

**Minutes of the 28th Meeting of the
INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD
Held on September 24-28, 2007 in Madrid**

Voting Members**Technical Advisors**

Present:	John Kellas (Chairman)	Kelly Ånerud (Mr. Larsson)
	Denise Esdon (Deputy Chair)	Philip Ashton (Ms. Hillier)
	Phil Cowperthwaite	Michele Caso (Mr. Tizzano)
	Craig Crawford (September 24-27)	Josef Ferlings (Mr. Kinney)
	John Fogarty	Cédric Gélard (Mr. Trémolière)
	Jan Bo Hansen	Jon Grant (Mr. Rainey)
	Diana Hillier	Debra Hahn (Ms. Jones)
	Susan Jones	Jennifer Haskell (Mr. Hansen)
	William Kinney	Shahid Hussain (Mr. Yusuf)
	Kjell Larsson	Richard Mifsud (Mr. McPhee)
	Ian McPhee	Daniel Montgomery (Ms. Esdon)
	Marcel Pheijffer (September 24-27)	Greg Shields (Mr. Cowperthwaite)
	Will Rainey	Sylvia Smith (Mr. Crawford)
	Makoto Shinohara	Hans Verkruijsse (Mr. Pheijffer)
	Roberto Tizzano	Sharon Walker (Mr. Fogarty)
	Gérard Trémolière (September 24-25)	Yuichi Yamamoto (Mr. Shinohara)
	Abdullah Yusuf	

Apologies: David Swanney

Non-Voting Observers

Present: David Damant (part)
Jennifer Rand
Jean-Philippe Rabine
Hisashi Yamaura

Public Interest Oversight Board (PIOB) Observer

Present: Aulana Peters (September 26-27), Donna Bovolaneas (September 28)

IAASB Technical Staff

Present: Jim Sylph (Executive Director), James Gunn, Kathleen Kerrigan, Michael Nugent, Alta Prinsloo, Ken Siong

1. Opening Remarks and Minutes

WELCOME AND INTRODUCTIONS

Mr. Kellas welcomed Mr. Daniel Montgomery and Ms. Debra Hahn as technical advisors to Ms. Esdon and Ms. Jones, respectively. He also welcomed Mr. George Tucker, former technical advisor to Ms. Esdon, who would present the ISAE 3402¹ agenda item as chair of that project later in the week. He bid farewell to Mr. Yamamoto, this being his last meeting as technical advisor to Mr. Shinohara.

Mr. Kellas welcomed as public observers Mr. Javier Martin and Ms. Adela Vila from the Instituto de Censores Jurados de Cuentas de España (ICJCE). He also extended a welcome to Messrs. Zhiguo Yang and Jianhua Tang from the Chinese Institute. He noted that Ms. Aulana Peters and Ms. Donna Bovolaneas from the Public Interest Oversight Board (PIOB) would join the meeting later in the week. Messrs. Fermin del Valle, IFAC President, and Ian Ball, IFAC Chief Executive, who were attending the PIOB meeting in Madrid, were to join the function hosted by ICJCE on Monday evening.

Mr. Kellas noted that he and Messrs. Sylph and Damant would be absent for parts of the meeting on Monday and Tuesday to attend the PIOB meeting. He also noted that Messrs. Crawford and Pheijffer would be absent on Friday, and that Mr. Trémolière would leave the meeting at the end of Tuesday. Mr. Swanney had expressed his apologies for not being able to attend the meeting.

Proxies were noted as follows: Ms. Smith for Mr. Crawford, Mr. Verkruijsse for Mr. Pheijffer, Mr. Kellas for Mr. Swanney, and Mr. Gélard for Mr. Trémolière.

Mr. Damant reported that representatives of the IAASB Consultative Advisory Group (CAG) were generally pleased that their input was being given appropriate consideration by the various IAASB project task forces. Mr. Sylph also noted that the PIOB observer at the September 20-21, 2007 IAASB CAG meeting had highlighted to the IAASB CAG Representatives that their views were being duly considered by the IAASB in the project deliberations.

Mr. Kellas reported that the IAASB Working Procedures Task Force had been set up. The task force, chaired by Ms. Esdon, held its first meeting on September 23, 2007. The task force has been charged with considering and making recommendations on how, if at all, the IAASB's working procedures for the development of its international pronouncements should be amended in the light of the intended equal balance of the IAASB's membership between practitioners and non-practitioners.

Mr. Kellas also reported that membership of the Pro forma/Prospectuses Task Force had now been finalized, and includes an observer from the Committee of European Securities Regulators. The task force, chaired by Mr. Swanney, planned to hold its first meeting in October 2007.

MINUTES OF PREVIOUS MEETING

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

¹ [Proposed] International Standard on Assurance Engagements (ISAE) 3402, "Assurance Reports on a Service Organization's Controls."

2. Written Representations

Mr. Fogarty noted that more than fifty-five comment letters were received on the exposure draft of proposed ISA 580 (Revised and Redrafted).²

Mr. Fogarty noted that the summary of significant comments and the proposed ISA had been discussed at the September IAASB CAG meeting. He noted that the IAASB CAG Representatives were very supportive of the proposed changes to the exposure draft. This was confirmed by Mr. Damant. Mr. Fogarty provided a brief overview of the comments of the IAASB CAG Representatives.

In addition, the IFAC Small and Medium Practices Committee had commented on the proposed ISA. The Committee is concerned that the management of an SME may not have the background or expertise necessary to define and identify control deficiencies and, as a result, would have difficulty providing the required written representation. The Committee explicitly supported the requirement to disclaim an opinion on the financial statements when the written representations about the premise are unreliable or management do not provide them.

Mr. Fogarty provided a brief overview of the significant comments on the exposure draft. On balance, the IAASB members were of the view that the proposed ISA is an improvement. In addition to editorial matters, the following matters were noted:

- The task force was asked to consider describing the “premise, relating to management’s responsibilities, on which an audit is based” in every ISA that refers to it. It was agreed that the description should be in line with that in proposed ISA 200 (Revised and Redrafted).³
- It was agreed that the reference to “management” should be replaced with “management or, where appropriate, those charged with governance” to be in line with the approach followed in proposed ISA 210 (Redrafted).⁴
- It was agreed that, based on a comment received from an IAASB CAG Representative, the term “corroborate” in the objectives will be reconsidered. IAASB members suggested “complement,” “substantiate” and “support.”
- It was agreed that references to written representations about specific assertions of the financial statements in the objectives and elsewhere in the proposed ISA should not be limited to those that involve management’s judgment or intent, or which may not be complete, only. The fact that they are prevalent in those circumstances could be explained in the application material.
- It was agreed that references to “their (our) knowledge and belief” in the written representations should be replaced with “to the best of their (our) knowledge and belief.” The task force was also asked to consider reinstating the phrase “having made appropriate inquiries.”

² [Proposed] ISA 580 (Revised and Redrafted), “Written Representations.”

³ [Proposed] ISA 200 (Revised and Redrafted), “Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing.”

⁴ [Proposed] ISA 210 (Redrafted), “Agreeing the Terms of Audit Engagements.”

- The term “internal control” in the written representation about the financial statements may not have the same meaning in all jurisdictions. The task force was asked to consider whether to allow for flexibility with regard to, or clarify, its meaning in the relevant ISA.
- Referring to the written representation about the completeness of information, and based on a comment from an IAASB CAG Representative, the task force was asked to consider whether to amend the word “required” in the following phrase: “... they have provided the auditor with all the information the auditor *required* in connection with the audit of the entity.” The IAASB CAG Representative suggested “requested;” but the task force did not consider it appropriate. An IAASB member suggested “reasonably required.”
- A few IAASB members were of the view that the written representation about disclosure to the auditors of control deficiencies creates the same difficulty as the previously required written representation about the adequacy of internal control for purposes of the preparation and presentation of the financial statements. Some IAASB members suggested that the two paragraphs dealing with the written representation about completeness of information be combined. It was also suggested that the written representation about control deficiencies should be limited to those that management are aware of and that may have a material effect on the financial statements.
- Referring to the date of the representation letter, the task force was asked to consider whether application material should be developed to explain what “*as near as practicable to*, but not after, the date of the auditor’s report on the financial statements” means. It was agreed that the application material should be in line with that in proposed ISA 560 (Revised and Redrafted).⁵
- The IAASB members debated whether it is appropriate to require a disclaimer of opinion in all circumstances when management fails to provide the written representation about its responsibility for the financial statements. The following was noted:
 - In many jurisdictions, management’s responsibility for the preparation and presentation of the financial statements is established by law or regulation. It is also acknowledged in the terms of engagement. As a result, management may not consider it necessary to acknowledge it again in the representation letter. Mr. Fogarty proposed that management’s acknowledgement of their responsibility for the preparation and presentation of the financial statements be split from their acknowledgement that they have fulfilled the responsibility. Acknowledgement of the responsibility could be addressed in the terms of engagement, while acknowledgement of the fulfillment of the responsibility could be addressed in the representation letter. The majority of the IAASB members supported this proposal. It was agreed that the task force should revise the proposed ISAs accordingly.
 - Management may acknowledge that they have fulfilled their responsibility for the preparation and presentation of the financial statements, and that the financial statements are prepared and presented in accordance with the applicable financial reporting framework, in a signed statement that accompanies the financial statements. As a result, management may not consider it necessary to make such statement again in the representation letter. Mr. Fogarty agreed that the task force should develop a stronger argument as to why it is important for the

⁵ [Proposed] ISA 560 (Revised and Redrafted), “Subsequent Events.”

statement to be made in the representation letter, and also consider whether other forms of written representation may be acceptable.

- A disclaimer of opinion may not be necessary in all circumstances when management fail to acknowledge that they have fulfilled their responsibility for the preparation and presentation of the financial statements, and that the financial statements are prepared and presented in accordance with the applicable financial reporting framework. The auditor may have obtained sufficient appropriate other audit evidence on which to base the opinion, and should therefore be allowed to apply professional judgment in this regard. The IAASB members held diverse views in this regard; however, many agreed that the requirement should be retained.
- Mr. Rabine was concerned that the requirement may give rise to widespread disclaimers of opinion. He asked whether the IAASB has assessed the impact that the requirement may have. Mr. Fogarty was of the view that such an assessment would not be practical as responses to a survey questionnaire, for example, would not reflect what people would do in actual circumstances. He did not believe that there would be a significant increase in disclaimers because it would be rare for management to deny that they are responsible for the financial statements.
- Some IAASB members were concerned that, if management fail to provide a written representation that is required by another ISA, it may be interpreted as management failing to provide a written representation about the premise and, as a result, give rise to an automatic disclaimer of opinion. They were of the view that the proposed ISA should provide for the auditor to apply professional judgment in this regard.
- The task force was asked to reconsider the manner in which the examples of additional written representations are stated in the application material and incorporated in the representation letter. Some IAASB members were concerned that they may be interpreted as being part of the written representations about the premise, giving rise to a disclaimer of opinion should management fail to provide them.
- Referring to the proposed amendments that provide for the auditor to use the description of management's responsibilities in law or regulation to the extent that the responsibilities are similar to those described in proposed ISA 210 (Redrafted), some IAASB members were concerned that word "similar" may not be strong enough. IAASB members suggested the task force consider such terms as "equivalent in effect" and "in substance the same", though it was queried how the auditor is to determine this.
- The IAASB members supported the proposed amendments to proposed ISA 700 (Redrafted)⁶ to allow more flexibility in the manner in which management's responsibilities are described, as they address matters affecting the acceptability of extant ISA 700 in various jurisdictions. It was agreed that the proposed amendments should be subject to due process. It should be clear that the flexibility in description relates only to the section on management's responsibilities for the financial statements.

⁶ [Proposed] ISA 700 (Redrafted), "The Independent Auditor's Report on General Purpose Financial Statements."

A proposed ISA will be submitted at the December IAASB meeting for approval to be issued as a final ISA.

3. Proposed Strategy for the IAASB for 2009 – 2011

Mr. Kellas provided a brief overview of the initial consultations, which formed the basis for developing the proposed consultation paper. He also noted the comments of the IAASB CAG Representatives, and that they were satisfied with a 60-day comment period. He indicated that he had discussed the time period with the PIOB and the PIOB was in agreement with a 60-day consultation period.

Overall, the IAASB members were very supportive of the proposed consultation paper. Comments included the following:

- It was suggested that the document might include a “vision” or goal, for example, to achieve acceptance of ISAs as an appropriate benchmark for audit quality by the world’s capital markets, to facilitate implementation of ISAs to the extent possible and consistent with the role of an international standard setter, etc.
- Whether the paper should refer to the identification of barriers to the adoption and implementation of ISAs; in particular, in jurisdictions other than those with which the IAASB has interacted in the past.
- The consultation paper should indicate that future projects are subject to project proposals being approved by the IAASB. In particular, it may be appropriate to include a caution that the project relating to the auditor’s involvement in prospectuses may prove difficult to pursue at an international level.
- The possible actions to enhance public confidence in financial reporting through the development of high-quality ISAs should be expanded to include the monitoring of developments with regard to continuous auditing and the continuous availability of information on which assurance will be sought.
- The proposal to establish a period in which no new auditing standards would be imposed should be clarified to indicate the period proposed is two years after *the effective date of the clarity redrafted ISAs*.
- The possible actions to address the needs of SMEs should include a revision of International Standard on Related Services (ISRS) 4410,⁷ which would complement the revision of International Standard on Review Engagements (ISRE) 2400.⁸
- The questions about priorities and further projects in the Guide for Respondents should be rephrased.

One IAASB member questioned whether it was appropriate to suggest that the IAASB would not apply the clarity drafting conventions to standards other than ISAs until such time as they are being revised. He also noted that, at some stage, the IAASB had considered developing a standard on forming an opinion.

⁷ ISRS 4410, “Engagements to Compile Financial Statements.”

⁸ ISRE 2400, “Engagements to Review Financial Statements.”

The IAASB approved the consultation paper with whatever amendments were considered appropriate as a result of the comments made during the meeting. Mr. Kellas noted that the final Strategic Plan and Work Program for 2009 – 2011 will be submitted for approval at the March 2008 IAASB meeting. It will also be reviewed at the March 2008 IAASB CAG meeting. Regular updates are being provided to the PIOB.

Ms. Peters indicated that the PIOB had seen the proposed consultation paper and will continue to follow the consultation process in order to be able to consider completeness of the final Work Program.

4. Other Information

Mr. Rainey introduced the topic and summarized the main issues arising on the exposure of proposed ISA 720 (Redrafted)⁹, and the proposed responses by the task force. He indicated that the task force received input from the IAASB CAG, IFAC Small and Medium Practices (SMP) Committee and IAASB members in advance of the meeting, and that he would raise their comments at relevant points in the discussion. Mr. Rainey then led a review of the ISA.

The IAASB considered and agreed the recommendations of the task force in light of the comments received on the exposure draft. In addition to editorial changes, the IAASB also agreed the following:

- The introduction of the ISA should be aligned more closely with the proposed objective. In particular, the introduction should explain that the auditor reads the other information because the credibility of the audited financial statements may be undermined by material inconsistencies between the audited financial statements and other information.
- The introduction of the ISA should describe “documents containing audited financial statements” in terms of “annual reports (or similar documents) that are issued to owners (or similar stakeholders) containing audited financial statements and the auditor’s report thereon.”
- The introduction should clarify that the ISA may be applied, adapted as necessary in the circumstances, to other documents containing audited financial statements, such as those used in securities document. This would be consistent with the extant ISA. In agreeing this matter, the IAASB noted that several respondents suggested that reference to securities documents be deleted. However, the IAASB noted that inclusion of reference to securities documents enhanced the clarity of the scope of the ISA, especially in light of the changes to be made to the scope of the ISA.
- References to “entity” should be change to “management” or “those charged with governance,” or both, as appropriate.
- Reference in the ISA to withdrawal from the engagement should be amended to acknowledge the fact that that option may exist only where withdrawal is legally permitted.
- When the auditor identifies material inconsistencies in other information obtained subsequent to the date of the auditor’s report, or material misstatements of fact in the other information, and management refuses to make the necessary revisions, the ISA should specify that the auditor

⁹ ISA 720 (Redrafted), “The Auditor’s Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements.”

shall notify those charged with governance of the auditor's concerns regarding the other information.

- The application material relating to considerations specific to smaller entities should acknowledge the fact that some smaller entities may be required by law or regulation to issue documents containing audited financial statements.
- The application material should acknowledge that the ISA does not preclude an auditor from qualifying any separate opinion that the auditor is required to give on the consistency of other information with the financial statements.

APPROVAL

The IAASB agreed that the changes made to the exposure draft in response to the comments received from respondents did not warrant re-exposure. Mr. Sylph advised the IAASB that it had adhered to its stated due process in finalizing the ISA. The IAASB unanimously approved the proposed ISA as a final ISA under the clarity drafting conventions, with an effective date for audits of financial statements for periods beginning on or after December 15, 2009. The issue of the final ISA is subject to confirmation from the Public Interest Oversight Board that due process has been followed.

5. Audit Documentation

Mr. Kellas introduced the discussion of the proposed ISA 230 (Redrafted),¹⁰ amended in light of comments received from respondents to the exposure draft. He indicated that, in leading the IAASB through the main changes to the exposure draft, he would explain the task force's recommendations in response to the significant comments received on exposure, as summarized in the issues paper. He noted that comments had also been received from the IFAC SMP Committee and that he would highlight these as appropriate during the discussion.

DEFINITION OF EXPERIENCED AUDITOR

Mr. Kellas noted that three respondents had argued that the definition of the term "experienced auditor" in the exposure draft should include some reference to the need for the auditor to have *relevant experience* in performing audits in specific industries. Some IAASB members questioned whether the proposed addition of the phrase "relevant audit experience" as a criterion in the revised definition, in response to these comments, was necessary. It was noted that without further articulation of the meaning of the phrase in the application material, this addition could be subject to different interpretations. One member disagreed on the ground that the term "*experienced auditor*" in itself implied a need for the auditor to have practical experience of participating in audits. It was also questioned whether the phrase "relevant audit experience" was intended to go beyond the four specific matters of which an experienced auditor would be expected to have a reasonable understanding (as listed in the definition), or whether the meaning of the phrase was embedded within these four matters. Mr. Kellas responded that the four matters did not include practical audit experience as they could equally be reasonably understood by a person who had studied such matters yet had no such experience.

After further deliberation, the IAASB agreed that the definition should be clarified to include a reference to the need for an 'experienced auditor' to have *practical audit experience*.

¹⁰ ISA 230 (Redrafted), "Audit Documentation."

DOCUMENTATION OF COMPLIANCE WITH ISAS

Mr. Kellas explained the task force's rationale for not agreeing to a suggestion from a few respondents that the ISA should clarify that it is neither necessary nor practicable for the auditor to document how the auditor has complied with *every requirement* in ISAs. One member was of the view that the respondents' suggestion would help address a perceived ambiguity in the ISA regarding what documentation of compliance with ISAs actually meant. Another member, however, pointed out that the documentation of compliance with individual ISA requirements is ultimately a matter for the auditor's professional judgment. Further, it was noted that the guidance in the ISA already made clear that it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in the audit, and that it is unnecessary for the auditor to document separately compliance with matters for which compliance is demonstrated by documents included within the audit file.

After further deliberation, the IAASB agreed that no changes should be made to the ISA with regard to this matter.

OTHER MATTERS

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

- In relation to the requirement that "if the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter, the auditor shall document how the auditor addressed the inconsistency in forming the final conclusion," the phrase "in forming the final conclusion" should be deleted as it was unnecessary.
- To improve the flow of the requirements dealing with changes to audit documentation after the date of the auditor's report, the ISA should first deal with substantive changes that arise in exceptional circumstances after the date of the auditor's report. This should be in a separate subsection within the section on documentation of audit procedures performed and audit evidence obtained. The requirement to document the reasons for any other changes, and when and by whom they were made and reviewed, should then follow in the section dealing with assembly of the final audit file. With regard to the latter, the IAASB also agreed to delete the requirement that the auditor also document why the changes have no effect on the auditor's conclusions and the auditor's report, because such changes would by definition not be substantive.
- A suggestion to include "failure to achieve an objective in a relevant ISA" in the list of examples of significant matters in the application material, consistent with guidance in proposed ISA 200 (Revised and Redrafted), should be reconsidered as a possible conforming amendment to ISA 230 (Redrafted) after the finalization of proposed ISA 200 (Revised and Redrafted).
- In relation to considerations specific to smaller entities, the guidance should clarify that although a sole practitioner need not document matters solely to inform or instruct members of an engagement team, the practitioner nevertheless is under the obligation to comply with the overriding requirement to prepare audit documentation that can be understood by an experienced auditor, as the documentation may be subject to review by external parties for regulatory or other purposes.

Except as discussed above, the IAASB agreed with the task force's recommendations as set out in the issues paper.

APPROVAL

The IAASB agreed that the changes made to the exposure draft in response to the comments received from respondents did not warrant re-exposure. Mr. Sylph advised the IAASB that it had adhered to its stated due process in finalizing the ISA. The IAASB unanimously approved the proposed ISA as a final ISA under the clarity drafting conventions, with an effective date for audits of financial statements for periods beginning on or after December 15, 2009. The issue of the final ISA is subject to confirmation from the Public Interest Oversight Board in December 2007 that due process has been followed.

6. Auditing Accounting Estimates, Including Fair Value Accounting Estimates

Mr. Ashton introduced the topic, noting that the purpose of the discussion was to review comments received on the exposure draft of proposed ISA 540 (Revised and Redrafted),¹¹ as well as comments received from the IAASB CAG and IFAC SMP Committee. He noted that the IAASB CAG working group was supportive of the exposure draft in terms of the combination of the two ISAs.

USE OF A SPECIALIST

Mr. Ashton noted that there was some concern at the IAASB CAG meeting over the distinction between the use of the terms "specialist," "specialized skill or knowledge" and "experts." Some IAASB CAG Representatives, as well as IAASB members, found the use of such varying terms confusing. Mr. Ashton noted that this was done in response to the scope of proposed ISA 620 (Revised and Redrafted)¹² because there is a gap between what had been referred to in ISAs as an expert, which excludes those with accounting and auditing expertise, and the common use in practice of individuals with such expertise. As a result, the IAASB agreed that the reference to "specialized skills and knowledge" was the most appropriate, in order to convey a broader range of skills and knowledge than is covered by the term "expert."

The task force was encouraged to clarify the text so that the interaction with other ISAs is clear and the requirement in this ISA does not duplicate what is required elsewhere. In addition, it should be clarified when such individuals would be considered to be part of the engagement team (and therefore subject to independence requirements), or when interaction with the specialists would be seen as a consultation only. It is likely that discussion will be needed to define what is meant by "accounting and auditing expertise," in order to clarify who is scoped out of the definition of 'expert' in proposed ISA 620 (Revised and Redrafted).

APPENDIX

Mr. Ashton explained that, while IAASB CAG Representatives had some comments as to whether the balance in the Appendix was quite right, most were of the view that another project proposal would need to be prepared to address the concerns originally raised by the Basel Committee on

¹¹ [Proposed] ISA 540 (Revised and Redrafted), "Auditing Accounting Estimates, including Fair Value Accounting Estimates, and Related Disclosures."

¹² [Proposed] ISA 620 (Revised and Redrafted), "Using the Work of an Auditor's Expert."

Banking Supervision in regard to additional topic-specific fair value guidance (see below for discussion of this suggestion). The IAASB was divided on whether the newly added material in the Appendix should be retained; some were of the view that it was too accounting-specific. The IAASB agreed to delete the material from the ISA and include it for context in the Basis for Conclusions when the final ISA was approved.

PROPOSED CHANGES

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

- The task force should consider whether the phrase “whether recognized or disclosed” in the context of the objective and requirements is necessary.
- The definition of “significant assumptions” should be revised to replace the word “materially.”
- Further revision to the requirement for the auditor to review the outcome of accounting estimates should be made. In particular, the task force should ensure that the distinction between this requirement and what is required by ISA 240 (Redrafted)¹³ is clear, which may include adding application material. In addition, the references to “re-estimation” in this requirement should be deleted, as this would fall under the other requirements.
- The requirement dealing with the adequacy of disclosure of estimation uncertainty in the context of the applicable financial reporting framework is meant to ensure that, even where the applicable financial reporting framework does not prescribe specific disclosures, the auditor is satisfied with the disclosures. The task force should consider whether language similar to that in proposed ISA 700 (Redrafted) may be helpful in this ISA.
- The discussion of misstatements in the application material should be revisited to provide an example of how the misstatement may be calculated, for example, the minimum misstatement that would arise in a particular circumstance.

OTHER MATTERS

An IAASB observer asked whether the inherent limitations noted in proposed ISA 200 (Revised and Redrafted) should be addressed in more detail in this ISA. Mr. Ashton was of the view that the ISA adequately addresses the concept of inherent limitations in the context of fair values, in particular the linkage between a high degree of estimation uncertainty and significant risks. Another observer did not support including discussion of inherent limitations in individual ISAs.

REQUEST FOR ADDITIONAL IMPLEMENTATION GUIDANCE

The task force has received input from respondents to the exposure draft, as well as IAASB CAG Representatives, that further guidance on the audit of fair values should be sponsored by IAASB, particularly in light of the current environment. It was noted that some of the organizations represented on the IAASB CAG offered to assist with the development of such guidance. The group to be responsible for developing the guidance will be chaired by an IAASB member.

IAASB members were generally supportive of the proposal, noting that an interaction with the accounting standards setters may be necessary. The PIOB was also supportive of further guidance on this topic. The task force plans to develop terms of reference for the group to be discussed at the

¹³ ISA 240, “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements.”

December IAASB meeting, and a point of emphasis will be included in the consultation paper on the IAASB's future strategy.

WAY FORWARD

The IAASB will consider a revised draft of the ISA for approval as a final standard at its December meeting.

7. External Confirmations

Mr. Crawford introduced proposed ISA 505 (Revised and Redrafted)¹⁴ and related conforming amendments. He highlighted the significant issues raised during IAASB's previous discussion of the proposed ISA, and the task force's responses. He also referred to comments received from the IFAC SMP Committee. Mr. Crawford led the IAASB through a review of the proposed ISA and related conforming amendments.

OBJECTIVE

Some IAASB members expressed concern about the absence in the objective of the need for the auditor to determine when it is necessary to use external confirmation procedures. It was suggested that the matter of when to use external confirmation procedures may in fact be the most important consideration in relation to the topic of external confirmations. Other members disagreed, noting that practice issues relate to performing effective confirmation procedures. Mr. Kellas reminded the IAASB that this matter was previously debated and concluded on.

After further consideration, it was agreed that the introductory section "External Confirmation Procedures as a Response to Assessed Risks" should link more directly to proposed ISA 500 (Redrafted)¹⁵ and include those generalizations about the reliability of audit evidence that are relevant to external confirmations. Further, it should identify other ISAs that provide guidance relevant to the auditor's decision about when to perform external confirmation procedures.

NEGATIVE CONFIRMATIONS

The IAASB deliberated the nature of the constraints that should be placed on the auditor's use of negative confirmation requests, and whether the use of such requests should be permitted as the sole substantive procedures in response to an assessed risk of material misstatement at the assertion level. The IAASB agreed that:

- The proposed ISA should make clear that negative confirmations provide less persuasive audit evidence than positive confirmations. In addition, it should explain that confirming parties are more likely to respond indicating their disagreement with a negative confirmation request when the information is not in their favor and less likely to respond otherwise (unless the information is material to them).
- The proposed ISA should limit the auditor's use of negative confirmation requests as the sole substantive procedure in response to an assessed risk of material misstatement at the assertion level to those circumstances where the auditor has obtained sufficient appropriate audit evidence

¹⁴ [Proposed] ISA 505 (Revised and Redrafted), "External Confirmations."

¹⁵ [Proposed] ISA 500 (Redrafted), "Considering the Relevance and Reliability of Audit Evidence."

regarding the operating effectiveness of controls relevant to the assertion and concluded that the risks of material misstatement are low. In addition, the use of negative confirmation requests should be restricted to circumstances where: the population of items subject to negative confirmation procedures comprises a large number of small, homogeneous account balances; very few or no exceptions are expected; and the auditor has no reason to believe that recipients of negative confirmation requests will disregard such requests.

EVALUATING THE RELIABILITY OF RESPONSES TO EXTERNAL CONFIRMATION REQUESTS

The IAASB deliberated the proposed requirement for the auditor to evaluate the reliability of responses to external confirmation requests. Some members were of the view that the requirement would enhance the auditor's considerations of the reliability of the audit evidence obtained through external confirmation procedures. Other members were of the view that the requirement is inconsistent with the requirement of proposed ISA 500 (Redrafted) for the auditor to consider matters that give rise to doubts about reliability. After further consideration, the IAASB agreed that the proposed requirement should be deleted, as it is unnecessary in light of related requirements in the proposed ISA and proposed ISA 500 (Redrafted).

The IAASB also agreed that the application material should address responses to external confirmation requests that contain disclaimers or other restrictive language. The IAASB was of the view that such disclaimers or restrictive language do not necessarily, in themselves, invalidate the responses as audit evidence.

The task force was asked to consider highlighting in the explanatory memorandum the question of whether there is sufficient guidance in the proposed ISA with respect to circumstances where external confirmation requests are sent via electronic means, such as email, and the reliability of audit evidence obtained through such means.

OTHER MATTERS

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

- The definition of "external confirmation process" should be deleted, as it is unnecessary. Appropriate consequential amendments should be made throughout the document.
- The definition of "non-response" should exclude the statement that an oral response to an external confirmation request constitutes a non-response. It is unnecessary in light of the definition of "external confirmation" and may, in some circumstances, be too restrictive. Rather, the application material dealing with the auditor's consideration of the reliability of responses to external confirmation requests should explain that, upon obtaining an oral response, the auditor may, depending on the circumstances, request the confirming party to respond in writing directly to the auditor, or seek audit evidence to support the information in the oral response.
- The proposed requirement for the auditor to ask management to withdraw its request not to confirm a matter should be deleted, as it is unnecessary in light of related requirements in the proposed ISA.
- The proposed ISA should clarify that, if the auditor concludes that management's refusal to allow the auditor to send an external confirmation request is unreasonable, the auditor is required to

communicate with those charged with governance and consider the possible effect on the auditor's opinion.

- Regarding the design of the auditor's external confirmation request, the proposed ISA should include application material regarding management's authorization or encouragement to confirming parties to respond to the auditor.

APPROVAL

The IAASB approved proposed ISA 505 (Revised and Redrafted) and related proposed conforming amendments for exposure with a 120-day comment period.

Mr. Kellas voted against the issue of the proposed ISA as an exposure draft. In his opinion, the failure to reflect in the objective and related requirements a directive for the auditor to consider the circumstances where it is necessary to use external confirmation procedures results in a weakening of the extant ISA, and does not convey an appropriate message in the current environment. However, he does believe that the proposed ISA should assist in improving the performance of external confirmation procedures.

Mr. Kellas abstained from voting on behalf of Mr. Swanney, on the basis that he was uncertain how Mr. Swanney would vote in light of the changes made to the document during the meeting.

8. Material Weaknesses

Mr. Ashton introduced the first-read draft of proposed ISA XXX,¹⁶ noting that a written response had been received from the European Commission (EC) regarding the IAASB's request for the EC's view as to the possible approaches to addressing the issue of whether and, if so, how the term "material weakness" should be defined in ISAs. He noted that the EC had indicated a preference for the IAASB not to seek to establish a new definition of "material weakness" at this time, but that if the IAASB were to proceed with the project, the EC would not be opposed to the task force's recommended approach of amending the requirement in ISAs for the auditor to communicate material weaknesses to a requirement to communicate "reportable deficiencies."

Mr. Ashton indicated that the task force had also received some comments from the IFAC SMP Committee. In addition, he noted that at the IAASB CAG meeting the previous week, the Representatives were very supportive of the task force's recommended approach. Mr. Ashton also highlighted the concerns of a member of the task force that the project was moving away from its original purpose.

EVALUATION OF CONTROL DEFICIENCIES

ISA 315 (Redrafted)¹⁷ requires the auditor to evaluate whether, on the basis of the audit work performed, the auditor has identified a material weakness in the design, implementation or maintenance of internal control. It was noted that the corresponding requirement proposed by the task force did not appear to reflect the intention of the ISA 315 (Redrafted) requirement that the

¹⁶ [Proposed] ISA XXX, "Communicating Deficiencies in Internal Control Noted in an Audit."

¹⁷ ISA 315 (Redrafted), "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment."

auditor *evaluate* whether, in fact, any reportable deficiencies have been identified from the audit work performed. Rather, it was suggested that the proposed requirement seemed to assume that the auditor had already identified such deficiencies. In addition, it was argued that the ISA 315 (Redrafted) requirement imposes a rather more active obligation on the auditor than a mere “stumble across” consideration. The IAASB asked the task force to reconsider the proposed requirement in light of the ISA 315 (Redrafted) requirement.

NATURE OF DEFICIENCIES TO BE COMMUNICATED TO THOSE CHARGED WITH GOVERNANCE

Mr. Ashton explained the proposed requirement for the auditor to communicate reportable deficiencies noted to management and, at an appropriate level of detail, to those charged with governance. It was questioned whether this requirement would cover the case where the auditor merely informs those charged with governance that a written communication on reportable deficiencies has been delivered to management, but does not provide those charged with governance with any of the details. Mr. Ashton indicated that the task force intended the requirement to include such an eventuality. Some IAASB members, however, were of the view that the wording of the requirement did not convey this intention clearly, as the requirement appeared to mandate that the *content* of the written communication to management also be communicated to those charged with governance. Other members highlighted the practical implications of overwhelming those charged with governance with voluminous detail on internal control matters, and suggested that the auditor should have as much flexibility as possible in determining the level and extent of the communication.

After further deliberation, the IAASB concluded that the definition of “reportable deficiency” should be aligned with the definition of “significant deficiency” in the U.S. Public Company Accounting Oversight Board’s (PCAOB) Auditing Standard 5, which sets the judgment-based threshold at which the auditor should communicate control deficiencies to those charged with governance. In relation to other non-trivial control deficiencies that do not reach a level of importance sufficient to merit the attention of those charged with governance, the IAASB agreed that the proposed ISA should, as best practice, encourage, but not require, the auditor to communicate these to management. To accommodate different circumstances in practice, the IAASB also agreed that the application material should explain that the level of detail at which control deficiencies are communicated to management and those charged with governance would vary with the engagement circumstances, and that the auditor may find it appropriate to discuss and agree this with them.

COMPENSATING CONTROLS

One IAASB member noted that the proposed definitions of the terms “deficiency in internal control” and “reportable deficiency” did not appear to take into account compensating controls that might exist. Mr. Ashton indicated that the approach to the evaluation of control deficiencies should have regard to the fact that the auditor, in the absence of additional national requirements, does not have a responsibility to report on the effectiveness of control. Accordingly, the auditor may acknowledge the existence of compensating controls but choose not to test them. He noted that, in practice, many auditors would take the extra step and test the operating effectiveness of compensating controls if these were brought to their attention but that, in the context of ISAs, they are under no obligation to do so. The IAASB asked the task force to make this clearer in the ISA. In this regard, it was noted that care should be taken not to over-emphasize tests of compensating controls as this could result in more matters of a theoretical nature being reported than would otherwise be the case.

OTHER MATTERS

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

- In the introductory material, the task force should consider using terminology the IAASB agreed for the auditor's report in proposed ISA 700 (Redrafted) when describing the auditor's responsibility to consider internal control for the purpose of performing risk assessment procedures but not for giving an opinion on the effectiveness of internal control.
- The task force should consider clarifying that the scope of the proposed definition of "deficiency in internal control" includes automated controls. In addition, the meaning of the term "control objective" (as used in the definitions of the terms "deficiency in design" and "deficiency in operation") should be explained in relation to the ISA 315 (Redrafted) concept of preventing or detecting material misstatements in relevant assertions.
- The requirement that when the auditor becomes aware of deficiencies in internal control, the auditor shall confirm the auditor's understanding of the underlying facts and circumstances with management or those charged with governance should be deleted, because this was implicitly part of the auditor's concluding on whether control deficiencies noted constitute reportable deficiencies. Guidance to that effect could, instead, be included in the application material.
- The proposed ISA should make clear in the application material that there is no requirement for the auditor to *quantify* the potential effects of the control deficiencies reported.
- The task force should reconsider the requirement to include specific disclaimers in the written communication to management and those charged with governance, as it appears overly defensive. Instead, the requirement should be directed at the underlying principle, which is the need to explain to the user the context of what the auditor has done.
- The task force should consider providing further guidance regarding the implications of the timing of the auditor's communication on control deficiencies noted relative to the date of the written representation letter, as the latter may include a representation from management regarding the adequacy of internal control. This guidance should take into account the need for the auditor to communicate control deficiencies to management and those charged with governance as these come to the auditor's attention during the audit.
- Guidance should be provided to clarify that the auditor may issue the auditor's report and state compliance with ISAs even if the auditor has not yet delivered the auditor's communication on control deficiencies to management and those charged with governance.
- The task force should consider using consistent terminology as various terms such as "noted," "identified," and "come to the auditor's attention" were used in the proposed ISA to mean the same thing.

WAY FORWARD

The IAASB asked the task force to consider its comments and present a revised draft of the proposed ISA for approval as an exposure draft at the December 2007 meeting.

9. Communication with Those Charged with Governance

Mr. McPhee introduced the topic of proposed ISA 260 (Revised and Redrafted),¹⁸ noting that comments had been received from IAASB CAG Representatives and the IFAC SMP Committee, who are generally in agreement with the ISA.

OBJECTIVES

The IAASB discussed a proposed addition to the objectives. The IAASB agreed that promoting effective two-way communication between the auditor and those charged with governance is an objective in its own right, and that the ISA should be revised to reflect this. It was noted that having this as an objective of the auditor is not beyond the authority of ISAs, as it does not seek to impose any obligation on those charged with governance.

QUALITATIVE ASPECTS OF THE ENTITY'S ACCOUNTING PRACTICES

The IAASB discussed the proposed deletion of the requirement for the auditor to request changes to accounting practices when the auditor considers it necessary. The IAASB agreed that this repeats the requirements of proposed ISA 450 (Revised and Redrafted)¹⁹ and should therefore be deleted. It was further agreed that the requirement for the auditor to explain to those charged with governance why the auditor considers a significant accounting practice not to be appropriate, should clearly state that the practices to which it refers are ones that are acceptable under the applicable financial reporting framework, rather than practices that would result in a modified opinion in the auditor's report.

OTHER MATTERS

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

- The ISA should apply to all audits of financial statements, not just general purpose financial statements.
- The requirement in relation to the actions the auditor should take when two-way communication is not adequate, should include evaluating the effect on the auditor's ability to obtain sufficient appropriate audit evidence.
- The sentence inserted in the application material that notes that requiring communication from those charged with governance is beyond the authority of ISAs should be deleted.
- The paragraphs in the application material that relate to legal considerations and confidentiality should be reconfigured such that the resulting text relates clearly to legal and regulatory restrictions on the one hand, and communication with third parties on the other.
- The phrase "care is required" in relation to communicating planned scope and timing of the audit should be reinstated, consistent with ISA 300 (Redrafted).²⁰

¹⁸ ISA 260 (Revised and Redrafted), "Communication with Those Charged with Governance."

¹⁹ [Proposed] ISA 450 (Revised and Redrafted), "Evaluation of Misstatements Identified during the Audit."

²⁰ ISA 300 (Redrafted), "Planning an Audit of Financial Statements."

- The application material should specifically state that the auditor need not design specific procedures to support the evaluation of the two-way communication between the auditor and those charged with governance.
- The appendix that lists requirements of other ISAs that refer to communication with those charged with governance should be amended to be consistent with the style used in the appendix to ISA 230 (Redrafted), in particular the appendix should include paragraph references to other ISAs rather than the text of referenced paragraphs.

APPROVAL

The IAASB agreed that the changes made to the exposure draft in response to the comments received from respondents did not warrant re-exposure. Mr. Sylph advised the IAASB that it had adhered to its stated due process in finalizing the ISA. The IAASB unanimously approved the proposed ISA as a final ISA under the clarity drafting conventions, with an effective date for audits of financial statements for periods beginning on or after December 15, 2009. The issue of the final ISA is subject to confirmation from the Public Interest Oversight Board that due process has been followed.

10. Assurance on a Service Organization's Controls

Mr. Tucker introduced the topic, providing an overview of relevant decisions made by the IAASB in previous discussions on this project, and noting the intention to expose the proposed ISAE at the same time as proposed ISA 402 (Revised and Redrafted).²¹ He also noted that, while there is currently no international standard on this topic, the task force has drawn upon established practice.

ASSERTION-BASED ENGAGEMENTS AND WORDING OF THE SERVICE AUDITOR'S OPINION

Mr. Tucker noted that the IAASB CAG Representatives had discussed whether "3402 engagements" should be assertion-based or direct reporting engagements, and had agreed with the task force's recommendation that assertion-based engagements are preferable because they reinforce the service organization's responsibility for the fair presentation of the description, and the suitability of the design and operating effectiveness of controls. The IAASB CAG Representatives further agreed that the service auditor's opinion should be stated in terms of the subject matter because this is a clearer form of communication than stating it in terms of the service organization's assertions. The IAASB agreed with these conclusions, but noted that an assertion-based approach would be a departure from current practice in many jurisdictions and therefore, while "assertion-based" engagements should be encouraged, "direct reporting" should not be prohibited.

When this issue was discussed at the April IAASB meeting, the IAASB asked the task force to liaise with the outsourcing industry about the implications of assertion-based reporting. Mr. Tucker reported that the task force had been unable to identify suitable global bodies that could be expected to represent the views of a broad cross-section of service organizations, and was reluctant to consult individual service organizations outside the normal due process. As an alternative, the task force suggested that, when the exposure draft is released, particular efforts should be made to ensure it receives broad distribution throughout the industry and to encourage feedback at that stage. The IAASB agreed with this approach.

²¹ [Proposed] ISA 402 (Revised and Redrafted), "Audit Considerations Relating to an Entity Using a Third Party Service Organization."

CRITERIA

The IAASB discussed whether it is the role of the auditing profession to create criteria for assertions prepared by the service organization. It was agreed that an approach similar to that for proposed ISA 805 (Revised and Redrafted)²² is appropriate. That is, the proposed ISAE should identify the attributes or minimum requirements that the criteria should encompass to be suitable for an assurance engagement.

Criteria for the Fair presentation of the Description of the System

The proposed ISAE has two criteria for the fair presentation of the description of the system. The first criterion links the content of the description with the information required by user auditors under ISA 315 (Redrafted). This criterion is consistent with, but more precisely articulated than criteria currently used in practice. The IAASB noted that clear articulation of this criterion in the ISAE may be expected to result in more concise and relevant descriptions in practice. The second criterion relates to the reliability of the description. The IAASB discussed whether other qualitative characteristics besides reliability, e.g., completeness and understandability, should be incorporated into this criterion. It was noted that consideration of such characteristics forms part of the service auditor's judgment when considering the fair presentation of the description. The task force was asked to consider this issue further.

Criteria for the Suitability of Design and Operating Effectiveness of Controls

The IAASB noted that the consideration of qualitative characteristics relevant to the second criterion noted above, will impact on how the auditor views the control objectives as part of the criteria for the suitability of the design and operating effectiveness of controls. The task force was asked to consider whether the criteria, which are currently expressed at the opinion level, should be further broken down to reflect in more detail the matters the service auditor considers when forming conclusions on suitability of the design and operating effectiveness of controls.

RELATIONSHIP WITH ISAS

The IAASB discussed the extent to which the proposed ISAE should replicate or adapt relevant requirements included in ISAs, particularly where significant additions to a particular ISA have been made since ISAE 3000²³ was issued, e.g., ISA 230 (Redrafted). It was agreed in principle that, if a service auditor is to obtain the same level of assurance as an auditor in a financial statement audit, then the requirements in the proposed ISAE should cover similar matters and at a similar level of detail to ISAs. Alternative ways to achieve this are to replicate or adapt relevant requirements included in ISAs, or to require that ISAs be applied, adapted as necessary in the circumstances of the engagement. Some IAASB members preferred replicating or adapting relevant requirements, and expressed general satisfaction with the manner in which this had been done in the proposed ISAE. On the other hand, it was questioned whether replicating or adapting more complex aspects of some ISAs, even when they are applicable (e.g., the distinction between an external expert, an expert who

²² [Proposed] ISA 805 (Revised and Redrafted), "Engagements to Report on Summary Financial Statements."

²³ International Standard on Assurance Engagements, "Assurance Engagements Other than Audits or Reviews of Historical Financial Information."

is a member of the engagement team, and a management expert), is appropriate. The following comments regarding specific ISAs were made for further consideration by the task force:

- (a) Additional application material could be added regarding the service auditor's use of the work of internal checking functions, such as internal audit or a compliance department, in particular any limitations on the extent to which service auditors can substitute such work for their own testing.
- (b) Some of the requirements of proposed ISA 530²⁴ should be considered for inclusion in the ISAE.
- (c) With respect to ISA 315 (Redrafted), it was noted that the service auditor's documentation related to the requirement to obtain an understanding of the system is not a documentation of the system because the description prepared by the service organization (which is the subject matter itself) does this. The proposed ISAE should recognize that the service auditor needs to obtain an understanding of the boundaries of the system included in the scope of the engagement.
- (d) The application material regarding the service auditor's report should include an explanation of the rationale as to why use of the report is restricted to those who have a practical understanding of the service organization's system. The task force should also reconsider whether the wording and structure of the unmodified reports included as an appendix in the ISAE could be misunderstood to be modified (e.g., use of the words "subject to," and the placement prior to the opinion of the paragraph dealing with limitations of the internal control).

OTHER MATTERS

- The IAASB agreed that the three components of the service auditor's opinion (fair description, suitable design, and effective operation) should be included together in one paragraph, and any modifications to the opinion should be included in the lead-in sentence to the three components.
- It was noted that in practice Type A reports are only used where a system is new and therefore there is no track record of whether it operates effectively or not. In these circumstances, a Type B report would not be possible.
- The proposed ISAE should include application material regarding the nature of adaptations that would be necessary if it is used for engagements to report on controls other than those related to financial reporting.
- The task force was asked to reconsider whether the proposed ISAE should apply only when the service organization considers that the controls to be reported on are likely to be part of a user entity's information systems relevant to financial reporting.
- The task force was asked to consider the authority of the objectives in the proposed ISAE, given that ISAEs were not encompassed by the revisions to the Preface to give effect to the clarity redrafted ISAs. It was also noted that the objectives for the proposed ISAE are modeled on the objectives of proposed ISA 200 (Revised and Redrafted), the exposure period of which had

²⁴ [Proposed] ISA 530 (Redrafted), "Audit Sampling."

recently closed. Any significant changes in the objectives of proposed ISA 200 (Revised and Redrafted) should be reflected in the proposed ISAE.

- The proposed ISAE uses the term “service auditor,” whereas ISAE 3000 uses the term “practitioner.” A practitioner in this context is a professional accountant, but may not be a specialist auditor. The task force was asked to consider whether any limitation should be imposed regarding who may use the proposed ISAE, or alternatively whether the service auditor’s report should require disclosure of information to assist the user auditor to evaluate the skills, knowledge and practical experience of the service auditor.
- The IAASB noted that, because of confidentiality considerations when a service auditor’s report is distributed to many user entities, that report will not ordinarily include details of illegal acts, fraud or uncorrected errors. User auditors therefore need to inquire of their clients whether the service organization has notified it of any such events. This matter is dealt with in proposed ISA 402 (Revised and Redrafted).
- The task force was asked to review those elements of the application material that listed “possible” procedures and consider whether any such procedures should be elevated to requirements.
- The IAASB agreed that providing the illustrative example of control objectives appended to the ISAE, will help bring greater consistency to the level at which such objectives are stated in practice. The task force was asked to consider whether the headings in the appendix should be more closely aligned with paragraph A92 of ISA 315 (Redrafted), and whether it was necessary to specify control objectives for all of the headings.
- The wording of the service auditor’s report should be amended to make it clear that the service auditor is not opining on all controls, but rather only those controls necessary to achieve the control objectives.

WAY FORWARD

The task force was asked to present a revised proposed ISAE for approval as an exposure draft at the December IAASB meeting.

11. Using the Work of an Auditor’s Expert

Mr. Ferlings introduced proposed ISA 620 (Revised and Redrafted).

AGREEMENT WITH THE EXPERT

The IAASB discussed whether the required agreement between the auditor and the expert always needs to be in writing. IAASB CAG Representatives had also raised this issue, requesting the IAASB to confirm its position. It was noted that practice inspections in the United Kingdom indicate that documentation of work done by internal experts, and the linkage of that work with other audit work, has been weak. Given that the proposed ISA covers a broad range of situations, the IAASB agreed that it would not be appropriate to require a written agreement in all cases. It was agreed, however, that the proposed ISA should require the agreement to be in writing when appropriate, and that the application material should note that the more significant the work of an expert in the context of the audit, the more likely it is that the agreement will need to be reasonably detailed and set out in writing.

OBJECTIVITY OF AN AUDITOR'S EXTERNAL EXPERT

The IAASB discussed the requirement for the auditor to evaluate the objectivity of an auditor's external expert, including inquiry regarding interests and relationships that may create a threat to that expert's objectivity. It considered whether the application material, some of which had been drawn directly from the independence provisions of the IFAC Code of Ethics for Professional Accountants, confuses the concepts of independence and objectivity and creates unrealistic expectations, particularly when an external expert is an organization or a member of organization. The IAASB agreed to focus the examples of matters to discuss with the external expert on those matters that are most likely to be relevant, and to link the guidance regarding an external expert who is an organization or a member of organization with the issue of other services provided.

OTHER MATTERS

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

- The application material should include examples of fields of expertise that fall under the proposed ISA. Expertise in tax compliance issues and the valuation of complex financial instruments should be included in the examples, but expertise in complex IT systems should be excluded. The proposed ISA should not attempt to define accounting and auditing expertise.
- The proposed ISA should clearly differentiate which elements apply to auditor's external experts and which apply to "internal" experts.
- The definition of "expertise" should refer to a particular "profession or specialist occupation" to ensure people possessing industry expertise are not considered experts for the purpose of the proposed ISA.
- The proposed ISA should apply whenever an expert's work is used, not only when it is necessary to use an expert.
- The possibility that the auditor should employ or engage another expert, if the work of an expert is inadequate, should be specifically mentioned in the application material.
- When other ISAs are referred to, the title of the ISA should be included in a footnote rather than in the text proper to enhance readability. The IAASB agreed that this convention should also be followed when applying the clarity drafting convention to other ISAs.
- Reference to "reading specialist literature" and "attending seminars" should be deleted from the list of sources from which an auditor may gain an understanding of the field of expertise sufficient to obviate the need for an expert.
- The application material regarding reliance on the firm's quality control policies and procedures with respect to an internal expert should be reordered and should draw directly on the wording in proposed ISA 220 (Redrafted).²⁵
- The proposed ISA should be clearer about what aspects of source data used by an expert should be tested.

²⁵ [Proposed] ISA 220, "Quality Control for an Audit of Financial Statements."

APPROVAL

The IAASB approved proposed ISA 620 (Revised and Redrafted) as an exposure draft with a 120-day comment period. Mr. Kellas, as proxy for Mr. Swanney, abstained. Ms. Esdon voted against the proposed ISA because she believes that it is inappropriate to deal with management's experts as a conforming amendment to proposed ISA 500 (Redrafted), rather than in proposed ISA 620 (Revised and Redrafted), particularly when proposed ISA 500 (Redrafted) has only recently been exposed in a "clarified form."

12. Agreeing the Terms of Audit Engagements

Mr. McPhee introduced the topic, noting that the covering memo addresses the points outstanding from the July IAASB meeting.

USE OF THE TERM "ENTITY"

The task force responded to the concerns over the use of the term "those charged with governance" within the proposed ISA, and the determination whether it was appropriate to use the phrase "management and/or those charged with governance," by replacing this phrase with the word "entity."

The IAASB debated whether the word "entity" was appropriate; some were of the view that the reference was not helpful and that the proposed ISA should refer to "management and, where appropriate, those charged with governance" and "management or those charged with governance," which are clearer. Mr. McPhee agreed to change the proposed ISA to reflect the language that was discussed at the July IAASB meeting.

REFERENCE TO PROPOSED ISA 706 (REVISED AND REDRAFTED)

Mr. McPhee noted that the IAASB had previously expressed concern over language added to the paragraph that deals with cases where an auditor is required to accept an audit of financial statements prepared in accordance with an unacceptable financial reporting framework. The concern was that, while an auditor's report in such circumstances could not claim that the audit had been conducted in accordance with ISAs, reference to the unacceptability of the framework would be warranted in the auditor's report. In order to address this concern, the task force reordered certain paragraphs, proposed an explicit requirement for the auditor not to refer to the audit as being one conducted in accordance with ISAs, and included additional application material to advise the auditor to consider including an explicit statement in the auditor's report that the audit is not conducted in accordance with ISAs.

The task force was also asked to consider whether a conforming amendment to proposed ISA 706 (Revised and Redrafted)²⁶ was needed to refer to an example of when an emphasis of matter would be used. The task force concluded that no reference was necessary in the proposed ISA.

PROPOSED CHANGES

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

²⁶ [Propose] ISA 705 (Revised and Redrafted), "Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor's Report."

- A reference to proposed ISA 200 (Revised and Redrafted) should be included in the application material and an encouragement for the auditor to apply ISAs, even when the auditor is not permitted to refer to the audit being conducted in accordance with ISAs.
- The application material should include “a review” as well as “a related service” as possible engagements conveying a lower level of assurance, where there is a reasonable justification for a change from an audit engagement.
- Application material dealing with the circumstances when the financial reporting framework is prescribed by law or regulation, but is deficient, should indicate that where an audit opinion is also required by law or regulation in fair presentation terms then that opinion is significantly different from the requirements of the ISAs and the corresponding provision of paragraph 14 of the draft applies.

OTHER MATTERS

It was suggested that the request for management or those charged with governance to acknowledge receipt of the audit engagement letter and to agree to the terms of the audit engagement outlined therein be elevated to a requirement. Mr. McPhee explained that the agreement between the parties was covered by another requirement. The majority of the IAASB members did not support the suggested change.

INTERACTION WITH PROPOSED ISA 580 (REVISED AND REDRAFTED) AND WAY FORWARD

Mr. McPhee noted that there were conforming amendments to the proposed ISA as a result of ISA 580 (Revised and Redrafted). The IAASB agreed that it would not be appropriate to issue proposed ISA 210 (Redrafted) before ISA 580 (Revised and Redrafted) was finalized. As a result, the IAASB agreed to approve proposed ISA 210 (Redrafted), subject to the proposed conforming amendments that would be considered for approval at the December IAASB meeting.

13. Audit Considerations Relating to an Entity Using a Third Party Service Organization

Ms. Esdon introduced the topic, noting that the task force has responded to the changes discussed during the first read of proposed ISA 402 at the April IAASB meeting.

APPLICABILITY OF THE PROPOSED ISA TO SHARED SERVICE CENTERS

Ms. Esdon explained that Appendix 2 was developed as a result of one task force member’s view that shared service centers should be covered by the proposed ISA. Based on the IAASB’s discussions in April, references to shared service centers within the body of the proposed ISA had been deleted, but Appendix 2 had been inserted to address this concern. The IAASB members were asked for their views on the matter.

The IAASB discussed Appendix 2 of the proposed ISA. Views on the usefulness of the Appendix were split between those who thought that it is too lengthy and those who thought that it is not detailed enough. Some members were of the view that, in the case of an intragroup shared service center, the provisions of ISA 600 (Revised and Redrafted)²⁷ would apply and that the guidance in

²⁷ ISA 600 (Revised and Redrafted), Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors).”

proposed ISA 402 (Revised and Redrafted) would be unnecessary. Ms. Esdon noted that the issue in practice primarily relates to statutory auditors who are looking to rely on controls at the shared service center, in particular when communication between the statutory auditor and the parent company auditor is limited. A few IAASB members and an observer noted that including a paragraph within the proposed ISA, illustrating that the concepts could be applicable in the shared service center context, may assist a statutory auditor in conducting a statutory audit.

After some debate, the IAASB agreed to revert to the wording in the draft discussed at the April IAASB meeting, which included reference to the applicability of the proposed ISA, adapted as necessary in the circumstances, to shared service centers. It was also agreed that the requirement for the auditor to perform further audit procedures to obtain sufficient appropriate audit evidence, or to request the service auditor to perform those procedures on the auditor's behalf, be reinstated. As a result of these changes, it was agreed that Appendix 2 should be deleted. The IAASB also agreed to include a question in the explanatory memorandum to obtain further information on the issue in order to determine the needs in practice.

It was discussed whether, in light of these changes, the definition of "service auditor" should be revised to refer to substantive testing. Ms. Esdon noted that the proposed ISA does not preclude a service auditor, who reports on controls at a service organization, from performing substantive procedures at the request of a user auditor, as explained in the application material.

REQUIREMENTS

Understanding the Controls at a Service Organization

One IAASB member, with the support of others, was of the view that the requirements do not clearly illustrate what a user auditor would be required to do if the user auditor is unable to obtain a sufficient understanding of controls over the activities of the service organization through interaction with the user entity alone. The task force was asked to add a requirement to bridge the gap between the requirements in paragraphs 9 and 10. This requirement should be a conditional requirement that indicates that, if the user auditor is unable to obtain the necessary understanding from the user entity alone, the user auditor is required to interact with the service organization. It was noted that the options in paragraph A15 address the options available to the user auditor and could be considered for elevation to a requirement.

Ms. Esdon agreed that the task force should include an additional requirement in the proposed ISA to be approved at the December IAASB meeting.

*Interaction with Proposed ISA 705 (Revised and Redrafted)*²⁸

One IAASB member noted that the consideration of a scope limitation when a sufficient understanding of the nature of the services provided by the service organization could not be obtained would be more appropriate as a requirement rather than a possible alternative in the application material. As a result, this was elevated to a conditional requirement when the auditor is unable to obtain a sufficient understanding about the nature of the activities of the service organization.

²⁸ [Proposed] ISA 705 (Revised and Redrafted), "Modifications to the Opinion in the Independent Auditor's Report."

Fraud, Illegal Acts and Uncorrected Misstatements

One IAASB member suggested that the requirement for the user auditor to inquire of management of the user entity whether the service organization has reported to the user entity any fraud, illegal acts, or uncorrected misstatements be expanded to require the user auditor to inquire of the service auditor. Ms. Esdon noted that, since there is no direct relationship between the user auditor and service auditor, this requirement is likely to be difficult to achieve. She acknowledged that in some cases the service auditor's report may include communications of this nature, but it is unlikely that the affected user entities would be disclosed by name, and as such, the task force did not believe that it is appropriate to include additional requirements or guidance for the user auditor to review the service auditor's report for this information.

PROPOSED CHANGES

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

- The objective of the proposed ISA should be changed to clearly link to the user auditor's need to understand the nature and significance of the services provided by the service organization, consider the effect on the user entity's internal control and identify, assess and respond to the risks of material misstatement in accordance with ISA 315 (Redrafted) and ISA 330 (Redrafted).²⁹
- The scope paragraphs of the proposed ISA should be edited so as not to use multiple terms like "service organizations" and "outsourcing organizations."
- The definitions of the service auditor's report, which had been taken from proposed ISAE 3402, should be generalized so as not to preclude a user auditor from using reports issued under other recognized national standards that may not include all the specific elements of an "ISAE 3402 report."
- The requirements should be revisited to determine whether it is necessary to refer to both the user entity's internal control relative to the audit and information systems relative to financial reporting, given that the information system is a subset of internal control in ISA 315 (Redrafted).
- The requirements should be reordered to separate those that apply when a user auditor decides to use a report from a service auditor, whether to obtain an understanding of the services provided by a service organization or as evidence about the operating effectiveness of controls at the service organization.
- Changes should be made to reflect the discussion by the IAASB that, when a user auditor evaluates the description of controls at the service organization in a Type B report, the user auditor evaluates whether the description is at a date or for a period that is appropriate, in light of the definition of "Type B report" in proposed ISAE 3402.

²⁹ ISA 330 (Redrafted), "The Auditor's Responses to Assessed Risks."

- The reference to illegal acts should be changed to non-compliance with laws and regulations to be consistent with proposed ISA 250 (Redrafted).³⁰
- References to the other procedures a service auditor could be asked to perform by the user auditor should be generalized, as the user auditor could request substantive procedures, procedures to test controls, or agreed-upon procedures.
- Inquiry as to whether the service auditor is subject to regulatory oversight should be added as a possible action for the user auditor to evaluate the service auditor's professional reputation, competence and independence. The IAASB agreed that it was not necessary to expand this requirement to be as comprehensive as what is required by ISA 600 (Revised and Redrafted) when dealing with a component auditor.

WAY FORWARD

Ms. Esdon noted that the task force will revise the proposed ISA to address the concern that an additional requirement is needed and to make the substantive changes agreed by the IAASB. A revised draft will be presented for approval as an exposure draft at the December IAASB meeting. It is not envisaged that any additional changes will be needed as a result of proposed ISAE 3402.

14. Next Meeting

The next meeting of the IAASB has been scheduled for December 10-14, 2007 in Washington, DC, United States.

15. Closing Remarks

Mr. Kellas asked members to encourage relevant parties in their jurisdictions to comment on the consultation paper of the IAASB's future strategy. He thanked the Instituto de Censores Jurados de Cuentas de España for hosting the meeting and its staff for assisting with the meeting arrangements.

³⁰ [Proposed] ISA 250 (Redrafted), "The Auditor's Responsibilities Relating to Laws and Regulations in an Audit of Financial Statements."

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