements of other ISAs regarding communication with those charged with governance (e.g., regarding weaknesses in internal control) should be repeated in the revised ISA 260, or whether the Appendix is adequate for this purpose.

The IAASB asked that the task force consider its comments and present a revised standard for approval as an exposure draft at the December 2004 meeting.

12. Independence for Assurance Engagements

Mr Kellas welcomed Ms Pendergast, Chair of the IFAC Ethics Committee (Ethics Committee), Ms Rothbarth, member of the Ethics Committee and task force addressing revision of the IFAC Code of Ethics (IFAC Code) and Ms Munro, IFAC staff working with the Ethics Committee.

Ms Pendergast noted that the Ethics Committee is proposing changes to the IFAC Code to conform it to the new International Assurance Framework for Assurance Engagements, and presented the preliminary proposals to the IAASB for discussion. It was noted that the proposals were the views of the Ethics Committee task force and would be discussed by the Ethics Committee at its next meeting.

Ms Rothbarth noted that, in considering the various types of assurance engagements performed by professional accountants in public practice, the Ethics Committee task force concluded that the vast

majority of these engagements are assertion-based. The Ethics Committee task force therefore drafted the proposed revisions to the Code with a focus on assertion-based engagements. In the application of the independence framework to direct reporting engagements, however, the Ethics Committee task force is of the provisional view that if the professional accountant in public practice directly performs the evaluation or measurement of the subject matter, the self-review threat created may be so significant that no safeguard would be available to reduce the threat to independence to an acceptable level. The question was whether the Ethics Committee task force was right in thinking that virtually all direct reporting engagements would fall into this latter category.

The IAASB discussed some of the differences between assertion-based and direct reporting engagements and identified a number of engagements, at present performed, that would be considered to be direct-reporting engagements but for which it seemed clear that there was in fact an underlying assertion by management or some other reason to consider that the self-review threat would be reduced to an acceptable level by appropriate safeguards. Accordingly, the IAASB suggested that the wording in paragraph 8.14 of the Code might be revised to indicate that before accepting such an engagement consideration should be given to self-review threats to independence and, if such threats exist, safeguards should be applied to reduce the threats to an acceptable level. Guidance would probably be necessary to assist the practitioner.

Ms Pendergast thanked the IAASB for their input.

13. Next Meeting

The next meeting of the IAASB is scheduled for December 6-10, 2004 in New Orleans.

14. Closing Remarks

Mr Kellas thanked Mrs Jones and Mr Landes and the staff of the American Institute of Certified Public Accountants for hosting the meeting and for assisting with the necessary arrangements.

Mr Kellas closed the meeting.

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