

**Draft Minutes of the 13th Meeting of the
INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD**

**Held on December 6-10, 2004
At the Ritz-Carlton Hotel, New Orleans**

Voting Members*Present:*

John Kellas (Chairman)
Denise Esdon (Deputy Chair)
John Archambault
Philip Ashton
Roger Dassen (except Dec. 10)
Sukanta Dutt
Josef Ferlings
John Fogarty
Rogério Gollo
Jan Bo Hansen
Gen Ikegami
Ian Plaistowe
Roger Simnett
Roberto Tizzano
Gérard Trémolière
Mowafak Al Yafi

Apologies:

Denis Desautels
Ian McPhee

Technical Advisors

Wolfgang Böhm (Mr Ferlings)
Cédric Gélard (Mr Trémolière)
Diana Hillier (Mr Ashton)
Susan Jones (Mr Fogarty)
Keith Newton (Mr Archambault)
Emilio Palma (Mr Tizzano) (except Dec. 10)
Greg Shields (Mr Desautels)
Tan Shook Kheng (Mr Dutt)
Sylvia Smith (Mr Kellas)
George Tucker (Mrs Esdon) (except Dec. 9-10)
Yuichi Yamamoto (Mr Ikegami)

Jon Grant (Mr Plaistowe)
Richard Mifsud (Mr McPhee)
Tania Sergott (Mr Hansen)
Hans Verkruijsse (Mr Dassen)

Non-Voting Observers*Present:*

David Damant
Thomas Ray
Hisashi Yamaura

IFAC Representatives and Technical Staff*Present:*

Jim Sylph (Technical Director), James Gunn, Jane Mancino (Dec. 6-8), Michael Nugent, Alta Prinsloo, Ken Siong (Dec 6-7)

1. Opening Remarks and Minutes

Welcome and Introductions

Mr Kellas welcomed the public observers to the meeting.

Mr Kellas explained that, as part of the effort to increase transparency, the IAASB is considering audio webcasting of its meetings; a trial recording was being made of this meeting. Initially, the webcasts will not be broadcast live but, if the recordings prove to be satisfactory they will be archived on the IAASB website after each meeting. If the process works well and if records show that the archives are being accessed by those interested in IAASB's work, consideration will be given to live broadcasting in the future.

Mr Kellas noted that apologies had been received from Messrs Desautels and McPhee. Mr Desautels appointed Mr Shields as his proxy. Mr McPhee appointed Mr Kellas as his proxy. Mr Kellas also noted that Mr Dassen will not be in attendance on December 10th, with Mr Hansen appointed as his proxy for matters requiring voting on that day.

Minutes of Previous Meeting

The minutes of the public session of the previous IAASB meeting were approved as presented. Mr Kellas noted that revised minutes of the June 2004 IAASB meeting reflecting the change requested by Mr Ashton will be posted to the IAASB website.

IAASB Consultative Advisory Group

Mr Kellas reported that the IAASB Consultative Advisory Group (CAG) met on November 29-30, 2004. The task force chairs of the various projects on the meeting agenda will report on matters raised by CAG during the presentation of the material on those projects.

Mr Kellas reported that Messrs Damant and Sylph have undertaken a review of the membership of the CAG and that some changes thereto have been made to ensure a balanced representation. He also reported that the CAG terms of reference and roles and responsibilities of the CAG chair documents were approved by the CAG subject to minor amendments, and are now ready for submission to the PIOB.

2. Estimates

Mr Ashton reported that the CAG had discussed aspects of the proposed revised ISA 540, "Auditing Accounting Estimates and Related Disclosures (Excluding Those Involving Fair Value Measurements and Disclosures)," at its November 2004 meeting. The CAG provided positive feedback on the overall balance and flow of the proposed ISA and were broadly supportive of the direction being taken by the task force. One CAG member expressed concern, however, over the proposed requirement for the auditor to develop a range when management has not adequately supported an estimate. His concern was that such a requirement would place an inappropriate managerial responsibility on the auditors. It had also been suggested that the linkage between the proposed ISA and the proposed standards and guidance on materiality, communication with those charged with governance, and the auditor's report should be enhanced, possibly by setting out their interrelationship in the explanatory memorandum accompanying the exposure draft.

Mr Ashton led a review of the proposed revised ISA 540. In addition to editorial changes, the IAASB agreed the following:

Risk Assessment Procedures

- The proposed ISA should not identify “significant estimates” as a class of estimates separate from those estimates that are material to the financial statements. The term “significant” should be used only in relation to: (i) the results of the assessment of risks (i.e., significant risks); and (ii) those assumptions where an estimate is highly sensitive to changes thereto (i.e., significant assumptions).
- In obtaining an understanding of management’s process for making accounting estimates, the proposed ISA should guide the auditor to consider the complete list of matters identified in the proposed ISA as relevant; such matters should not be presented as examples. In addition, the list of identified matters should include the auditor’s consideration of whether generally accepted techniques for making particular accounting estimates exist.
- The proposed ISA should explain that the determination by management of a “point estimate” may in some cases be made directly, while in other cases it may be made by developing a range of outcomes. It should also explain that the most likely outcome within a range is required to be used as the “point estimate” by many, but not all, financial reporting frameworks.
- The auditor should determine which accounting estimates have high estimation uncertainty and may, therefore, be significant risks that require special audit consideration. The proposed factors that may indicate high estimation uncertainty, however, should exclude matters relating to weaknesses in internal controls. This change would align the proposed ISA with the audit risk standards, which require the assessment of risks before consideration of the effectiveness of internal controls.
- The proposed ISA should make clear that management judgment is necessary in determining the assumptions underlying an accounting estimate, and that management’s attitudes and motivations influence these judgments.

Responses to the Risks of Material Misstatements and Significant Risks

- The proposed ISA should not establish bold type requirements that repeat those contained in the audit risk standards, unless they are introducing additional requirements or prescribe how those requirements are to be applied. Accordingly, the proposed requirements relating to the auditor’s response to the risks of material misstatements and responses to significant risks should be replaced by cross references to the related requirements of the audit risk standards.

Substantive Procedures to Respond to Significant Risks

- The proposed ISA should clarify that the substantive procedures identified in the standard are in addition to any other substantive procedures performed to meet the requirements of ISA 330, “The Auditor’s Procedures in Response to Assessed Risks.”
- The proposed ISA should not require the auditor to develop a “reasonable range of outcomes” with which to evaluate the reasonableness of management’s point estimate when management has not adequately supported a point estimate. Rather, it should require the auditor to consider whether it is practicable to develop such a range in the circumstance where management has not

applied a sensitivity analysis or considered alternative outcomes in determining a point estimate. Where management does not perform further work requested by the auditor, or if the auditor believes that management has failed to consider information that is reasonably available to it, then the auditor should consider the implications for the auditor's report.

- The proposed ISA should explain that the purpose of developing a “reasonable range of outcomes” is to establish a range that is sufficiently narrow to be useful to the auditor in evaluating the reasonableness of management's point estimate. The development of a reasonable range of outcomes should be presented as a two-step process whereby the auditor excludes from the range outcome values that are considered to have a remote likelihood of occurrence, followed by the exclusion of those outcome values judged by the auditor to be unlikely to occur.

Evaluating the Reliability of the Measurement of Accounting Estimates

- The proposed ISA should clarify that the auditor is required to evaluate whether the audit evidence obtained is sufficient and appropriate to support management's judgment regarding both the recognition and, where appropriate, non-recognition of an accounting estimate in the financial statements in accordance with the entity's applicable financial reporting framework.

Evaluating Audit Evidence and Determining Misstatements and Indicators of Possible Management Bias

- The proposed ISA should require the auditor to determine whether accounting estimates and related disclosures are reasonable in the context of the entity's applicable financial reporting framework. The related explanatory guidance should explain that this determination is made based on the auditor's evaluation of the sufficiency and appropriateness of the audit evidence obtained.
- To clarify further the responsibilities of the auditor under the proposed ISA and those established by proposed revised ISA 320, “Materiality in the Identification and Evaluation of Misstatements,” the proposed ISA should explain that: (i) the auditor's determination and documentation of misstatements and indicators of possible management bias under the proposed ISA relates to *individual* accounting estimates; and (ii) the implications of the findings arising from the auditor's consideration of indicators of possible management bias form a part of the auditor's evaluation of whether the financial statements as a whole are free of material misstatements, as required by ISA 320.
- The explanatory guidance pertaining to the identification of indicators of possible management bias should not include examples that illustrate a quantification of possible management bias.

Documentation

- The proposed documentation requirements should include the documentation of the result of tests of controls that have been performed in response to significant risks.

The IAASB reviewed and discussed a revised draft reflecting the changes agreed upon during the earlier discussion and approved the issue of proposed ISA 540 (Revised) as an exposure draft. The closing date for comments was set as April 30, 2005.

3. Materiality

Mr Kellas welcomed Mr Lindsell, task force chair, and Mr Billing, task force staff, to the meeting. Mr Lindsell noted that, since September, the task force considered the IAASB's comments on the application of the proposed revised ISA 320 to special purpose audit engagements; the definition of materiality; and the standards and guidance on users, quantitative guidelines, communication of misstatements to management, undetected misstatements, prior period misstatements, and management bias. The revised proposed ISA was also reviewed by the UK Auditing Practices Board and by CAG, both of which were generally supportive thereof.

Mr Lindsell led a review of the proposed revised ISA 320. In addition to editorial changes, the IAASB agreed the following:

- The first paragraph should be amended to indicate that the standards and guidance in the ISA are to be adapted for audits of historical financial information other than financial statements. In discussing this matter, it was noted that the intention is not to apply the limited scope of proposed ISA 700 (Revised) (i.e., the audit of a complete set of general purpose financial statements) to other ISAs.
- The guidance on the definition of materiality in the context of an audit should state that if the applicable financial reporting framework provides a different definition of materiality, the auditor uses that definition for the purpose of the audit. In discussing the definition of materiality, it was noted that it would be acceptable for a national standard setter, in aligning its national standards with the ISAs, to replace the definition of materiality with the definition in the national financial reporting framework, if different. Mr Damant cautioned that the proposed definition of materiality, which is from the IASB pronouncements, was developed in a decision-making context (i.e., users of financial statements), while in the case of other financial reporting frameworks the definition has often been developed in a stewardship context.
- The evaluation of whether a misstatement could influence economic decisions of users, and therefore be material, involves consideration of the characteristics of those users. Accordingly, the guidance on users should be more closely linked with the proposed definition of materiality.
- The guidance on users should not refer to "intended users" and "other users, if any, to whom the auditor has a legal responsibility." The guidance, however, should explain more clearly why users are to be considered as a group.
- The heading "Determining Materiality for the Financial Statements as a Whole" should be amended to clarify that the standards and guidance that follow apply to the determination of materiality levels when establishing the overall audit strategy and not for evaluating identified misstatements.
- Factors to be considered in identifying an appropriate benchmark should refer to the users, with the related guidance clarifying why the illustrative examples of percentages applied to the benchmarks are appropriate to the needs of the users. In addition, the illustrative examples for a profit oriented listed entity and a profit oriented owner managed entity should be combined.
- The auditor should be required to determine levels of tolerable error for classes of transactions, account balances and disclosures. In addition, it was noted that the guidance on tolerable error could be read as though different levels of tolerable error may be determined for a particular class

of transaction, account balance or disclosure. Since this is not the case, this should be clarified in the proposed revised ISA.

- The standards and guidance on misstatements should be amended to clarify that the auditor should accumulate misstatements, other than those which are “clearly trivial,” and that the auditor does not need to communicate trivial misstatements to management.
- Consideration should be given to indicating that a misstatement identified as result of a substantive analytical procedure may be a “likely misstatement.”
- The proposed ISA should indicate that the auditor considers the implications for the auditor’s report when the auditor requests management to examine a class of transactions, account balance or disclosure in order to identify and correct misstatements therein and management refuses to do so.
- In evaluating whether uncorrected misstatements are material, the guidance should clarify that the auditor considers both materiality for the financial statements as a whole and materiality for particular items of lesser amounts.
- Management bias is a matter to evaluate in conjunction with the uncorrected misstatements. Accordingly, the guidance should be clear on what the auditor does when he or she is of the opinion that there is management bias.
- The requirement to document levels of materiality and tolerable error should be simplified. It should not be implied that there are individual materiality levels identified when making qualitative judgments at the evaluation stage that need to be documented.
- The reference to the use of “professional judgment by the auditor” should be used sparingly and only when it is considered necessary to convey its importance in relation to a specific matter.

The IAASB reviewed and discussed a revised draft reflecting the changes agreed upon during the earlier discussion and approved the issue of proposed ISA 320 (Revised) as an exposure draft. The closing date for comments was set as April 30, 2005.

4. The Audit of Group Financial Statements

Mr Hansen provided background to the project, noting that an exposure draft (ED) had been issued in December 2003 and that comments received had been analyzed and discussed with CAG and the IAASB in June and July 2004, respectively. Subsequent to the July IAASB meeting, the Transnational Auditors Committee, Forum of Firms, IFAC Small and Medium Practices (SMP) Permanent Task Force, and a joint meeting of the SMP Permanent Task Force and FEE Small and Medium Sized Entities/Small and Medium Sized Practices Working Group were consulted on the task force’s proposals.

The IAASB was asked to consider the following new matters:

JOINT AUDITS

ED-ISA 600 excluded joint audits from its scope. Although the proposed standards and guidance do not deal with the conduct of a joint audit, they apply to the audit of group financial statements conducted by joint auditors. One respondent felt particularly strongly that this fact should be clarified.

After debate, the IAASB agreed that a footnote should be added to the definition of “group auditor” to clarify that the group auditor can be a single auditor or joint auditors. This change should also be made to the definition of “auditor” in the Glossary of Terms. Furthermore, the IAASB should consider including a project on joint audits on its work program.

ACCESS TO INFORMATION

Respondents to the exposure draft and members of the groups consulted, including CAG, commented that legal or professional impediments may prevent the group auditor from having the access, as contemplated by the task force’s proposals, to component management, component information or the other auditors, including their audit documentation.

The task force was asked to reconsider the requirement for the group auditor not to accept the engagement, or to resign from the engagement, when a scope limitation (due to restricted access to information) results in a disclaimer of opinion. Furthermore, guidance should be provided on the circumstances in which a scope limitation will result in a disclaimer of opinion. The task force was also asked to consult the IAASB members on the implications that the proposals may have in their countries.

OTHER MATTER PARAGRAPH – WORK PERFORMED BY AN UNRELATED AUDITOR

The “other matter paragraph – work performed by an unrelated auditor” was developed in response to comments from some CAG members who were of the view that it is important to inform readers of the group auditor’s report of the involvement of unrelated auditors in the audit of the group financial statements. The consultation process indicated that the paragraph does not add to the clarity of the auditor’s report.

The task force proposed, and the IAASB agreed, that the related proposed standard and guidance should be deleted.

STANDARDS AND GUIDANCE IN ONE ISA

Based on the comments received on the exposure draft, guidance was moved from the International Auditing Practice Statement (IAPS) to the ISA, and changed to standards or retained as guidance. The task force (except for one member) is of the view that the standards and guidance would be better presented in a single document.

After debate, the majority of IAASB members were of the view that the standards and guidance should be presented in an ISA and IAPS. Furthermore, the standards and guidance in the ISA should be limited to issues unique to the audit of group financial statements. This should assist in determining the split between the ISA and IAPS.

DETAILED REVIEW OF EXPOSURE DRAFT

Mr Hansen led a review of the revised exposure draft. The IAASB agreed the following:

Scope and Definitions

- The ISA and IAPS should indicate that the standards and guidance, adapted as necessary in the circumstances, apply to the work of another auditor performed in the context of an audit of the financial statements of a single entity.

- The definition of “group auditor” should be revised to clarify that it is the auditor who takes responsibility for the audit opinion on the group financial statements. The definitions of “related auditor” and “unrelated auditor” should make it clear that they refer to another auditor that performs work on the financial information of one or more components. The definition of “significant component” should first indicate risk and then size. This approach should be applied throughout the ISA and IAPS.

Obtaining a preliminary understanding and acceptance and continuance as group auditors

- The standards and guidance on obtaining a preliminary understanding form the basis of the group auditor’s acceptance and continuance considerations and, accordingly, should be incorporated in the section on Acceptance and Continuance as Group Auditor. Furthermore, the guidance that states that the group auditor may apply a percentage to a chosen benchmark as a step in identifying components that are of individual financial significance and that a component representing 20% or more of group assets, liabilities, cash flows, profit or turnover is regarded financially significant, should make it clear that, depending on the nature and circumstances of the group, a lower percentage than 20% often may be appropriate. Part of the guidance could be in the IAPS.
- The standards and guidance on acceptance and continuance as group auditor should be linked to ISA 220 (Revised), “Quality Control for Audits of Historical Financial Information.” The focus should be on the principle that the group auditor should be in a position to obtain sufficient appropriate audit evidence on which to base the audit opinion on the group financial statements. The guidance should explain how a related auditor helps the group auditor to be in such a position. The standards and guidance should remain in the ISA.

Access to information

- This section should be restructured to indicate more clearly when the group auditor should not accept an engagement or, subsequent to accepting an engagement, to consider the effect of a scope limitation. The standards and guidance should remain in the ISA.

Terms of engagement

- The matter relating to access to information should be incorporated in the section on Access to Information. The remainder of the guidance could be in the IAPS.

Evaluation of other auditors

- The task force should consider whether to use the term “evaluate” or “consider.” The guidance on the consideration of the related auditor should cover the related auditor’s professional qualifications, independence and professional competence. The guidance on the consideration of a related auditor that is not known by the group auditor should be expanded. The guidance on the consideration of an unrelated auditor should include reference to the regulatory environment in which the unrelated auditor operates. The standards and guidance should remain in the ISA.

Materiality

- This section should be restructured to indicate more clearly matters unique to the audit of group financial statements. The standards and guidance should remain in the ISA.

Obtaining an understanding of the group, its components, and their environments, and of the consolidation process

- The standards and guidance could be in the IAPS. The task force should consider whether it is necessary to retain one or more requirement, unique to the audit of group financial statements, in the ISA.

Discussion among engagement team members regarding the risks of material misstatement of the group financial statements, including risks of fraud

- The guidance could be in the IAPS.

Assessing the risks of material misstatement of the group financial statements

- The standards and guidance could be in the IAPS.

Responding to assessed risks

- This section should be restructured to distinguish the standards and guidance on determining the scope of work to be performed on the components' financial information from those on the procedures to be performed on the consolidation. The task force should reconsider the guidance on identifying the different categories of component and the description of these categories to address matters of potential confusion raised by the IAASB members. The standards and guidance should remain in the ISA.

Involvement in the work of other auditors

- The standards and guidance should be revised to allow for flexibility, acknowledging that there are different ways to achieve the same results, and to focus on components that are likely to give rise to significant risks of material misstatement of the group financial statements. Furthermore, the group auditor does not have to have the same level of understanding of the component as the other auditor, but should be able to identify significant risks of material misstatement of the group financial statements. References to unrelated auditors' audit documentation (working papers) and related auditors' documentation (review memorandum) should be clarified. The standards and guidance should remain in the ISA.

Performing further audit procedures

- The task force should consider retaining one or more requirements, unique to the audit of group financial statements, in the ISA. Otherwise, the guidance could be in the IAPS.

Evaluating the sufficiency and appropriateness of audit evidence

- References to unrelated auditors' audit documentation (working papers) and related auditors' documentation (review memorandum) should be clarified. The standards and guidance should remain in the ISA.

Considering the findings of another auditor

- The term "findings" may be too generic and should be reconsidered. The standard and guidance should remain in the ISA.

Reporting considerations

- The standards and guidance could be in the IAPS.

Communication

- The guidance on communication with group management should cross reference to the ISA requirement to report material weaknesses in internal control. The guidance could be in the IAPS.
- The standards and guidance on communication with those charged with governance should remain in the ISA.
- This section on communication with another auditor should appear earlier in the ISA. The group auditor should be required to request confirmations from the other auditor. The other auditor's understanding of the applicable financial reporting framework could be limited to that described in the group's accounting manual. Confirmation in the other auditor's report or memorandum of the other auditor's compliance with the firm's quality control policies and procedures goes further than what is normally required in an auditor's report and, accordingly, should be reconsidered.
- The guidance on communication with another auditor who is required to audit the financial statements of a component should remain in the ISA. Furthermore, the guidance should clarify that the communication is both from the group auditor to the other auditor and from the other auditor to the group auditor.

Documentation.

- The standards should remain in the ISA.

The IAASB asked that the task force consider its comments and present draft revised ISA and IAPS for approval for issue as a re-exposure draft at the March 2005 IAASB meeting.

5. Communications

Mr Kellas noted the apologies of the chair of the task force, Mr McPhee, who was unable to attend the session due to unavoidable commitments, and welcomed Ms Tove Myklebust to the table as the INTOSAI representative to the task force.

On behalf of the task force chair, Mr Nugent provided an overview of the project to revise ISA 260, "The Auditor's Communication with Those Charged with Governance." He indicated that the project was a joint effort with the Australian Auditing and Assurance Standards Board (AUASB) and that the proposed revised ISA was acceptable to the AUASB. In addition, the CAG had discussed the main issues in this project and provided feedback to the task force at its November meeting. Mr Nugent reported that the SMP Permanent Task Force had also reviewed and commented upon the draft ISA.

Mr Nugent led a review of the proposed revised ISA.

"Those charged with governance" versus "management"

The IAASB discussed the draft protocol for use of "those charged with governance," "management" and related terms, and debated whether it is appropriate for ISAs to identify responsibilities in terms of "the entity," or whether responsibilities should be assigned to individuals. It was noted that the entity *per se* is unable to act on its own, and that it is therefore preferable to identify individuals or groups of individuals who are capable of taking responsibility. The IAASB agreed that the protocol

should refer specifically to either or both (as appropriate) management or those charged with governance when discussing responsibilities within the entity.

Application of the ISA

The IAASB discussed whether all of the ISA's requirements should be applied for all audits, and considered such options as making the ISA applicable to listed entity audits only, with other entities being encouraged to apply it as appropriate. It was noted that the SMP Permanent Task Force had expressed concern about responsibilities beyond forming an opinion on the financial statements being introduced in the ISAs. The IAASB discussed these concerns and concluded that communicating with those charged with governance is an essential part of the audit process, and that the ISA should be applicable to all financial statement audits. The IAASB further agreed, however, that certain requirements need not be applied when all of those charged with governance are actively involved in the day-to-day management of the entity, and asked the Task Force to consider how such an exemption could be applied. In this context, the IAASB noted the following in particular:

- *Planned scope and timing of the audit:* It was questioned whether it is appropriate for the ISA to require the auditor to communicate an outline of the planned scope and timing of the audit to those charged with governance when these individuals were also members of management. It was noted that the purpose of such a communication is to assist those charged with governance in discharging their oversight responsibilities, and therefore such communication would not be necessary, and may be inappropriate, when those charged with governance and management are the same individuals.
- *Conduct of, and findings from the audit:* Communication of matters to those charged with governance that had already been communicated with management is not necessary when those charged with governance and management are the same individuals.

It was also noted that the IAASB Steering Committee may in due course recommend that a separate task force of the IAASB be established to deal with the applicability of ISAs to small and medium sized practices.

The auditor's responsibilities

It was noted that proposed guidance regarding the auditor's responsibility to communicate matters that come to the attention of personnel outside the audit team only when those matters arise from the audit of a component of the entity, had too narrow a focus. The CAG had also raised a similar question. The IAASB asked the task force to reconsider this issue, noting in particular that:

- Neither the auditor nor other personnel should have a responsibility to proactively seek out matters of governance interest to communicate.
- Consideration needs to be given to whether it is reasonable to expect experts engaged by the auditor to (a) identify accounting matters as being of governance interest should they happen to observe them, and (b) inform the auditor of matters of which they become aware other than as a result of their engagement by the auditor (i.e. confidentiality considerations).

Statement of Auditor Independence

The IAASB debated whether an ISA is an appropriate place to specify a requirement that in essence relates to ethics. In this regard, Mr Sylph indicated that IFAC's Ethics Committee had been consulted

on the inclusion of this proposed requirement in the ISA and had not raised any objection. The IAASB also debated the issue of defining audit versus non-audit services in respect of the proposed requirement to communicate fees charged for these services, but agreed that it was unnecessary to give further guidance on this matter. The purpose of the requirement to communicate fees was also debated, and it was noted that because fees are perceived by some segments of the public to be associated with threats to independence, the drafting should better reflect this if the requirement is to be retained.

In addition to editorial changes, the IAASB asked the task force to:

- Reconsider how the importance of effective two-way communication is explained, and the consequences of ineffective two-way communication.
- Provide guidance for the auditor to inquire of those charged with governance regarding what matters they consider to be relevant to their responsibilities.
- Consider whether the reference to “accountability obligations” in the definition of “those charged with governance” is necessary.
- Consider whether the proposed ISA should contain a requirement for listed entities only that auditor-initiated adjustments be communicated to those charged with governance.
- Consider, as proposed by CAG, whether there should be a dispensation in respect of wholly-owned components since matters for communication could be dealt with on a group basis.
- Add a summary of significant matters that other ISAs require to be communicated in the body of the ISA, and to streamline Appendix 2 to retain only the most important items.

The IAASB asked that the task force consider its comments and present a draft revised ISA for approval for issue as an exposure draft at the March 2005 IAASB meeting.

6. Independent Auditor’s Report

Mr Ashton led a review of the proposed revised ISA 700 and the related amendments to ISAs 200, 210, 560, 701 and 800.

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

Financial Reporting Frameworks Established by Authorized or Recognized Organizations

Mr Damant noted that at the last CAG meeting held in November, the World Bank’s representative had expressed a concern that it became apparent as a result of the Asian financial crisis that the financial statements of many entities were issued with unqualified true and fair/present fairly opinions even though their jurisdictions had inadequate financial reporting frameworks. In that CAG member’s view the problem would worsen if a “gold standard” ISA on audit reporting were to be issued that would continue to allow such opinions despite the financial reporting framework used to prepare the financial statements being inadequate. The World Bank representative did not believe that the proposed guidance would prevent such opinions from being issued. Mr Damant expressed the view that this issue might possibly be resolved if auditors in jurisdictions with such financial reporting frameworks were only allowed to report that financial statements had been prepared in accordance with the applicable financial reporting framework (“compliance reporting”), as opposed to providing true and fair/present fairly opinions on these financial statements.

The IAASB noted that requiring only compliance reporting when the financial reporting framework is not acceptable would place a burden on the auditor, or the professional body in the auditor's jurisdiction, to challenge the acceptability of the financial reporting framework even in jurisdictions in which there is a recognized standard setter that has followed a transparent due process to set the financial reporting framework. Such a burden would be unfair because the issue could not be resolved unless all relevant stakeholders such as standard setters, governments, regulators and practitioners were involved together in finding a mutually acceptable solution. It was also noted that this was a difficult issue for the profession because law or regulation in certain jurisdictions may prescribe the use of true and fair/present fairly wording for the auditor's report regardless of whether the applicable financial reporting framework has been determined to be acceptable. An added difficulty was that users might not be able to understand the distinction between true and fair/present fairly reporting and compliance reporting unless the difference between the two was clearly explained.

The IAASB agreed that there is currently no objective and authoritative basis that has been generally recognized globally for judging the acceptability of financial reporting frameworks for general purpose financial statements. ISA 200 should recognize this and leave open the possibility that in the future objective criteria might be established to evaluate the acceptability of financial reporting frameworks. ISA 210 was also amended to state that, if the entity is required by law or regulation to use a financial reporting framework that is determined not to be acceptable, the auditor does not express the opinion using the terms "give a true and fair view" or "are presented fairly, in all material respects" unless required to do so by law or regulation. The IAASB also concluded that until a basis for judging the acceptability of financial reporting frameworks is agreed, financial reporting frameworks that are set by organizations authorized or recognized to promulgate standards to be used by certain types of entities should be presumed to be acceptable for general purpose financial statements prepared by such entities, provided the organizations follow an established and transparent due process.

Other Issues

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

- To include additional guidance in ISA 200 (as well as the introductory paragraphs in ISA 700 and ISA 800) to clarify further the circumstances when the auditor should follow the requirements and guidance in ISA 700 addressing the audit of general purpose financial statements, or the requirements and guidance in ISA 800 addressing other audit engagements. In particular, ISA 700 had been drafted on the presumption that most acceptable general purpose frameworks would be intended to provide 'fair presentation.' It was clear from discussion, and some comment letters, that there may be cases where law or regulation governing the financial statements of certain entities, that are regarded as general purpose statements in those jurisdictions, specifies the use of a financial reporting framework that is not designed to achieve fair presentation. The intention of the IAASB was that such cases would be within the scope of ISA 800, rather than ISA 700. In order to make this clear, the IAASB agreed that ISA 700 should address audit reports for general purpose financial statements that have been prepared in accordance with financial reporting frameworks designed to achieve fair presentation.
- To retain the distinction between jurisdiction and country because a jurisdiction could be part of a country.

ISA 700, THE INDEPENDENT AUDITOR'S REPORT ON A COMPLETE SET OF GENERAL PURPOSE FINANCIAL STATEMENTS

Extremely Rare Circumstances When Applying the Financial Reporting Framework Results in Misleading Financial Statements

The IAASB deliberated whether it was appropriate for ISA 700 to allow the auditor to consider overriding the applicable financial reporting framework when application of the framework would result in misleading financial statements. Some IAASB members noted that law or regulation in certain jurisdictions might not permit override of the financial reporting framework and that it would be difficult for the auditor to consider such an override when the financial reporting framework did not provide for such a possibility. It was also questioned whether this would require the auditor to reconsider the acceptability of the financial reporting framework that the auditor would have addressed under ISA 200.

The IAASB noted that it was necessary to balance strict compliance with the financial reporting framework with the need to ensure that the auditor did not report on a true and fair/present fairly basis on financial statements that were misleading. In addition, while ISA 200 dealt with a more general requirement to consider the acceptability of the applicable financial reporting framework, ISA 700 addressed the *particular circumstances of the entity* when application of the financial reporting framework would result in misleading financial statements. It was noted that additional guidance had been added to the section following the September IAASB meeting to help emphasise that distinction. After further deliberation, the IAASB agreed to retain the guidance for the auditor to consider the need to modify the auditor's report in the extremely rare circumstances when application of the financial reporting framework would result in misleading financial statements.

Date of the Auditor's Report

The IAASB deliberated the proposed wording that sufficient appropriate audit evidence should include evidence that those with the recognized authority have determined that a complete set of financial statements has been prepared. It was noted that this wording was not sufficiently clear and that further explanatory guidance might be necessary. After due deliberation, the IAASB agreed that the concept of sufficient appropriate audit evidence should continue to include the fact that a complete set of financial statements has been prepared but it was important for the auditor to ensure that those with the recognized authority have asserted that they have taken responsibility for them.

Effective Dates

The IAASB deliberated the proposed effective dates for the revised ISAs 200, 201 and 700. It was noted that the original proposal for tying the effective date of ISA 700 to auditors' reports dated on or after December 31, 2005 would not allow sufficient time for implementation. The IAASB considered instead whether it would be more appropriate to tie the effective date to an accounting period. This option, however, would result in auditors using a mixture of old-style and new-style auditor's reports depending upon the accounting periods being reported, thus leading to potential confusion among users of financial statements. After further deliberation, the IAASB agreed to extend the effective date so that ISA 700 should be effective for auditors' reports dated on or after December 31, 2006. The proposed effective dates for revised ISAs 200 and 210 were also extended so that both ISAs 200 and 210 would be effective for audits of financial statements for periods beginning on or after December 15, 2005.

The IAASB also agreed certain other editorial changes to the proposed revised ISA 700.

ISAS 210, 560, 701 AND 800

The IAASB agreed the revised drafts of ISAs 210, 560, 701 and 800 as presented.

The IAASB reviewed and discussed revised drafts reflecting the changes agreed upon during the earlier discussion. After considering final revised wording to ISAs 200 and 700, the IAASB agreed that the nature of the revisions are such that re-exposure is not warranted. The IAASB approved the revised and amended standards for issue.

Mr Archambault voted against the issue of the standards because, in his opinion: (i) one of the main objectives of the revision of ISA 700 – to achieve greater consistency in reporting by auditors – will not be achieved given that the proposed revised ISA 700 allows the auditor’s report to be changed based on the requirements of local laws and regulations; (ii) the narrow scope afforded the proposed revised ISA 700 is inconsistent with a principles-based approach to standard setting and unduly restricts its broader application; and (iii) the issue of ISA 700 should be made concurrently with the exposure of revisions to ISA 701 and ISA 800 to assist in ensuring there are no discrepancies between these three reporting standards and to allow users to consider a complete package of standards and guidance.

Mr Ferlings noted that, although he has voted in favor of the issue of the standards, he shares many of the concerns raised by Mr Archambault. In the future, he would not support the issue of a standard that adopts a similar narrowly defined scope.

7. Qualifications to the Opinion in the Independent Auditor’s Report

Mr Hansen led a review of the proposed ISA on qualifications to the opinion in the independent auditor’s report and the proposed standards and guidance on the use of emphasis of matter paragraphs in the auditor’s report. In addition to editorial and structural changes, the IAASB agreed the following:

Development of Two Separate ISAs

- The task force should develop two separate ISAs addressing qualifications to the opinion in the auditor’s report and emphasis of matter (EOM) paragraphs: ISA 701, which should provide guidance on auditor reports with other than unqualified opinions; and a new ISA (i.e., ISA 702) which should provide guidance on the use of EOM paragraphs and “Other Matters” paragraphs in auditor reports. In doing so, the Task Force should develop appropriate introductory material since guidance on the use of EOM and “Other Matters” paragraphs will now be included in a stand-alone ISA rather than as a conforming change to ISA 700, as originally planned.

Standards and Guidance in Proposed Revised ISA 701

The IAASB asked to task force to:

- Consider identifying another term to use in place of “qualification” or “qualified” report when referring to a report that is other than unqualified.
- Clarify that disagreements with management also include disagreements about underlying facts and circumstances.

- Provide consistent guidance on the impact on the audit opinion of a matter's materiality and pervasiveness.
- Consider providing guidance that prohibits the issuance of piecemeal opinions.
- Provide guidance stating that it is possible that a material misstatement in one line item in the financial statements could be so material as to lead to an adverse opinion; inclusion of an example report would be helpful.

In developing the proposed revised ISA 701, the Task Force was asked to consider carefully whether ISA 800 circumstances are treated appropriately.

Use of Emphasis of Matter (EOM) and "Other Matters" Paragraphs

Mr Hansen noted that the CAG, at its November 2004 meeting, was of the view that: (i) in order to be considered for inclusion in an EOM paragraph, a matter should be both significant and unusual; and (ii) the ISA should not be so restrictive that an industry specific uncertainty cannot be included in an EOM paragraph. The CAG also asked the task force to make it clear that "Other Matters" paragraphs cover only matters that are not required to be included or disclosed in the financial statements.

With respect to the use of EOM paragraphs in the auditor's report, the IAASB expressed support for the principle that the use of such a paragraph in the auditor's report is not required but should always be at the auditor's discretion or judgment.

In addition, the IAASB asked the task force to:

- Revise the ISA to state that the auditor should consider inclusion of an EOM paragraph in the auditor's report if: (i) a matter is significant and unusual; and (ii) in the auditor's judgment, the matter is of fundamental importance to the user's understanding of the true and fair view or fair presentation of the financial statements. However, the auditor should not include an EOM paragraph in the auditor's report unless the following conditions are met: (i) the matter is appropriately presented and disclosed in the entity's financial statements in accordance with the applicable financial reporting framework; and (ii) the auditor agrees with management on the accounting policy selected, the application of the accounting policy and the adequacy of related disclosures.
- Provide additional guidance on what constitutes an "unusual" matter in relation to the proposed "significant and unusual" criterion for the use of an EOM paragraph.
- Provide more examples of matters to be included in EOM paragraphs, for example, the existence of an unusual accounting policy.
- Provide additional guidance on the placement or order of EOM and "Other Matters" paragraphs in the auditor's report. The guidance should take account of the fact that the auditor might want to include one or more EOM paragraphs, and may also want to include an "Other Matters" paragraph in the report.
- Consider inclusion of an appendix that identifies all of the places in the ISAs that require or discuss the use of EOM paragraphs.

- Clarify the difference between the “Report on Other Legal and Regulatory Requirements,” which is described in ISA 700, and “other statutory requirements,” which is one of the matters that may be included in an “Other Matters” paragraph.

The IAASB asked that the task force consider its comments and present draft revised ISAs for approval for issue as exposure drafts at the March 2005 IAASB meeting.

8. The Independent Auditor’s Report on Historical Financial Information Other Than a Complete Set of General Purpose Financial Statements

Mr Dutt provided background to the project, noting that the IAASB had requested the task force to expedite the project timetable. It is intended to submit a proposed exposure draft for approval at the March 2005 IAASB meeting. Mr Dutt reported that since last discussion of the project by the IAASB, the task force has:

- Expanded the guidance in the introduction to the proposed ISA to clarify the scope of the proposed revised ISA 800, “The Independent Auditor’s Report on Historical Financial Information Other Than a Complete Set of General Purpose Financial Statements” in relation to proposed ISA 700 (Revised), “The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements.”
- Liaised with the Audit Materiality Task Force in order to expand the standards and guidance in proposed ISA 320 (Revised), “Materiality in the Identification and Evaluation of Misstatements” to include audits of historical financial information other than a complete set of general purpose financial statements.
- Revised the proposed guidance on the use of the terms “true and fair” / “present fairly, in all material respects” to provide for a “step-back responsibility” where they are used. This guidance is in line with that in proposed ISA 700 (Revised).

Mr Dutt noted that the task force also considered the positioning of the standards and guidance on the auditor’s report on summarized historical financial information. Because summarized historical financial information is derived from audited historical financial information and the auditor’s report thereon is closely linked to the auditor’s report on the historical financial information from which it has been derived, the task force is of the view that the standards and guidance would be better placed in a separate ISA, i.e. ISA 801, “The Independent Auditor’s Report on Summarized Historical Financial Information.” The IAASB agreed with this proposal.

Mr Dutt led a review of the proposed exposure draft. The IAASB asked the task force to:

Auditor’s Report on Other Historical Financial Information (Except Summarized Historical Financial Information)

- Clarify the scope of the proposed revised ISA 800 to indicate that it also includes auditor’s reports on financial statements prepared in accordance with a financial reporting framework designed for a general purpose, but without the requirement to achieve fair presentation.
- Consider expanding the guidance to make it clear that it applies to auditor’s reports issued as a result of reasonable assurance engagements.

- Consider revising the guidance to make it clear that the auditor should not accept an engagement to audit special purpose historical financial information when the responsible party should, but for some reason decides not to, prepare general purpose historical financial information.
- Clarify the fact that there may be a difference between the purpose for which the applicable financial reporting framework has been designed and the use to which the historical financial information prepared in accordance with that framework are put.
- Clarify the guidance indicating that the auditor applies, adapted as necessary, the ISAs in an audit of other historical financial information.
- Consider expanding the guidance on the application of proposed ISA 320 (Revised) in an audit of other historical financial information.
- Consider expanding the guidance on, or developing criteria for, the use of the terms “true and fair” / “present fairly, in all material respects.” In the light of proposed ISA 700 (Revised), these terms should be used in an auditor’s report on other historical financial information only when appropriate.
- Expand the auditor’s report to include an element on restriction on distribution and use of the auditor’s report. Furthermore, consideration should be given to including bold lettered requirements in the guidance on distribution and use of the auditor’s report. Complete sets of general purpose financial statements not requiring the achievement of fair presentation, however, should not be restricted in this manner.
- Consider whether the wording of the opinion paragraph could make it clear whether a “true and fair” or other, e.g. “prepared in accordance with,” opinion is expressed.

Auditor’s Report on Summarized Historical Financial Information

- Consider expanding the explanation as to why the auditor should not report on summarized historical financial information which has been derived from historical financial information that the auditor has not expressed an audit opinion on.
- Review the proposed opinion on summarized historical financial information prepared without reference to criteria, as it appears to be a stronger opinion than the one proposed for an auditor’s report on summarized historical financial information prepared in accordance with established criteria. Consideration should be given to more closely aligning these opinions. Mr Yamaura noted that the auditor should not be permitted to report on summarized historical financial information which has not been prepared in accordance with established criteria. The task force was requested to consider addressing such situations with sufficiently strong guidance in the proposed revised ISA.

The IAASB asked that the task force consider its comments and present a draft revised ISA for approval for issue as an exposure draft at the March 2005 IAASB meeting.

9. Withdrawal of Certain IAPSs

Mr Sylph led a review of a staff proposal to withdraw the following IT-related IAPSs as of December 31, 2004:

- IAPS 1001, “IT Environments—Stand-Alone Computers”

- IAPS 1002, “IT Environments–On-Line Computer Systems”
- IAPS 1003, “IT Environments–Database Systems”
- IAPS 1009, “Computer-Assisted Audit Techniques”

The IAASB deliberated whether it is appropriate to withdraw these IAPS due to the fact that they are outdated, or whether any of the four IAPSs continue to provide useful guidance and consequently should be retained. The IAASB also considered whether the proposal to withdraw the IAPSs should be exposed for public comment.

The IAASB agreed that each of the identified IAPSs should be withdrawn without exposure effective December 31, 2004. A press release should be issued describing the withdrawal.

Mr Simnett voted against the withdrawal of the IAPSs. In his opinion, the guidance in the IAPSs is useful from a practical and educational point of view, and in terms of interpreting the application of the standards and guidance of ISA 500, “Audit Evidence.” Mr Shields voted against the withdrawal of IAPS 1009. In his opinion, the guidance in that IAPS is considered useful.

10. Project Proposal – Using the Work of an Expert

The IAASB reviewed the project proposal to revise ISA 620, “Using the Work of an Expert.” One IAASB member emphasized the importance of the project in the light of its interrelationship with other ISAs, such as the audit of fair values, and proposed that it be commenced as soon as possible. The IAASB approved the project proposal. Mr Kellas invited IAASB members who are interested in serving on the task force to contact him or Mr Sylph.

11. Action Plan

Mr Kellas presented the meeting agenda material addressing project priorities and the draft IAASB 2005-2006 Action Plan. He explained that the objective of the session was to provide the IAASB with an opportunity to advise on possible project priorities for inclusion in the draft Action Plan, the nature of other assurance projects that the IAASB might consider undertaking, and any other matters of importance in planning for 2005-2006.

Mr Kellas explained that while priority is given to the development and revision of standards for financial statement audits, the proposed priorities take account also of the growing demand for guidance on other assurance services. The overall project plan, however, is subject to the effect of the implementation strategy to be adopted in relation to the Clarity project. Further, the priorities may change in response to circumstances, and that commencement of work on any new project is subject to IAASB approval of a formal project proposal.

Mr Kellas indicated that there was a degree of consistency between the projects being addressed or considered by the IAASB and those being pursued by the US Public Company Accounting Oversight Board (PCAOB), based on discussions held at the last meeting of the PCAOB’s Standing Advisory Group. Mr Ray summarized the projects that are under consideration by the PCAOB.

Reporting on Internal Control

The IAASB generally supported the need to address reporting on internal control as a priority for 2005-2006. It was noted, however, that: (i) the existence of different regulatory and legislative

frameworks and environments internationally makes the development of auditing standards and guidance on this topics difficult; (ii) the selection of the internal control framework and reporting criteria, and the determination of whether direct reporting versus assertion-based engagements should be adopted, are critical decisions to be made in relation to such a project; (iii) without an obligation for management to report on internal control using a specified framework as a basis for doing so, it may be impossible for the IAASB to develop standards and guidance that are applicable globally. It will therefore be important to establish carefully the scope of a project on reporting on internal control. Mr Kellas suggested that the development of a discussion paper, building on the work that FEE is currently undertaking on the subject, might be a possible way forward on this topic.

External Confirmations

The IAASB expressed mixed views on the proposal to revise ISA 505, "External Confirmations," as part of the 2005-2006 priorities. Some members were of the view that the environment has not changed sufficiently since the ISA was last revised to warrant revision, and that there is an increasing number of entities refusing to provide third party confirmations to either an entity whose financial statements are being audited or to the auditor thereof. Accordingly, it was suggested that change to the legal or regulatory environments to require those that have business relationships with an entity to answer confirmation requests in good faith may be needed before the IAASB embarks on a revision of the ISA. Other members were of the view that revision at this time is appropriate. It was noted that IOSCO had requested revision of the ISA, and that indications by other national standards setters suggest that revision may be needed at this time.

It was agreed that discussion should be held with members of the Monitoring Group, in particular with IOSCO and Basel Committee on Banking Supervision, as to whether there is anything that can be done from a regulatory point of view to improve the environment with regards to entities' responses to confirmation requests.

Reasonable Assurance

Mr Kellas noted that it will be important to balance the need to address the issues associated with the term "reasonable assurance," including the consideration of the conceptual framework in which the term is used, with the impact that such a project might have on the time and resources of the IAASB. It was agreed that the national standard setters should be asked at their February 2005 meeting whether a cooperative project on the study of the conceptual framework and reasonable assurance might be a way forward in addressing the topic.

Assurance Projects

The IAASB expressed differing views on the priority between possible assurance projects on sustainability reporting, reporting on prospective financial information and auditor involvement with prospectuses. Concern was generally expressed however over whether the profession is, or will, apply such assurance standards given the fact that there are few regulatory requirements enforcing their application.

The Steering Committee was asked to consider the findings from the discussion of the European national auditing standards setters meeting in January 2005 at which the European Prospectuses Directive will be discussed and, in particular, whether the national standard setters see an opportunity to develop guidance within the context of the IAASB Assurance Framework.

Mr Kellas noted that the topic of XBRL is of interest to some national standard setters as well as others, and that the Steering Committee will be further considering this topic.

The IAASB asked that the Action Plan be submitted for approval at the March 2005 meeting.

12. Next Meeting

The next meeting of the IAASB is scheduled for March 7-11, 2005 in Lima, Peru.

13. Closing Remarks

Mr Kellas thanked those members who will be rotating from the IAASB at the end of 2004 for their contribution to the work of the IAASB. He also thanked the other members of the IAASB as well as the chairs, members and staff of the task forces for their hard work and support.

Mr Kellas closed the meeting.

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