

**Minutes of the 19th Meeting of the
INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD
Held on March 6-10, 2006 in Hong Kong**

Voting Members

Present: John Kellas (Chairman)
Denise Esdon (Deputy Chair)
Craig Crawford
Phil Cowperthwaite
Sukanta Dutt
Josef Ferlings
John Fogarty
Jan Bo Hansen
Diana Hillier
Kjell Larsson
Marcel Pheijffer
Ian McPhee
Will Rainey
Bodo Richardt
Makoto Shinohara
David Swanney
Roberto Tizzano (March 6-7)
Gérard Trémolière

Technical Advisors

Kelly Ånerud (Mr Larsson)
Wolfgang Böhm (Mr Ferlings)
Philip Ashton (Ms Hillier)
Cédric Gélard (Mr Trémolière)
Jon Grant (Mr Rainey)
Jennifer Haskell (Mr Hansen)
Richard Mifsud (Mr McPhee)
Greg Shields (Mr Cowperthwaite)
Sylvia Smith (Mr Crawford)
Shook Kheng Tan (Mr Dutt)
George Tucker (Ms Esdon)
Hans Verkruijsse (Mr Pheijffer)
Sharon Walker (Mr Fogarty)
Yuichi Yamamoto (Mr Shinohara)

*Absent:***Non-Voting Observers**

Present: Jennifer Rand
Hisashi Yamaura
David Damant

Public Interest Oversight Board (PIOB) Members Observer

Present: Faye Zul Choudhury (March 7-9)

IAASB Technical Staff

Present: Jim Sylph (Technical Director), James Gunn, Michael Nugent, Alta Prinsloo, Ken Siong, Jan Tyl

1. Opening Remarks and Minutes

WELCOME AND INTRODUCTIONS

Mr Kellas noted that Mr Fayezul Choudhury, a PIOB member, would be attending the meeting later in the week. Other expected observers included an IOSCO representative from the Hong Kong Securities and Exchange Commission, and representatives of the Hong Kong ICPA.

Mr Kellas introduced new IAASB members appointed since the last meeting. They are Mr Kjell Larsson (technical advisor Ms Kelly Ånerud), Mr Phil Cowperthwaite (technical advisor Mr Greg Shields), Ms Diana Hillier (technical advisor Mr Philip Ashton), Mr Marcel Pheijffer (technical advisor Mr Hans Verkruijsse), Mr Makoto Shinohara (technical advisor Mr Yuichi Yamamoto) and Mr David Swanney. In addition, Ms Denise Esdon and Mr Gérard Trémolière have been reappointed to the Board, Ms Sharon Walker has replaced Mr Landes as Mr Fogarty's technical advisor and Ms Jennifer Rand has replaced Mr Ray as the PCAOB observer following the appointment of Mr Ray as Chief Auditor of the PCAOB. Mr Kellas also regretted to report that Ms Mary Radford, an INTOSAI representative who had made a great contribution as a member of the Modifications task force had died after being hit a car and that condolences on behalf of the IAASB had been sent.

Mr Kellas informed members that public interest declarations had been received from all but one member. He reiterated that the IAASB members must act in public interest, not in the interest of the firms, professional bodies or countries from which they come.

Mr Kellas noted that, when appointing a proxy, the proxy preferably should be the member's technical advisor, the IAASB Chair, Deputy Chair or Technical Director.

The annual report and the 2006 edition of the IAASB Handbook would be distributed by mid-March. Also, an additional IAASB meeting was scheduled for October 25-27; the location and venue would be announced later.

Mr Kellas further informed the members that, in February, IFAC President Mr Ward, CEO Mr. Ball and Mr Kellas had attended a ceremony in the People's Republic of China. The Chinese Ministry of Finance released new accounting and auditing standards which conform more closely to international standards and reflect China's commitment to international convergence with accounting and auditing standards and recognition of the importance of these standards in building public confidence in financial statements.

Mr Kellas reported that the European Commission had responded to the invitation to appoint an observer to the IAASB by appointing Mr Jurgen Tiedje as its representative supported by Mr. Jean-Philippe Rabine. The EC has also appointed two observers to the PIOB.

MINUTES OF PREVIOUS MEETING

The minutes of the public session of the previous IAASB meeting were approved as presented.

OTHER MATTERS

Mr Tizzano appointed Mr Sylph as his proxy for the part of the meeting that he was not able to attend.

2. Group Audits

Mr. Hansen led the discussion of a re-exposure draft of the proposed ISA 600 (Revised and Redrafted), "The Audit of Group Financial Statements." Mr. Hansen noted that the SMP Committee had expressed its satisfaction with the proposed ISA.

Significant comments raised by the IAASB are summarized below.

INTRODUCTION

The IAASB agreed that the scope paragraph should be amended to indicate that it may be necessary to adapt the ISA when applying it in those cases where it is relevant to the audit of the financial statements of a single entity.

Some IAASB members noted that the explanation of the effect on audit risk of using the work of another auditor should not include the list of actions that the group auditor could undertake to be involved in the work of another auditor. It was agreed that this list should be moved to the requirements section.

OBJECTIVE TO BE ACHIEVED

Some IAASB members were of the view that the objective paragraph stated both the objective and the procedures to achieve the objective. Mr. Hansen explained that the objective is drafted in the same manner as the objectives in the clarity exposure draft and will be revised in accordance with the outcome of the clarity project.

REQUIREMENTS

Acceptance and Continuance as Group Auditor

The IAASB agreed that the requirement dealing with acceptance and continuance as a group auditor should be revised to reflect the responsibilities of the group engagement partner as opposed to the responsibilities of the group engagement partner's firm. It was also agreed that explanatory material in this section should be deleted or moved to the application material.

Obtaining an Understanding of the Other Auditors

The IAASB agreed that the relevant requirement should clarify that the other auditor has to comply with those ethical requirements relevant to the group auditor. This is in addition to the ethical requirements relevant to the other auditor.

IAASB members raised a number of concerns about the requirement for the group auditor to obtain a confirmation from the other auditor whether his or her firm's quality control system complies with ISQC 1. It was agreed that this requirement should be deleted, but that the group auditor should be required to obtain an understanding of the other auditor's firm's quality control system, including whether it has implemented ISQC 1. It was also agreed that the application material should explain how in a case where the group auditor and another auditor operate under common quality control policies and procedures, that fact affects the group auditor's understanding of that other auditor and the procedures the group auditor performs in relation to that other auditor's work.

Obtaining an Understanding of the Group

The IAASB agreed that the requirement and application material should be revised to clarify that the group auditor's understanding of the group should be sufficient to confirm his or her initial identification of significant components and to assess risks of material misstatement of the group financial statements at the group level.

Materiality

The IAASB agreed that the requirements should be revised to clarify that the group auditor should determine the materiality level for the group financial statements as a whole when establishing the overall audit strategy for the group audit. To reduce the risk that the aggregate of detected and undetected misstatements in the group financial statements exceeds the materiality level for the group financial statements as a whole, the group auditor should determine materiality levels for the components that are lower than the materiality level for the group financial statements as a whole. The group auditor or the other auditor should also determine an amount lower than the materiality level for the component for purposes of assessing the risks of material misstatement and designing further audit procedures to respond to assessed risks at the component level. If the other auditor determines this amount, the group auditor should determine its appropriateness.

Responding to Assessed Risks

The IAASB agreed that the reference to "a review of the financial information of the component performed in accordance with standards determined by the group auditor" should be clarified by reference to the International Standards on Review Engagements, and the fact that the group auditor may specify additional procedures to supplement the work.

One IAASB member was concerned about the requirement for the group auditor, in the case of a significant component, to review the other auditor's documentation of identified and assessed risks of material misstatement – in particular, where the other auditor was from a network firm. Mr. Hansen explained the importance of this requirement. The IAASB agreed that the requirement should be revised to focus on the review of the other auditor's documentation of *significant risks*.

The IAASB also agreed that, in the case of identified significant risks of material misstatement, the group auditor should be satisfied with the further audit procedures to be performed to respond to them. Originally it was proposed that the group auditor, together with the other auditor, should determine the further audit procedures.

For components subject to audit by statute, regulation or other reason, the IAASB agreed that it should be clarified that, should the group auditor decide to use those audits, the requirements of the proposed ISA should nevertheless be met. It was also agreed to move some of the text to the application material.

Consolidation Process

The IAASB agreed that the requirement for the group auditor to consider possible indicators of management bias should be expanded to include consideration of fraud risk factors.

For components with financial reporting period-ends that differ from that of the group, it was agreed that the requirement should be revised such that the group auditor should determine whether group

management has identified any significant transactions, rather than a requirement that the group auditor should identify such transactions.

Subsequent events

One IAASB member noted that the requirement in relation to components that are not individually significant appears to be stronger than the requirement in relation to significant components. The task force was asked to reconsider the requirements.

Communication with Other Auditors

The IAASB agreed that the requirement for the group auditor to communicate his or her requirements to the other auditor should be expanded to clarify that communication with the other auditor takes place throughout the group audit.

The task force was asked to consider whether the information to be communicated by the group auditor to the other auditor and by the other auditor to the group auditor applies to all types of work performed by other auditors (at the request of the group auditor) on the components' financial information.

The IAASB debated the information to be included in the other auditor's memorandum or report of work performed. In particular, one IAASB member was concerned about the requirement to describe the work performed by the other auditor, including, where applicable, materiality used to plan and perform the work, a list of significant risks identified at the component level that may result in a misstatement in excess of component materiality, the other auditor's response to such risks, and the results of additional audit procedures. In response to this concern, the IAASB agreed that, to the extent not already communicated to the group auditor, the other auditor's memorandum or report of work performed should include a list of significant risks that have been identified in the component, the other auditor's response to such risks, and the results thereof.

It was also agreed that, in line with the requirements and guidance in proposed ISA 260 (Revised), "Communication with Those Charged with Governance," the reference to corrected misstatements in the list of information to be included in the other auditor's memorandum or report of work performed should be reconsidered.

Considering the Effect of the Other Auditors' Memoranda or Reports of Work Performed on the Auditor's Report on the Group Financial Statements

The IAASB agreed that the requirement for the group auditor not to refer to the involvement of another auditor in the auditor's report on the group financial statements, unless relevant to a modification of the group audit opinion, should be deleted. Paragraph 4 of the proposed ISA clearly states that the group auditor alone is responsible for the group audit opinion.

Documentation

An IAASB member questioned how the group auditor was to document his or her understanding of the other auditor. The IAASB agreed that the group auditor should be required to document the nature, timing and extent of his or her involvement in the work of the other auditor and the basis thereof.

Other

An IAASB member asked whether the requirements or guidance could be expanded to cover situations where the other auditor's audit documentation has been prepared in a language foreign to the group auditor. After debating the matter, the IAASB concluded that it was not necessary for the proposed ISA to cover such a specific situation.

Approval of Exposure Draft

After considering the changes processed by the task force to respond to the IAASB's comments, the IAASB unanimously approved the exposure draft. It was agreed that comments should be invited on the re-exposure draft, as well as on the application of the clarity drafting conventions. It was agreed that the exposure period should be 120 days.

3. Estimates

Mr Ashton noted that the objective of the session was to obtain the IAASB's agreement on the proposed revised ISA 540, "Auditing Accounting Estimates and Disclosures (Other than Those Involving Fair Value Measurements and Disclosures)," drafted following the IAASB's pre-clarity drafting conventions, and to discuss the way forward for dealing with the interrelationship between ISA 540 and ISA 545, "Auditing Fair Value Measurements and Disclosures."

He explained that the task force had reconsidered some of its views following the comments made by the IAASB and IAASB CAG in October. In particular, the task force revisited the issue of point estimates and ranges; often the audit of accounting estimates is an iterative process which starts with either a point estimate or a range, either of which may be appropriate according to the circumstances. Further, changes were made to improve the flow of the proposed revised ISA. He noted also that the IFAC Public Sector Committee had indicated that no public sector perspective was required for the ISA, and that the IFAC Small and Medium Practice Committee gave a positive assessment on the latest draft, with only a few technical observations.

Mr Ashton led a review of the proposed revised ISA.

RISK ASSESSMENT PROCEDURES AND RESPONSES TO RISKS OF MATERIAL MISSTATEMENT

The IAASB noted that the proposed risk assessment procedure for the auditor to obtain an understanding of whether the method for making the accounting estimates has been applied consistently, and the basis for changes (if any) from the prior year, appears to go beyond the purpose of risk assessment procedures. Rather, it represents the type of procedure the auditor would perform when auditing an accounting estimate in response to the assessed risks of material misstatement. The IAASB agreed that the proposed risk assessment procedure should be redrafted to reflect the necessary understanding of whether there have been changes to management's process for making accounting estimates.

In addition, it was noted that the ISA appears to omit a requirement that drives the auditor to consider whether management has properly applied all the requirements of the applicable financial reporting framework relevant to the accounting estimate, as part of the auditor's response to the assessed risks.

After further deliberation, the IAASB agreed that the auditor should be required, in responding to the assessed risks of material misstatement, to:

- Determine, to the extent not already done, whether management has properly applied the requirements of the applicable financial reporting framework relevant to the accounting estimate.
- Determine whether the methods for making the accounting estimates have been applied consistently, and the basis for changes, if any, in accounting estimates from the prior period.

RECOGNITION OF THE ACCOUNTING ESTIMATE IN THE FINANCIAL STATEMENTS

With regard to the proposed requirement for the auditor to evaluate, for significant risks, whether audit evidence supports management's decision as to whether or not to recognize an accounting estimate in accordance with the recognition criteria of the applicable financial reporting framework, the IAASB observed that the application material focuses only on the issue of measurement reliability. There are, however, other matters that affect recognition that may need to be considered by the auditor. The IAASB agreed that the application material should be reworded to avoid giving the impression that issue of measurement reliability is the only matter of concern, thereby aligning the guidance with the broader focus of the proposed requirement.

DEVELOPING A POINT ESTIMATE OR RANGE

The IAASB was of the view that it is only in rare cases that the auditor will be able to narrow the range to a point where audit evidence indicates a point estimate that differs from the management estimate (in circumstances other than where there has been a factual error, such as an incorrect calculation). Accordingly, the IAASB agreed that the flow and wording of the explanatory guidance dealing with the development of a point estimate or a range should be revised to place greater emphasis on the development and narrowing of ranges. The IAASB also agreed that a corresponding change in emphasis is needed in the wording of the guidance dealing with the auditor's evaluation of the reasonableness of the accounting estimates and determining misstatements.

With respect to the description of the process of narrowing the auditor's range, the IAASB agreed that the wording should emphasize that the range should be narrowed to the point where the auditor is unable to distinguish a best estimate based upon the relative likelihood of occurrence of the remaining outcomes, and accordingly all outcomes within the range are considered reasonable.

ASSUMPTIONS AND SIGNIFICANT ASSUMPTIONS

The IAASB asked the task force to reconsider whether the proposed revised ISA is sufficiently clear about the difference in the required work effort in relation to assumptions and significant assumptions.

MANAGEMENT REPRESENTATIONS

The IAASB expressed concern over the proposed addition of "management's intent and ability" to the representations required to be obtained from management, which was made to align revised ISA 540 with extant ISA 545. It was noted that the addition creates the potential of narrowing inappropriately the focus of the requirement, and for the inappropriate inclusion of requests for such a representation without consideration of the context. Further, it was noted that this consideration is not applicable to the audit of all estimates.

After due consideration, the IAASB agreed that the “intent and ability” should be established as guidance as one of the representations that the auditor may consider obtaining in light of the circumstances of the audit, and not part of the required representations.

OTHER MATTERS

Several editorial suggestions were discussed and agreed.

The IAASB reviewed the revised draft of the proposed revised ISA 540, reflecting the changes agreed during the earlier discussions. The IAASB agreed that the final version as presented, subject to minor editorial changes, is the basis to be used for applying the clarity drafting conventions.

WAY FORWARD FOR ISAS 540 AND 545

Mr Ashton explained that the task force had reviewed the requirements of ISA 545 in relation to those of the proposed revised ISA 540, and that staff has begun a review of sentences containing the existing present tenses that may warrant elevation to requirements. Further, the task force has considered on a preliminary basis whether there should continue to be two separate, but largely repetitive, ISAs, or one “combined ISA” where guidance on fair values is included in ISA 540 within a separate section of the application material to ISA 540. Mr Ashton noted that none of the alternatives is without some drawback. As a further option, the guidance on fair values could be revised in the form of a new IAPS. He also noted that the task force will need to be augmented to include an expert on fair values, in determining the appropriate way forward.

One IAASB member noted that whatever approach would be taken, it must not result in a loss of key elements of ISA 545, particularly internal assumptions which separate fair values from estimates. This concern may be allayed if the wording is clear and users understand the difference.

The IAASB asked the task force to continue to seek and propose an optimal solution, in such a way that fair values are dealt with simultaneously with the future exposure of ISA 540 redrafted in accordance with the clarity drafting conventions.

4. Communication with those charged with governance

Mr McPhee introduced the topic noting that correspondence had been received since the December meeting from (i) the World Bank (WB), and (ii) the Small and Medium Practice Committee (SMPC). The main points raised by WB included the following:

- The scope of the draft ISA is too restrictive regarding supplementary matters – this matter was discussed later in the meeting (see SUPPLEMENTARY MATTERS).
- There is an apparent assumption in the draft that shareholders play no role in the governance process. Mr McPhee indicated that the task force has suggested additional text in the introduction to address this matter. The IAASB discussed that text and agreed that it should be retained, with some additional amendments.

SMPC noted improvements in the draft, and suggested, amongst other things, that it be further amended to note that communication in the case of SMEs is often simpler and less frequent. Mr McPhee indicated that the task force has suggested wording to address the matter.

REQUIREMENTS OF OTHER ISAS

Mr McPhee noted that at the previous meeting, the IAASB had asked the task force to reconsider whether an appendix to the ISA, or other form of communication (such as a document on the IAASB website), should include a list of communication requirements contained in other ISAs. The task force had noted that some older ISAs did not distinguish between “management” and “those charged with governance,” and recommended that this issue be addressed through the clarity process, with an appendix (or other form of communication) being prepared after that process is complete. The IAASB discussed the matter and agreed that an appendix restricted to references to “those charged with governance” would be helpful at this stage, and that it should be updated by conforming amendments as other ISAs change in future.

OTHER HISTORICAL FINANCIAL INFORMATION

The IAASB discussed whether and, if so, to what extent, the ISA should be applicable to audits of information other than financial statement audits. It was noted that the IAASB Preface includes a statement that ISAs are applicable to all audits of historical financial information and, therefore, if an ISA is not fully applicable, it should be explicitly stated. The IAASB agreed that application of this ISA differs from many ISAs in that expectations regarding communication with those charged with governance in “other” audits vary significantly. It was agreed that the ISA should state that it may be applicable, adapted as necessary in the circumstances, to audits of other financial information.

MATERIALITY LEVEL

The IAASB debated whether the auditor’s planning materiality level should be communicated. While in some countries it has been beneficial for the materiality level to be discussed with those charged with governance, in others it has led to management, when preparing the financial statements (i) not properly considering qualitative factors, or (ii) inappropriately working to the auditor’s materiality level. It was agreed that the ISA should not refer to the specific materiality level.

ACCOUNTING PRACTICES

The IAASB discussed whether communication of the auditor’s views about significant qualitative aspects of the entity’s accounting practices should be required in all cases, in particular whether it is necessary for SME audits, and whether such communication needs to be in writing. It was agreed that communication regarding qualitative aspects of accounting practices is important for all audits and that the requirement should be retained. It was recognized that, consistent with the section of the ISA dealing with forms of communication, this communication may be oral, particularly in the case of SMEs.

CORRECTED MISSTATEMENTS AND WEAKNESSES IN INTERNAL CONTROL

The draft contained a requirement to communicate material corrected misstatements that indicate a weakness in internal control. The IAASB discussed whether it is the corrected misstatement or the weakness in internal control that is important to those charged with governance. It was also noted that even though ISA 315 requires communication of material weaknesses in design or implementation of internal control, the ISAs do not currently require communication of material

weakness in operating effectiveness. It was agreed that the requirement here should be to communicate material weaknesses in design, implementation or operating effectiveness of internal control that have come to the auditor's attention, rather than corrected misstatements.

SUPPLEMENTARY MATTERS

The task force, having been asked at the previous meeting to consider the material regarding communication of supplementary matters, had presented two versions of the material – one as guidance, the other as a requirement. Concern was expressed about whether retaining this material as a requirement would create expectations that could not be fulfilled, and about whether it could be effectively implemented given the lack of clear boundaries around what could reasonably be expected to be communicated. While acknowledging the public interest issue that the proposed requirement sought to meet, the IAASB agreed that it should be included as guidance rather than as a requirement.

OTHER MATTERS

The IAASB agreed that:

- The definition of “significant” should be deleted.
- References to the “relevant ethical requirements” should be conformed to the wording in ISA 200.
- As written, the requirement regarding documentation is unnecessary as it merely repeats the generic requirement of ISA 230. On the other hand, the ISA should require that where matters required by the ISA are communicated orally, they should be documented.

CONCLUSION

The task force was asked to submit a final pre-clarity version of the ISA for close off, and an exposure draft of the clarity version for approval at the next meeting. It was noted that the main issues outstanding were (i) final wording for the documentation requirement, (ii) the objective for the clarity version, and (iii) whether agreed changes regarding supplementary matters warranted re-exposure.

5. Special Reports

Thirty four comment letters were received on the exposure draft of proposed ISA 701, “The Independent Auditor’s Report on Other Historical Financial Information,” which was issued in June 2005. Mr. Dutt presented a paper explaining the significant issues identified by the task force based on the comments received and discussing the task force’s deliberations and, where appropriate, recommendations.

ISSUE 1: WHETHER ISA 200 AND ISA 210 APPLY TO ALL FINANCIAL STATEMENTS OR TO GENERAL PURPOSE FINANCIAL STATEMENTS ONLY?

The task force supported the current practice of writing the ISAs in the context of financial statements as defined in paragraph 34 of ISA 200, “Objective and General Principles Governing an Audit of Financial Statements,” irrespective of whether they have been prepared for a general or

special purpose. To eliminate ambiguity, the task force recommended that ISA 200 and ISA 210, “Terms of Audit Engagements” be revised to make it clear that they apply to audits of both general purpose and special purpose financial statements.

One IAASB member felt strongly that the ISAs should be written in the context of a complete set of general purpose financial statements prepared in accordance with a financial reporting framework designed to achieve fair presentation. She was of the view that changing the presentation of the ISAs in order to develop generic requirements and guidance to be tailored based on the circumstances of the engagement would be less useful for readers. Furthermore, she was concerned that it could be seen by some readers as diluting the requirements and guidance in the ISAs as they relate to true and fair/fairly presents audits. The majority of IAASB members, however, supported the task force’s recommendation to revise ISA 200 and ISA 210 to make it clear that they apply to audits of both general and special purpose financial statements.

Mr. Dutt explained that the task force was of the view that the ISAs should recognize differences that may exist in the audits of general purpose financial statements and the audits of special purpose financial statements. Such differences exist only for a limited number of ISAs (e.g., communications with those charged with governance, materiality, going concern, and the auditor’s report). They could be recognized in the relevant ISAs without providing detailed guidance. Going forward, task forces responsible for developing or revising specific ISAs could be responsible for identifying such differences.

One participant questioned the extent of modification to the individual ISAs necessary to make them applicable to the audits of special purpose financial statements. Recognizing differences in the ISAs, as recommended by the task force, may create the impression that the IAASB has a comprehensive set of standards for audits of special purpose financial statements, while this is not the case. Including detailed guidance for audits of special purpose financial statements in the ISAs, however, will lead to the ISAs losing their focus, as suggested in the earlier discussion.

Mr. Kellas explained that the task force’s recommendation is made in the context of special purpose financial statements (not specific elements, accounts or items of a financial statement). He noted that these types of audit engagement are common in many jurisdictions. He was of the view that virtually all the ISAs should be capable of application in such audits. He also noted that the responses to the exposure draft did not indicate that the respondents were of the view that the ISAs do not apply to audits of special purpose financial statements. To limit the ISAs to audits of general purpose financial statements at this stage, will be a backward move, and not one supported by responses to the exposure draft. The IAASB did not dissent from this view.

ISSUE 2: THE DESCRIPTION OF THE FINANCIAL REPORTING FRAMEWORK AND THE PROPOSED LIST OF FACTORS THAT THE AUDITOR MAY CONSIDER WHEN EVALUATING THE ACCEPTABILITY OF THE FRAMEWORK

The task force recommended that the description of the financial reporting framework in the exposure draft, appropriately amended, be retained and moved to ISA 200. It also recommended that new guidance in ISA 200 clarify that the auditor considers the relative authority of the different sources from which the financial reporting requirements are derived, and, where conflicts exist

amongst them, that the source with the highest authority prevails. Such levels of authority are frequently set out as a hierarchy of sources of authority in financial reporting frameworks.

The IAASB supported the task force's recommendation, but asked that the task force in describing the financial reporting framework distinguish between (a) accounting standards established by authorized or recognized standards setting organizations and legislative and regulatory requirements (or, in the case of special purpose financial statements, the financial reporting provisions of a contract); and (b) the different sources from which management has obtained guidance for application of those standards and requirements (or the financial reporting provisions of a contract).

ISSUE 3: WHEN IT IS APPROPRIATE TO USE THE PHRASE "TRUE AND FAIR/FAIRLY PRESENTS" IN AUDITORS' REPORTS

The task force was of the view that, subject to applicable law or regulation, the form of opinion is determined by the applicable financial reporting framework. Fair presentation is achieved when the applicable financial reporting framework (a) provides a context for the auditor's evaluation of the fair presentation of the financial statements; and (b) acknowledges that to achieve the objective of fair presentation of the financial statements (i) it may be necessary for management to provide disclosures beyond the specific requirements of the framework, or (ii) in extremely rare circumstances, it may be necessary for management to depart from the specific requirements of the framework.

The task force's view is based on a belief that financial statements represent, for example, the financial position, financial performance or cash flows of an entity, and that fair presentation is achieved when these are represented fairly by the financial statements. An opinion on the fair presentation of the financial statements is therefore not only an opinion on the preparation of the financial statements, but also on the "picture" that they present. It follows that the framework must be designed to enable this to be done.

The IAASB debated the task force's four alternative responses to the comments received on the exposure draft in the context of complete sets of financial statements. One IAASB member suggested a fifth alternative – that is, accepting that it may not be possible to resolve this issue. The majority of IAASB members, however, supported Alternative 3. That is: Link the form of opinion exclusively to whether the framework is a fair presentation framework. Thus, in the case of a fair presentation framework, the opinion would be either that "the financial statements give a true and fair view of or present fairly, in all material respects, the financial position, financial performance and cash flows of the entity in accordance with the framework;" or "the financial statements are fairly presented, in all material respects, in accordance with the framework." In all other cases, the required opinion would be that the financial statements are prepared, in all material respects, in accordance with the framework.

The IAASB also debated the two alternative approaches identified by the task force with regard to the form of opinion on single financial statements. A very small majority of IAASB members preferred the second approach: That is, to require "prepared, in all material respects in accordance with" opinions for all single financial statements. This would be subject to the provisions of applicable law or regulation, or explicit confirmation in the financial reporting framework that a single financial statement is capable of achieving fair presentation (of, for example in the case of a balance sheet, the financial position).

ISSUE 4: WHETHER THE RIGHT SPLIT HAS BEEN MADE BETWEEN THE SCOPE OF ISA 700 (REVISED) AND THAT OF ED-ISA 701

The task force recommended that ISA 700 (Revised) address auditors' reports on general purpose financial statements and proposed ISA 701 address auditors' reports on special purpose financial statements. Both ISAs should address complete sets of financial statements and single financial statements.

The IAASB agreed with the proposed split, subject to the requirements and guidance on forming an opinion being moved to a separate ISA on forming an opinion or, in the interim, to ISA 200 – as suggested by the proposed changes to ISA 200, which were included for illustrative purposes.

ISSUE 5: WHETHER THE ISAS SHOULD ADDRESS AUDITS OF SPECIFIC ELEMENTS, ACCOUNTS OR ITEMS OF A FINANCIAL STATEMENT AND THE PRACTICALITY OF LEAVING IT TO THE AUDITOR'S JUDGMENT TO DETERMINE WHICH ISAS OR REQUIREMENTS THEREOF ARE RELEVANT TO SUCH AUDITS

The task force recommended that (a) the IAASB initiate a separate project to develop a separate ISA on the special considerations in the audit of specific elements, accounts or items of a financial statement; (b) in the interim, paragraph 7 of the exposure draft, appropriately amended, be moved to ISA 200; and (c) the reporting requirements and guidance, including examples, within extant ISA 800, appropriately amended, be retained in proposed ISA 701 until the project in (a) commences.

Some IAASB members confirmed the demand in their jurisdictions for audits of specific elements, accounts or items of a financial statement. Mr. Kellas noted that the majority of respondents to the exposure draft were of the view that the IAASB should address such engagements. The IAASB agreed that (b) and (c) of the task force's recommendation should be adopted. Considering the public interest aspects of IAASB projects, however, it is unlikely that the project recommended in (a) will be of high priority to the IAASB.

6. Modifications (ISA 705)

The comment period on the exposure drafts of the proposed ISA 705, "Modifications to the Opinion in the Independent Auditor's Report," and proposed ISA 706, "Emphasis of Matter Paragraphs and Other Matters Paragraphs in the Independent Auditor's Report," closed on July 31, 2005. Mr Hansen proposed to discuss the significant comments received, as summarized in the issues paper, through a paragraph review of the revised drafts.

*Proposed ISA 705***DESCRIPTION OF PERVASIVENESS**

Mr Hansen explained that the task force proposed to describe the meaning of a pervasive disagreement with management in terms of whether the disagreement affects the financial statements to such an extent that they become misleading as a whole. It was noted that the proposed footnote reference to the IFAC Code of Ethics for the term "misleading" only dealt with the auditor's ethical responsibilities as opposed to establishing a criterion for determining whether the effects of the disagreement were pervasive. Accordingly, it was agreed that the footnote should be deleted. It was also noted that there could be some situations where a disagreement caused the financial statements to be misleading but a qualified opinion would still be adequate. It was suggested that a quantifiable

criterion might be more helpful. The IAASB asked the task force to consider whether an explanation of the meaning of “misleading” would be appropriate, such as in terms of the user’s ability to understand the effects of the misstatement. The IAASB also asked the task force to consider providing guidance where a matter is pervasive to a single financial statement as a whole.

MULTIPLE UNCERTAINTIES

In response to the exposure draft comments, the task force proposed to revise the rationale for a disclaimer of opinion in the case of multiple uncertainties in terms of the auditor being unable to obtain sufficient appropriate audit evidence about management’s assertions regarding the uncertainties, as this would be consistent with the conceptual framework for disclaimers. It was observed that this situation was not truly an evidence issue, as the need to disclaim an opinion arose more from the combined effects of the interaction of the various uncertainties on the financial statements as a whole. Some members argued against this view, as there should be no rational basis for the auditor to disclaim an opinion if the auditor has obtained sufficient appropriate audit evidence about management’s assertions regarding the uncertainties. A vote was taken, and a majority of the IAASB agreed that it should be the combined multiple effects of the uncertainties that lead to the disclaimer. Accordingly, the IAASB asked the task force to incorporate this conceptual approach into the proposed ISA.

DISCLOSURE OF OMITTED INFORMATION IN THE AUDITOR’S REPORT

Based on comments received on exposure and from the IAASB CAG, Mr Hansen explained that the task force proposed that the ISA should not require the auditor to include in the auditor’s report information that management was required, but had failed, to disclose. Some members disagreed with this position, arguing that it would not be in the public interest. Others agreed with the approach taken in the revised draft, arguing that the opposite approach would extend the auditor’s responsibilities to include management’s responsibility for preparing the financial statements, and that it should be the responsibility of regulators to police compliance. It was, however, observed that the auditor would not really be assuming management’s role if the information were readily available. A vote was taken, and a majority of the IAASB agreed that the ISA should require the auditor to disclose omitted information unless impracticable or prohibited by law or regulation. The IAASB asked the task force to clarify the guidance on impracticability and to consider whether such guidance should address the situation where the disclosures would be voluminous.

OTHER COMMENTS OR CHANGES

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

- The task force should consider providing some guidance or examples on how to apply the ISA for engagements to report under financial reporting frameworks not designed to achieve fair presentation. The task force should also consider clarifying the meaning of the term “adaptation” in the introduction in relation to the need to adapt the ISA for engagements to report under such frameworks.
- It was unnecessary to refer in a narrow sense to disagreements with management as one type of circumstance that could lead to a modified opinion. Instead, the proposed ISA should refer more broadly to material misstatements of the financial statements as a cause of modified opinions, as

this would also include situations where management agrees that the financial statements are materially misstated but refuses to correct them.

- The guidance on the meaning of materiality should be deleted as it duplicated guidance addressed in the Materiality ISA.
- The task force should reconsider the guidance distinguishing a disagreement with management that is pervasive from one that is merely material, as there seemed to be some inconsistency in the guidance addressing the auditor's ability to *clearly explain* the effects of the disagreement.
- In relation to disagreements with management about the appropriateness or adequacy of disclosures, the task force should reinstate the circumstance when, in the context of a financial reporting framework designed to achieve fair presentation, the financial statements do not provide sufficiently clear disclosures to enable users to understand the effect of material transactions and events on the information conveyed in the financial statements.
- The requirements and guidance addressing the implications of a scope limitation imposed by management after engagement acceptance should be streamlined, and a requirement to communicate with those charged with governance should be added.
- The guidance regarding piecemeal opinions should be enhanced to distinguish cases that meet the definition of a piecemeal opinion as proposed, from those that do not (for example, the situation addressed in paragraph 11(c) of ISA 510). In addition, the task force should reconsider the need to use the term "piecemeal opinion" as it appeared to be used only in the subheading.
- The guidance on the Basis for Modification paragraph should clarify how misstatements regarding quantitative disclosures should be addressed.
- In relation to the illustrative reports, the last sentence of the Auditor's Responsibility section should be amended to refer to the auditor having obtained sufficient appropriate audit evidence to provide a basis for the auditor's *modified* opinion.

Proposed ISA 706

CRITERIA FOR EMPHASIS OF MATTER PARAGRAPHS

Mr Hansen indicated that respondents to the exposure draft had expressed concern regarding the proposal that the auditor should emphasize a matter when the specified criteria are met. The task force believed that the objective of the requirement should be more a limitation on the use of emphasis of matter paragraphs to specified circumstances to prevent a proliferation of such paragraphs, which would undermine their effectiveness. Accordingly, the task force proposed revised wording to that effect. It was noted that the task force's revised wording appeared to convey an inconsistent message. Further, it was noted that the auditor should not be prohibited from communicating matters that the auditor believes should be brought to users' attention. Consequently, a consideration of the need to emphasize a matter might be a more appropriate approach for the ISA. A requirement for the auditor to consider an emphasis of matter, however, could be problematical, as it would compel the auditor to consider such matters for each and every audit. The IAASB asked the task force to reconsider the approach and wording based on the discussion.

OTHER COMMENTS OR CHANGES

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

- The wording “without qualifying our opinion” in the lead-in to an emphasis of matter paragraph should be reinstated.
- The guidance addressing other matters paragraphs should be clarified, as it was unclear whether such paragraphs include the other matters referred to in paragraph 45 of ISA 700 (Revised), and whether they also include the matters dealing with other reporting responsibilities under law or regulation (as addressed in paragraphs 46-69 of ISA 700 (Revised)).
- The task force should reconsider the example used for the other matters paragraph in Example Report 1, as pro forma financial information is quite prevalent in many jurisdictions. The wording of the illustrative emphasis of matter paragraph should also be enhanced to be more meaningful.

WAY FORWARD

The IAASB asked the task force to present revised drafts of the proposed ISAs 705 & 706 for close off at the May 2006 meeting.

7. Written Representations

Mr. Fogarty introduced the members of the task force and indicated that the Small and Medium Practice Committee (SMPC) had provided written comments to the task force. In general, SMPC expressed support for the first-read draft being presented. He explained that the aim of the project is not only to provide a more rigorous framework for written representations as necessary audit evidence, including providing an intellectual framework as to why representations are needed and to address concerns that auditors over-rely on the representations, but also to establish appropriate bounds to prevent an unwarranted proliferation of such representations. He then led a paragraph review of the draft.

OBJECTIVE TO BE ACHIEVED

Mr. Fogarty acknowledged to the IAASB that the objective sets out a summary of what the auditor is to accomplish rather than perhaps a true objective or outcome. The way in which the objective is to be drafted is expected to become clearer once comment letters on the clarity project have been considered by the clarity task force.

Some members questioned whether the objective as drafted would require that the auditor obtain general written representations from relevant persons in all circumstances, even when relevant persons' responsibility for preparing the financial statements is prescribed in law and relevant persons acknowledge responsibility by signing the financial statements. However, general support was expressed for an objective that would require the auditor to obtain general written representations in all circumstances, regardless of the legal responsibilities of relevant persons. There is a difference between a direct communication to the auditor and a general certification made to the public. The law is often written in generic terms. It is important that relevant persons and the auditor have the same understanding of relevant persons' responsibility and that they explicitly acknowledge understanding and acceptance of that responsibility to the auditor. Providing the auditor with general

written representations is an accepted practice in many jurisdictions even when relevant persons sign the financial statements.

The IAASB asked the task force to consider whether the objective should be oriented toward obtaining appropriate audit evidence that relevant persons understand their responsibility for the financial statements and that they acknowledge that responsibility. The task force was also asked to give further consideration to how the representations are to be expressed and whether they need to be specifically addressed to the auditor.

One participant also expressed concern about describing relevant persons' responsibilities in the requirements because of the requirements being taken into law in some jurisdictions. It was felt that this would not be viewed as an appropriate way of creating or describing relevant persons' responsibilities in law. This is a wider issue than written representations.

GENERAL WRITTEN REPRESENTATIONS

There was general support from the IAASB that the general written representations presented in the ISA were needed, and that it would not be unreasonable for the auditor to obtain these representations, as they ultimately fall within relevant persons' responsibilities, and in some jurisdictions relevant persons acknowledge their responsibilities by signing the financial statements. Obtaining these representations is fundamental to articulating the lines of responsibility between relevant persons and the auditor. In addition, it was noted that the more detailed general representations reflect current practice, and it is important to be able to clarify and articulate these responsibilities to assist relevant persons in focusing on them. Concern was expressed by a few members that the proposed list of nine general written representations required to be obtained from relevant persons appeared excessive, particularly given that the first two general representations seemed to cover a number of the other more detailed general written representations in the same list. A number of the representations end with "in accordance with the applicable financial reporting framework" and are therefore implicit in the first general representation. Concern was also expressed that these are requirements and therefore the auditor is expected to obtain these representations on all audits. Some members of the IAASB questioned whether the absence of some of the required representations should result in a disclaimer or refusal to issue a report. Mr. Fogarty noted that the intention of the task force in including the more detailed representations that refer back to the applicable financial reporting framework was to balance the very detailed representations that exist in practice today with the first general representation that is an umbrella representation.

The IAASB asked the task force to consider whether there should be a qualitative difference between the first two high-level general written representations and the other more detailed general written representations. The proposal should also recognize that some of the representations require that relevant persons make appropriate inquiries within the entity before signing the representations, that is, that the representations are made to the best of relevant persons' knowledge and belief, having made all necessary inquiries.

The proposed requirements referred to a number of technical terms such as materiality and uncorrected misstatements. It was noted that obtaining a representation letter involves not only the obtaining of audit evidence but is also a communication exercise between the auditor and relevant persons. Accordingly, care should be taken in using language in representations that may not be readily understood by non-auditors. Although it was acknowledged that the concept of materiality is

already built into the financial reporting framework, the IAASB asked the task force to consider whether some explanation of how materiality is referred to in the context of the letter would be appropriate.

EXPECTATION ABOUT THE RECEIPT OF WRITTEN REPRESENTATIONS

The majority of the IAASB supported the requirement to obtain an agreement from management and those charged with governance prior to the acceptance of the audit engagement that appropriate general written representations are necessary. Concern was expressed by a minority of the IAASB about the implication of relevant persons refusing to sign the general representations, especially if relevant persons have already signed the engagement letter.

PERIODS FOR WHICH GENERAL REPRESENTATIONS SHOULD BE OBTAINED

The IAASB questioned the need to obtain a representation letter covering all periods presented. It was noted that it would be unnecessary to require the representation letter to cover the corresponding figures in the financial statements, as doing so would seem excessive relative to the level of work involved in verifying the correct extraction of the corresponding figures from the previous audited financial statements. The IAASB agreed that the representation letter should only cover the period (or periods) on which an audit opinion is provided.

OTHER CHANGES

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

- The task force should consider streamlining the essential material immediately after the definitions section but preceding the requirements section by appropriately linking it with the subsequent requirements for general and specific representations.
- The task force will reconsider whether the proposed requirement for the auditor to determine the relevant persons who are expected to provide general and specific written representations is necessary. It is implicit in the requirement to obtain written representations from relevant persons.
- The principle that a specific written representation on its own is not sufficient appropriate audit evidence is a premise that is appropriate in this ISA. The task force will include additional guidance that, without undermining this premise, recognizes that for some matters, it will be difficult to obtain audit evidence in forms other than a written representation.
- Guidance on the dating of general representations in the application material should be incorporated into the requirements section.
- In relation to guidance regarding obtaining specific written representation from management in relation to their intentions on certain matters, additional explanation should be provided regarding the concept of intent.
- The task force will consider whether the requirement to update specific representations reflects current practice and is therefore necessary.
- The task force should consider adding guidance to explain that where persons with expertise pertaining to specific assertions have provided specific representations to the auditor, such representations should be communicated to appropriate levels of management to ensure that they are consistent with management's knowledge of the business.

- The task force should consider adding guidance similar to that included in the UK APB's standard on representations to the effect that the auditor may consider it appropriate to discuss key representations with those charged with governance.

The IAASB asked the task force to limit the illustrative representation letter to those representations that would be required in all circumstances.

8. Project Proposal – Revision of ISA 402, “Service Organizations”

Mr Sylph noted that the project proposal had been submitted to the IAASB for consideration at the IAASB meeting in Rome. However, due to time constraints, that discussion had to be postponed.

As a result of recent developments the IAASB reconsidered its program and timeline. This gave rise to the need to revisit the ISA 402 project proposal. The original proposal anticipated an initial assessment stage to determine whether one or two projects and task forces should work on the revision.

To accelerate the revision program the proposal was updated to separate the original proposal into two parts. The first part would require a task force to draft a standard for entity auditor considerations and the second part would require a task force to consider service auditor responsibilities. These two proposals were now before the IAASB for consideration.

Due to the overlap of issues to be covered by both task forces, their work would benefit from some overlap in the membership of the task forces. Mr Sylph then asked the IAASB to approve the projects to revise ISA 402 and to draft an ISAE on service auditor responsibilities.

APPROVAL

Following a brief discussion, the IAASB unanimously approved both project proposals. Mr Kellas indicated that Ms Esdon and Mr Tucker had agreed to chair the task forces. Mr Nugent and Mr Jeffries will support the task forces. Mr Kellas invited other IAASB members interested in participating on the task forces to let him or Mr Sylph know.

9. Terms of Reference

Mr Sylph noted that the objective of this discussion was for the members to review the Terms of Reference (TOR) to ensure they did not contain a “fatal flaw.” The Public Interest Oversight Board (PIOB) had reviewed TORs of all Public Interest Activity Boards (PIABs) and suggested that minor amendments be made. In particular, the attention of members was drawn to changes in Section 4.0 (Membership), which had been made on the request of the PIOB to all TORs. As a result, the proposed TORs of all IFAC PIABs are now consistent. The markup version of the TOR submitted to the IAASB for consideration had in principle been accepted by the PIOB. Mr Sylph informed members that any changes made to TOR at this juncture would have to be approved by both the IFAC Board and the PIOB. Mr Sylph then asked members for their comments and suggestions. No comments or suggestions were made by members. The IAASB TOR are expected to be approved by the PIOB at its meeting later in the month.

10. Clarity Update

To provide new members with background, Mr Kellas briefly outlined history of the project.

Mr Kellas then gave the IAASB a brief preliminary report on responses to the latest Clarity Project consultation. These have not yet been considered by the Task Force. Approximately 40 comment letters had been received prior to the meeting and some more were expected. Broadly, respondents expressed strong support for the overall direction of the project. In particular, identifying objectives, separation of requirements and the application material and the steps taken to improve readability and drafting were supported. Some respondents cited a significant improvement over the existing style. However, the respondents also expressed some concerns. The main areas of concern were aspects of the proposals for objectives, application of guidelines for specifying requirements, implementation and some other matters.

OBJECTIVES

In relation to objectives, a majority of respondents called for development of an entire set of objectives and consideration of how the objectives relate to the overall objective of audit. Specific concerns included questions about the form and coherence of the objectives, their extent and the related obligation being imposed on auditors.

In relation to form and coherence, some respondents were of the view that some of the objectives were more a summary of requirements than outcomes to be achieved. The objectives were viewed as inconsistent in this respect and pitched at different levels for different ISAs. Some respondents provided useful wording suggestion. Further, the relationship of objectives to the objective of audit was not clear.

As to the extent of objectives, some respondents questioned whether the assumption that each ISA required an objective was correct. ISAs are not independent of one another and such an assumption gave rise to a potential for detailed and input-focused objectives at too low a level. The objectives should be set at a higher level and focused on outcomes. Again, some respondents provided useful suggestions and/or models.

With regard to the obligation being imposed on auditors by an objective, respondents expressed different views on the use of "...auditor must achieve objective specified in ISA..." Those who supported the obligation saw it as a key strength because the obligation sets objectives as more than merely a summary of the requirements. Those who expressed concern cited the apparent need for a stand-back at too low a level, lack of reference to the limitations of audit and the difficulty in defending the completeness of the work done by reference to the objective.

REQUIREMENTS

On balance, respondents were satisfied that the criteria for setting requirements are appropriate. However, differing views were expressed on how they had been applied. Some respondents were satisfied that the criteria had been applied properly and consistently in most cases and that there were only a few inappropriate elevations or omissions. Others believed that the criteria had not been applied appropriately or consistently and that there were too many elevations, and in particular too many detailed requirements whose applicability to SMEs would be questionable.

With respect to SME considerations, some respondents called for a cost-benefit/impact assessment of the new requirements, simplification of the documentation requirements, wording that is more clearly applicable to SMEs and the highlighting of conditional requirements. Some respondents included proposed drafting.

Significant concern was cited over the use of “shall consider” due to ambiguity as to the expected performance. Further, it was not used consistently; sometimes the term involved genuine consideration, at other times, its meaning was closer to “assess” or “evaluate.” The respondents criticizing use of the term believed it should be removed, or its use reduced. In addition, related documentation requirements should be clarified.

IMPLEMENTATION

A majority of respondents called for an accelerated implementation of the timetable, even though some recognized that such acceleration would result in mere redrafting, as opposed to redrafting and revising, of some standards. Some respondents, however, saw advantages in not attempting to clarify all standards at once. Such gradual implementation would allow for other improvements or revisions that may need to be addressed.

OTHER CONCERNS

Some respondents questioned the clarity of the phrase “...relevant in the circumstances...”, when used to determine whether a requirement is applicable. It is not clear whether it can in fact relate to each of an ISA, the objective, or individual requirements. Further, it was questioned how the phrase relates to materiality and judgments and how it would be enforced. Finally, the respondents were not clear as to what the documentation requirements would be when the auditor departed from a requirement not relevant in the circumstances.

Several respondents found the inclusion of some essential explanatory material within the requirements section confusing and were not sure of its status. These respondents suggested that the amount of such material be kept to a minimum or removed.

Some respondents believed that aspects of the drafting were inconsistent, e.g., in the Introduction sections. These respondents questioned the status of these sections and whether their placement was appropriate.

Respondents sought further application of drafting improvements and streamlined, succinct SME guidance.

WAY FORWARD

The project is on the agenda of the next IAASB meeting with national auditing standard setters in March. Results of the meeting will be discussed at the task force meetings to take place in April and June. The task force will submit its recommendations to the IAASB for consideration at the May and July meetings. Also discussed at these IAASB meetings will be the comments made during the May meeting of the IAASB CAG.

11. Next Meeting

The next meeting of the IAASB has been scheduled for May 22-26, 2006 in New York.

12. Closing Remarks

Mr Kellas announced the departures of Ms Tan (technical advisor to Mr Dutt) and Mr Tyl (IAASB Staff) and thanked both for their contribution.

Mr Kellas thanked the Hong Kong Institute of Certified Public Accountants for hosting the meeting, and its staff for the assistance offered with the meeting arrangements.

Mr. Kellas closed the meeting.