

**Minutes of the 6th Meeting of the
INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD**

**Held on July 21-25, 2003
At the AICPA, 1211 Avenue of the Americas, New York City**

	Members	Technical Advisors
<i>Present:</i>	Dietz Mertin (Chair)	Bernard Agulhas (Mr Kana)
	Denise Esdon (Vice Chair)	Wolfgang Böhm (Mr Mertin)
	Philip Ashton	John Fogarty (Mr Hansen)
	Denis Desautels	Cédric Gélard (Mr Trémolière)
	Ana Maria Elorrieta	Jon Grant (Mr Plaistowe)
	Jan Bo Hansen	Diana Hillier (Mr Ashton)
	Gen Ikegami	Susan Jones (Mr Noonan)
	Suresh Kana	Paul Lohnes (Mr Desautels)
	John Kellas	Richard Mifsud (Mr McPhee)
	Ian McPhee	Emilio Palma (Mr Tizzano)
	Edmund Noonan	Sylvia Smith (Mr Kellas)
	Ian Plaistowe	George Tucker (Ms Esdon)
	Roger Simnett	Hans Verkruijsse (Mr Dassen)
	Gérard Trémolière	Yuichi Yamamoto (Mr Ikegami)
<i>Absent:</i>	John Archambault	Xi Wu (Mr Yang)
	Roger Dassen	
	Roberto Tizzano	
	Zhiguo Yang	
	IFAC Technical Staff	
<i>Present:</i>	Jim Sylph (Technical Director)	
	Sylvia Barrett	
	James Gunn	
	Jan Munro	
	Michael Nugent	
	Alta Prinsloo	
	Ken Siong	

1. Opening

Mr Mertin opened the meeting to the public.

The minutes of the public session of the meeting held on May 11-13, 2003 in New York were approved, subject to an addendum that indicates the exposure draft of the proposed ISA on “Review of Interim Financial Information by the Auditor of the Entity” was approved by written ballot. Seventeen members voted in favor and one member voted against the issue of the exposure draft.

The Chair noted that Mr Dassen and Mr. Tizzano had named Mr Verkruijse and Mr Palma respectively as their proxies.

2. Fraud

Ms Esdon presented the proposed revised ISA 240 “The Auditor’s Responsibility to Consider Fraud in an Audit of Financial Statements” for approval to be issued as an exposure draft

Mr Sylph indicated that IFAC is in the process of completing copyright documentation with regard to the posting of the exhibit to SAS 99 “Management Antifraud Programs and Controls” on the IFAC website. It was recommended that, depending on the timing of issuing the exposure draft and of posting the exhibit to the website, the matter should be covered in the explanatory memorandum that will accompany the exposure draft.

The IAASB considered the exposure draft by paragraph. In addition to editorial and structural comments, the following changes were agreed:

- The concept of a continuum of earnings management dealt with in paragraph 10 does not agree with the continuum reflected in the proposed revised ISA 540 “Accounting Estimates.” Therefore the discussion in paragraph 10 should focus on earnings management that is intended to deceive financial statement users.
- Paragraph 22 could be interpreted as though the auditor is not allowed to take account of any past experience with the entity, which may destroy protection that an auditor may have under certain national legal frameworks. It was agreed that the paragraph should be restructured, and that the auditor should be required to “maintain an attitude of professional skepticism recognizing the possibility that a material misstatement due to fraud could exist notwithstanding the auditor’s past experience with the entity and the auditor’s belief about the honesty and integrity of management and those charged with governance.”
- References to “risk of material misstatement” should be changed to “risks of material misstatement” (i.e. in accordance with the proposed Audit Risk Standards) and the references to “fraud risk factors” should be reconsidered to ensure that the intention was not to refer to “fraud risks” or “risks of material misstatement.”
- Paragraph 36 should also require the auditor to inquire of those charged with governance whether they have knowledge of actual, alleged or suspected frauds (i.e. as per paragraph 31). In addition, the auditor corroborates the understanding of how those charged with governance exercise oversight of management processes by, for example, attending audit committee meetings and reading of minutes.
- Paragraph 48 should not be limited to fraud risk factors, but should cover the auditor’s consideration of all the information referred to in paragraphs 40 to 47, and the auditor’s understanding of the controls that management has designed and implemented to mitigate risks.

- The explanatory text following paragraph 83 should be expanded to encourage communication in writing.
- The use of the term “applicable” in relation to the financial reporting framework should be used for purposes of the exposure draft, but that its use should be reconsidered in the final ISA depending on the outcome of future deliberations of the Auditor’s Report Task Force.
- The proposed ISA should clarify that any assessed risk that could result in a material misstatement due to fraud should be deemed to be a significant risk, which is consistent with the conclusion reached by the IAASB on the proposed revised ISA 540 “Audit of Accounting Estimates.”
- The guidance on documentation should be retained for purposes of the exposure process, but may have to be conformed to the final Audit Risk Standards at a later stage.

The IAASB unanimously approved the document for issuance as an exposure draft. The comment deadline was set as November 15, 2003. The IAASB agreed that an explanatory memorandum should accompany the exposure draft to explain its purpose and its main differences from the existing ISA 240. The task force indicated its intention to present a proposed final ISA to the IAASB, in either February or April 2004, depending on the nature and extent of comments received on exposure.

Ms Esdon thanked the task force and responsible IAASB Staff for their hard work in developing the proposed revised ISA.

3. Auditor’s Report

Mr Ashton reported on the task force’s activities since the May 2003 IAASB meeting, and highlighted issues for consideration by the IAASB.

FINANCIAL REPORTING FRAMEWORK

Mr. Ashton explained that, in response to questions raised during the May 2003 IAASB meeting, the task force had revisited the proposed approach on the auditor’s consideration of the financial reporting framework. The task force continued to propose that both International Financial Reporting Standards (IFRSs) and national accounting standards are appropriate for general purpose financial statements. Where national standards are issued or adopted by national organizations authorized to establish such standards through a process involving deliberation and consultation or to adopt IFRSs or standards of another authorized national organization, the task force proposed that they would be presumed to be appropriate. Such standards would be generally accepted in that jurisdiction and broadly available. In the absence of such an authorized national organization; however, the auditor would need to assess whether the proposed financial reporting framework is comprehensive and authoritative. This is necessary to be consistent with the Assurance Framework, which establishes the principle that the auditor can only accept the engagement if there are suitable criteria.

The proposed revisions to the ISAs included:

- Proposed new guidance in ISA 200 that defines an “applicable” financial reporting framework (the term used in the Audit Risk Exposure Draft) and provides criteria for assessing, in those circumstances when necessary, whether a framework is comprehensive and authoritative.
- Introducing a requirement in ISA 210 “Terms of Audit Engagements” to identify the applicable financial reporting framework in the terms of engagement, and a prohibition against accepting an engagement for general purpose financial statements when, in the

absence of a statutory requirement to adopt an identified financial reporting framework, the financial reporting framework chosen by management is not comprehensive and authoritative.

- Adding guidance in ISA 700 on what the auditor should do if, after accepting an engagement involving a financial reporting framework chosen by management, deficiencies in that framework are identified.

In the discussion of the proposed revisions to the ISAs, the following questions were raised:

- Whether it was reasonable for the auditor to have a responsibility to consider the “appropriateness” or “acceptability” of the financial reporting framework, or whether disclosing the identified financial reporting framework, including the country of origin of that framework, was sufficient because it is users who must assess whether the financial reporting framework used is suitable for their needs.
- Whether auditors would be able to apply the criteria consistently or whether different auditors may come to different conclusions in similar situations.
- Whether the proposed standard clearly describes the approach an auditor may take if he/she concludes the criteria are not met (e.g. discuss with the client the possibility that the financial statements might be regarded as special purpose financial statements and the auditor would apply ISA 800 “The Auditor’s Report on Special Purpose Audit Engagements.”)
- Whether it was appropriate that an authorized national organization’s accounting standards could be accepted as comprehensive and authoritative even though they may not meet the criteria against which non-authoritative frameworks would be judged.
- Whether the proposed standard addressed the effect of having an authorized national organization that does not follow a “process involving deliberation and consultation.”
- Whether reporting on a single financial statement, such as a balance sheet, would be better addressed in ISA 800 (as proposed by the task force) or in ISA 700.
- How the proposals would deal with the example of an audit client that changed from national accounting standards to IFRSs, but then changed back to the national accounting standards when International Accounting Standards dealing with financial instruments became effective – even though the IFRSs were regarded as of a higher quality than then national accounting standards.

After considerable discussion, it was agreed that the task force should progress as proposed. It was recognized that, while perhaps imperfect in some ways, the proposals do fill a gap that exists in ISAs today. They will also help advance practice in the profession’s own area of expertise. However, the task force was asked to consider the following:

- Limiting the category of “national accounting standards” to those established by an authorized national organization and creating a separate category for those jurisdictions that do not have such organizations.
- Clarifying that the latter category, which is not set by an authorized national organization, will only exist in a small number of cases.
- Recognizing the International Public Sector Accounting Standards as an applicable financial reporting framework.
- Using the characteristics of suitable criteria in the Assurance Framework rather than the proposed criteria to evaluate whether a framework is comprehensive and authoritative, which had been derived from the IAS Framework.

- Ensuring that the guidance would not put in place a disincentive to improve upon national financial reporting frameworks by adopting certain IFRS standards for certain accounting policies.
- The pros and cons of including auditors' reports on a single financial statement (e.g. a balance sheet) in ISA 800 or ISA 700.

AFTER ACCEPTANCE OF THE ENGAGEMENT

The task force proposed that if, after accepting an engagement, the auditor identifies deficiencies in the financial reporting framework that were not anticipated when the engagement was accepted, the auditor discusses the reasons for the deficiencies with management and encourages management to address these deficiencies. When the auditor concludes that the financial reporting framework is not comprehensive and authoritative, the auditor expresses a disclaimer of opinion or withdraws from the engagement.

One member questioned whether this guidance was necessary. Although it is broadly consistent with the Assurance Framework, the member argued that the circumstances being addressed by the guidance would be extremely rare and yet the amount of guidance needed to address it comprehensively gives it more prominence than is warranted.

Members noted that the proposed Assurance Framework also provides for a qualified opinion because there may be only one aspect of the criteria that is not suitable. However, the task force argued that if the financial reporting framework is not suitable, there would be no basis for an opinion. Furthermore, a modification of the auditor's opinion in existing ISAs relates to the subject matter rather than to the suitability of the criteria. Other members also cautioned that it is not appropriate to disclaim an opinion on only certain aspects of the financial reporting framework, as "piece meal" opinions are not allowed.

FORMING A "TRUE AND FAIR" / "PRESENT FAIRLY" OPINION

The task force sought input from the IAASB on whether the auditor should be required to "stand back" when forming an opinion on the financial statements. That is, the auditor has to conclude whether the financial statements give a true and fair view (are fairly presented), irrespective of whether they have been prepared in accordance with the financial reporting framework. This might involve, for example, considering whether the financial statements need to include additional disclosures when the particular requirements of the financial reporting framework are insufficient to enable users to understand the impact of particular transactions or other events on the entity's financial position and financial performance.

One member argued that the auditor would not have criteria against which to make such a judgment and, therefore, expressed concern that it will open the door to inconsistent application. The member also questioned the implications for the wording of the auditor's opinion. However, the majority of members were in favor of asking the task force to draft additional guidance that emphasizes the "stand back" in forming the audit opinion. Most agreed; however, that the situation should be characterized as being relatively rare and that the underlying principle should be that the auditor should not be associated with misleading information.

Some members questioned whether the guidance will need to deal comprehensively with differing circumstances arising from how different financial reporting frameworks deal with the possibility of an "override" within the framework. Others asked whether the guidance should address whether an "override" would more commonly relate to additional disclosures or whether it could relate to recognition and measurement as well. The task force agreed to reconsider the

need for guidance pertaining to these issues, but cautioned about the need to consider the timeline of the project.

SUPPLEMENTARY INFORMATION

The proposed guidance focuses on how supplementary information relates to the auditor's opinion on the financial statements, indicating when such information should be covered by the auditor's opinion. It was proposed that the task force consider expanding the guidance to indicate that if unaudited information forms part of audited information, but is not, in the auditor's opinion, sufficiently differentiated (e.g. clearly marked as unaudited), the auditor should include a disclaimer in relation to the unaudited information in the auditor's report. It was also noted that supplementary information may not always be presented voluntarily, but may be required by law or regulation or standards.

PROPOSED REVISED ISA 700

The IAASB considered the proposed ISA 700. In the section on "The Auditor's Opinion on Financial Statements," in addition to editorial matters the task force was asked to reconsider the use of the phrase "in all material respects" when referring to auditor's reports that opine on fair presentation. However, the guidance should be expanded to convey the thought that the notion of "fairness" assumes materiality, and acknowledge that, in some jurisdictions, the phrase "in all material respects" is included in the wording of the opinion. The IAASB also suggested that guidance emphasize the fact that the audit work conducted and assurance provided are the same regardless of which form of wording of the opinion is used.

In the title of the report, it was agreed that the principle is that the report have a title that clearly indicates that it is the report of an independent auditor. "Independent Auditor's Report" would be used only for illustrative purposes. The related discussion on translating the term "independent" should be deleted as the underlying message will be adequately conveyed with the changes proposed.

In the section on "Management's Responsibilities," in addition to editorial matters, it was agreed that management's responsibility for making the necessary accounting estimates should be aligned with the wording proposed for the Estimates project, and that the Task Force should add a statement about management's responsibility regarding the adequacy of disclosures. The task force was also requested to re-consider whether a statement should be added about management's responsibilities regarding compliance with laws and regulations in relation to the preparation of financial statements and going concern.

The IAASB discussed the proposed guidance dealing with reporting under both ISAs and national auditing standards (paragraph 38 under the section on "The Auditor's Responsibilities"). Members questioned how to interpret and effect the proposed guidance in the circumstances where, for example, an emphasis of matter paragraph in the auditor's report is required under the ISAs but is not permitted by a national auditing standard (or when a national auditing standard requires a different reporting treatment). Members also asked the task force to reconsider the interrelationship between paragraph 15 and paragraph 38, and the overall tone of the guidance (e.g. the reference to "sections") with respect to how much flexibility in reporting is permitted. In principle, most members supported the view that the proposed revised ISA should mandate certain elements of the auditor's report, but that flexibility should be permitted in the form and structure of the report. For some elements of the report, however, it was agreed that language and words should be mandated.

There was quite strong support for the proposal that the auditor's report defines the limits on the auditor's responsibilities with respect to internal control. Some members expressed concern,

however, that paragraph 40 introduces a requirement to understand internal control, but omits guidance on the auditor's reporting responsibilities when the auditor identifies a deficiency or material weakness in internal control. It was agreed that the wording of the sentence could be improved to be less defensive, for example, by clarifying that an audit does not provide a basis for forming an opinion on internal control. It was also suggested that the task force consider the placement of this sentence in relation to paragraph 39. However, there was not support for the auditor's report being expanded to describe the auditor's reporting responsibilities to management and those charged with governance when a material weakness in internal control is identified.

The IAASB agreed to delete paragraph 42, which suggested using an emphasis of matter to describe additional procedures that the auditor may have performed.

In the section on "Other Reporting Responsibilities," the Task Force was asked to incorporate wording stating that other reporting responsibilities may arise from circumstances other than legal or regulatory requirements, for example, as a result of contractual obligations.

In the section on "The Auditor's Signature," it was agreed to explain that, in some jurisdictions, it may be advisable to specify the auditor's professional credentials along with the name of the auditor or the firm.

PROPOSED CONFORMING CHANGES

The IAASB discussed the proposed conforming changes to ISA 200, ISA 210, ISA 560 "Subsequent Events," ISA 580 "Management Representations," ISA 800, and proposed ISA 701 "Modifications to the Auditor's Report."

In addition to editorial comments, it was agreed that:

- Since ISA 200 applies to auditor's reports issued under both ISA 700 and ISA 800, a general discussion of what constitutes financial statements, along with examples, should be provided in ISA 200.
- ISA 560 should define the "date the financial statements are issued" as the date that they are made available to a third party.
- The proposed guidance in ISA 560 relating to a significant or unusual delay in the issuance of the financial statements, and the related need to consider obtaining an updated representation letter from management, should be deleted since the changes extend beyond conforming changes and introduce new concepts.
- Additional guidance should be added to ISA 701, indicating where modifications to the auditor's report should be placed in the report.
- The task force should consider whether additional language in the ISAs is necessary to clarify their relationship with the revised ISA 800.

The task force suggested that two complementary projects be considered by the IAASB, i.e. revision of ISA 800 and a new IAPS pertaining to the first time application of IFRSs. Mr Sylph noted that a project proposal to revise ISA 800 is being developed. Mr Mertin noted that the IAASB Planning Committee considered the topic of first time application of IFRSs, and concluded to defer development of related guidance until the actual audit problems that may arise are clear.

NEXT STEPS

It is envisaged that the proposed revised ISA 700 and conforming changes will be submitted for approval to be issued as an exposure draft at the October 2003 IAASB meeting.

4. Audit Risk

Mr Kellas provided a summary of the comments received on the proposed Audit Risk Standards, and described the preliminary reactions of the task force. He noted that most of the significant issues raised by respondents were anticipated and previously deliberated by the task force and the IAASB in developing the proposed ISAs.

Mr Kellas provided a summary of the significant issues raised with respect to the proposed guidance on internal control. He noted in particular issues with regard to the length of the guidance, the scope of the understanding required, references to automated and manual systems, the possibility of a wholly substantive approach, and the proposal to test internal controls at least every third year. On the latter point, the task force indicated that it intends to retain the requirement to test internal controls at least every third year, as no compelling arguments to the contrary were made. As regards the other issues, the task force believes it can improve on the length and clarity of the drafts with the assistance of the comments received.

Mr Kellas also noted that there had been some comments about the use of the COSO model, at least to the extent of referring in the draft ISAs to the COSO components. The task force believes that this level of COSO incorporation should not limit the use of other models provided that the auditor meets the objectives specified in the draft ISAs. An initial reaction to the recently-published Enterprise Risk Management development of COSO is that it does not serve to undermine what is in the ISA. However, some useful comments were received about developments in internal control which can be reflected in the final ISAs where appropriate.

Some members questioned the merits of the concerns expressed by respondents with regard to the required level of documentation, in particular in relation to small entity audits. Mr Kellas explained the purpose and benefits of the proposed requirements, and indicated that the task force would consider how to convey this message in the proposed ISAs.

Mr Kellas noted that some respondents expressed a concern about the extent of bold lettered paragraphs. He indicated that the task force is of the opinion that the proposed ISAs are constructed with an objective to drive changes in behavior. While some bold lettered sentences might be eliminated, for the most part they will be retained. Mr Kellas circulated for the information of the Board the bold lettered sentences from the draft ISA on risk assessment, and invited the Board to consider whether in fact it was reasonable to suggest that the amount of bold lettering was too extensive. The Board made no suggestions for eliminations.

NEXT STEPS

It is envisaged that the proposed final Audit Risk Standards would be presented to the IAASB in October 2003. Due to the extent of work involved in revising the proposed ISAs, Mr Kellas noted that it is likely to be necessary to address related conforming changes at a subsequent IAASB meeting.

5. Bold Lettering

Mr Gunn provided background to the project. He noted that IAASB Staff has further explored the consequences of moving to “equal authority” and has prepared a proposal for consideration by the IAASB, outlining ways in which the clarity of ISAs could be improved.

The key aspects of the IAASB Staff proposal were:

- Bold lettering should be retained, but the description of the basic principles and essential procedures should be re-characterized as “main principles”;
- Bold and ordinary lettering should have equal authority; and

- The auditor's obligations should be distinguished from explanatory guidance by way of appropriate descriptive language, and the prohibition on the use of the word "should" in the ordinary lettering should be removed.

In light of the present workload of the IAASB and the deliberations necessary to conclude on, and determine the application of, any revised approach to drafting IAASB standards, it was noted that the completion of the project is likely to occur only towards the end of 2005 or during 2006, rather than along the preliminary timeline outlined in the Staff proposal.

It was agreed that an IAASB task force, comprising Mertin, Kellas, Fogarty, Esdon and Sylph should revise the proposal for further consideration by IOSCO and the IAASB. The IAASB was requested to provide direction to the task force. While no definitive conclusions were reached, the IAASB noted the following:

- There is strong merit in establishing equal authority to bold and ordinary lettering in ISAs.
- Consideration should be given to retaining the concept of "essential procedures," but to possibly describe the procedures differently. Also, the proposed term "main principles" should be reconsidered, as it may indicate the existences of "secondary (subsidiary) principles," which is not the case.
- The present tense may be interpreted as being more definitive than the use of "should," and therefore may be problematic when interpreting and translating the ISAs.
- Allowing greater flexibility in the language used in the ordinary lettering would improve the clarity of ISAs. There were, however, differing views expressed on whether the word "should" should be used in the ordinary lettering. The matter was not concluded.
- The words "shall" and "must" implies "unconditional" and do not provide for professional judgment. As a result, these terms should not be used in the ISAs.
- Based on the fact that IAPs are issued by an authoritative body and included in the same handbook as the ISAs, IAPs might be deemed to have the same authority as the ISAs. As a result, clear and descriptive language should be used to express the intention of the guidance in IAPs. It was also suggested that it may be necessary for the IAASB to consider the issuance of separate guides on certain subject matters, as opposed to IAPs.
- Consideration should be given to using an external body of experts to comment on the understandability of a small number of existing ISAs.

It was questioned whether task forces working on current projects should follow the existing approach of drafting ISAs or the proposed approach. It was agreed that the existing approach should be followed until such time as a new approach has been agreed with all interested parties. However, project task forces should bear in mind the definitive nature of the present tense when drafting new or revised standards.

NEXT STEPS

It was agreed that the IAASB Staff and the task force should further deliberate the comments received from the IAASB, and submit a revised proposal for consideration at a future IAASB meeting.

6. Preface

Mr Gunn presented the proposed "Preface to International Standards on Quality Control, Auditing, Assurance and Related Services" for approval to be issued. It was noted that the IFAC

Board approved an Interim Terms of Reference for the IAASB at its July 2003 meeting, and that the proposed revised Preface is consistent with the provisions therein.

The IAASB re-debated its position on whether the revised Preface should require a professional accountant to document the justification for a departure from a basic principle or essential procedure where, in exceptional circumstances, it is judged necessary to achieve more effectively the objective of an engagement. The majority of IAASB members concluded that the proposed revised Preface should remain unchanged from the exposed version, and that such requirement should not be included in the revised Preface.

The IAASB also re-debated its position on the use of the phrase “relevant ISAs” and the application of ISAs to “material matters.” The majority of IAASB members were of the view that it is clear that a professional accountant has to apply professional judgment in the application of ISAs and that it is not appropriate to provide such qualifying language in the revised Preface. It was also noted that the Preface indicates that any limitation on the applicability of a specific ISA is made clear within that ISA.

The IAASB debated the issues associated with, and the practicality of, establishing an effective date for IAPSs. It was agreed that the Preface should state that the IAASB will set a date by which professional accountants should be aware of and consider a relevant IAPS.

In addition to editorial and structural comments, the IAASB also agreed that:

- The proposed description of the term of service of IAASB members should be aligned fully with the provisions of the IFAC Constitution, indicating that a member’s term may be extended if that member is appointed to serve as Chair.
- The description of IAASB’s Standards as containing basic principles and essential procedures should be retained until such time the IAASB concludes otherwise.
- The provision for the IAASB to vote on other papers by simple majority should be removed.
- The Preface should include the provision that the appointment of a proxy is to be disclosed and recorded in the minutes of an IAASB meeting.

Subject to the processing of editorial changes, the IAASB approved the revised Preface. There were four dissenting views, which were as follows:

- Mr McPhee disagreed with the content of paragraph 16. In his view, it is in the public interest to require professional accountants to document in the working papers the justification for a departure from a bold lettered requirement in an ISA. In addition, he considered the Preface to be inconsistent with ISA 230 “Documentation,” which requires the auditor to evidence that the audit was carried out in accordance with ISAs.
- Mr Simnett also disagreed with the contents of paragraph 16, in particular since the circumstances in which a departure could occur were characterized as “exceptional.” In his view, the Preface is the authoritative document to which readers of ISAs refer when considering and applying IAASB pronouncements, and the omission of a requirement for professional accountants to document a departure from a bold lettered requirement may send an inappropriate message to the public.
- Mr Plaistowe did not agree with the revised Preface for the same reasons expressed by Messrs McPhee and Simnett.
- Mr Kana did not agree with the revised Preface for the same reasons expressed by Messrs McPhee, Simnett and Plaistowe, and further indicated that, in his view, the wording of

paragraph 16, which stated that a professional accountant “should be prepared to justify the departure,” is open to interpretation.

7. Planning

Ms Esdon presented an exposure draft of the proposed revised ISA 300 “Planning the Audit” for a first read.

The IAASB considered the appropriateness of the proposal to include in the ISA matters that the auditor should consider prior to performing detailed planning activities, i.e. client acceptance and retention, independence and conflict of interest and establishing the terms of the engagement. Ms Esdon indicated that the task force believes that audit planning is two-fold: (1) Audit planning relates to developing and overall strategy to the audit; and (2) Audit planning relates to planning each audit procedure prior to the detailed performance of the procedure. The IAASB considered the proposal to rename “overall audit plan” as “overall audit strategy,” and to redefine “audit program” to encompass use wider than testing of accounts (e.g. to include risk assessment procedures) and to rename it as “audit plan.”

Ms Esdon indicated that, although submitted for a first read, the task force was of the opinion that the proposed revised ISA was ready for approval to be issued as an exposure draft. The late distribution of the papers was questioned. It was noted that the late distribution of the papers was due to a change in the agenda and not due to a delay on the part of the task force. It was agreed to consider this proposal subsequent to the review of the document.

The IAASB considered the proposed revised ISA 300 by paragraph. In addition to editorial and structural comments, the following were noted:

- The link between the proposed ISA and the proposed Audit Risk Standards was questioned. Concern was expressed about overlap with other ISAs. It was suggested that the proposed ISA be re-read with this in mind, and amendments processed where considered necessary.
- Paragraph 7, dealing with the relationship between audit planning and risk assessment procedures in the proposed Audit Risk Standards, was considered confusing, and consequently the IAASB agreed to delete this paragraph.
- Paragraph 8 should be redrafted to separately deal with the discussions with management and the discussions with those charged with governance. This paragraph should also include changes to strengthen the guidance related to the auditor not compromising the effectiveness of the audit by making audit procedures too predictable.
- Paragraph 9, dealing with the matters that the auditor considers prior to planning the audit, should be bold lettered and redrafted accordingly.
- The term “overall audit strategy” and the content of the overall audit strategy were debated. It was agreed to retain the term, but to expand paragraph 13 to clarify the content of the overall audit strategy.
- Paragraph 15: The concept of starting the planning of the audit at the completion of the previous period’s audit is not unique to small audits, and consideration should be given to moving this sentence to the beginning of the proposed revised ISA to reflect its applicability to all audits.
- Paragraph 16, providing guidance to auditors of small entities who also render accounting services to those entities, applies only in certain jurisdictions. The majority of the members were of the opinion that this paragraph should be deleted.

- Paragraphs 17 to 20: The difference between the “overall audit strategy,” “audit plan” and “audit program” was not clear to some members. After debate, the majority of members agreed to redraft the paragraphs to clarify the purpose and content of the audit plan and to delete the reference to audit program.
- The first sentence of paragraph 23, dealing with the direction and supervision of engagement team members and the review of their work should be bold lettered and the ordinary text should be expanded to refer to the proposed ISA 220 “Quality Control for Audit Engagements.”
- Paragraphs 28 and 29 should be combined, indicating that the form and extent of documentation may vary and that, in the case of small audits, a practical approach may not involve excessive documentation.
- Paragraph 30, fourth bullet: Determining the audit scope for entities with multi-locations, including arranging the involvement of group or other auditors, is not unique to initial engagements and, as a result, this bullet should be deleted.
- The context of paragraph 31 is not clear and, as a result, the paragraph should be deleted.

The task force brought back a revised draft for consideration and approval as an exposure draft. In addition to editorial comments, it was noted that some of the example procedures in the appendix repeat the guidance in the proposed Audit Risk Standards. Consequently, it was agreed that the appendix should focus on example procedures that are unique to planning, execution and coordination of the audit.

A member continued to express concern with regard to the interrelationship between the proposed ISA and the proposed Audit Risk Standards and other ISAs. It was questioned whether the focus on “planning” should be changed to “coordinating and managing the audit.” Recognizing the need to have a revised ISA on planning and its importance in relation to the proposed Audit Risk Standards, it was agreed that the proposed ISA should be issued as an exposure draft, but that the explanatory memorandum that will accompany the exposure draft should explain its purpose and objectives.

Subject to the above, the IAASB unanimously approved as an exposure draft. The comment deadline was set as November 15, 2003.

Ms Esdon thanked the task force and responsible IAASB Staff for their hard work in developing the proposed revised ISA. The Chair congratulated Ms Esdon on guiding the IAASB through approval of two exposure drafts in one meeting.

8. International Convergence

Ms Prinsloo presented the proposed “Policy Statement – International Convergence” for approval to be issued as an exposure draft.

Mr Ikegami indicated that he was in agreement with the future direction of the basic concepts but he could not support the proposed policy statement due to the difficulty of applying it as it is in his country. He was of the opinion that the definition of convergence was too narrow and that more flexibility for interpreting the definition of convergence should be allowed in light of the differences in the standard setting procedures, capital markets, corporate cultures including governance structures, characteristics of languages and so on, and that different approaches adopted by different countries should be allowed. Other IAASB members supported this view. In addition, the following were noted:

- The paper appears to be in the form of an international convergence strategy rather than a policy statement. Mr Sylph indicated that the purpose of the paper is to establish a framework that national standard setters, who seek international convergence, may adopt.
- International convergence could take on various forms, i.e. harmonization, implementation and adoption, and national standard setters could be at different stages of international convergence, e.g. some could start with harmonization and have adoption as their ultimate goal, while others may opt to adopt the ISAs. The paper should encourage national standard setters to develop a strategy to affect international convergence. In addition, the paper should provide for the different approaches and stages of international convergence.
- The paper should refer to IFAC's Statements of Membership Obligations, including the responsibility of Member Bodies to persuade national governments and standard setters to embark on international convergence.
- The paper should refer to the consultative relationship between the IAASB and national standard setters, the existence of the National Standard Setters Network and joint projects.
- Consideration should be given not to limit the paper to ISAs, but also to include IAPs and other IAASB pronouncements. In addition, national standard setters should be allowed to exclude ISAs not applicable in their jurisdictions.

NEXT STEPS

It was agreed that IAASB Staff should revise the proposed policy statement for future consideration by the IAASB.

9. Materiality

Mr Ward presented an exposure draft of the proposed ISA 320 "Materiality in the Identification and Evaluation of Misstatements" for a first read. The IAASB reviewed the proposed ISA 320 by paragraph and, debated the following significant matters:

MATERIALITY AT THE PLANNING STAGE

The majority of members were of the opinion that the task force's proposals with regard to the determination of materiality at the planning stage of an audit are not practicable. Mr Ward stated that the task force had considered the practicability of the proposals and that the practitioner members of the task force were of the opinion that the proposals could be applied on audits they are responsible for.

Generally, members were of the opinion that planning materiality should be determined primarily on a quantitative basis, with a single figure for materiality set at the overall financial statement level. This amount should be allocated for purposes of planning audit tests. Consideration should be given to prescribing a maximum level of planning materiality (possibly percentages of particular benchmarks) in order to introduce consistency between firms. A preference was shown for adopting a formulaic approach for purposes of allocating materiality.

Members agreed that there should be a qualitative evaluation of misstatements identified during the audit. Mr Ward pointed out that, in practice, auditors are likely to be held culpable if they determine, at the evaluation stage, that particular errors are material, but did not actually plan to detect such errors.

It was suggested that the link between the determination of planning materiality and the risk assessment be considered. Further, the risk assessment might identify areas where more audit

effort should be focused, but not necessarily a lower materiality. It was also questioned at what stage of the audit process planning materiality is determined.

CLASSIFICATION OF MISSTATEMENTS

Some IAASB members expressed concerns with regard to the proposed separate classification of “differences in judgment.” The following were noted:

- It should be clarified that the category relates to differences in judgment that is considered by the auditor to be a misstatement(s).
- Auditors might find it difficult to determine whether misstatements were factual or judgmental.
- It is not clear whether disagreements about the application of accounting principles are errors or differences in judgments.
- More guidance should be given as to how the auditor should consider these types of misstatement.

Approximately half of the IAASB members were in favor of retaining the separate classification.

MANAGEMENT REPRESENTATIONS

The task force is of the opinion that those responsible for approving the financial statements should be the persons from whom the auditor obtains a representation that uncorrected misstatements are not material. However, there is a lack of clarity as to who is responsible for approving and issuing the financial statements. Some members indicated that, in practice, it may be more difficult to obtain representations from those responsible for approving the financial statements than from management who is responsible for preparing the financial statements. The fact that the financial statements are approved by them could be taken as a form of representation to the auditor. Mr Ward indicated that the process of writing a letter is a more powerful tool for focusing the minds of responsible persons, and provides greater assurance that they have considered the specific issues.

OTHER

The following were noted:

- The task force should consider whether the guidance on users should be covered in ISA 200. The conforming changes proposed by the Auditor’s Report Task Force could incorporate this.
- Consideration should be given to distinguishing between a “true and fair override” provided for in the financial reporting framework and instances where the auditor’s override is not supported by the applicable financial reporting framework. This may also be addressed as part of the conforming changes to ISA 200 proposed by the Auditor’s Report Task Force.
- With regard to uncorrected misstatements from prior periods, guidance should be provided on how to evaluate which method (i.e. “iron curtain” or “roll over”) is most appropriate when the financial reporting framework provides a choice. Mr Ward indicated that that the method of accounting for prior year errors is a matter for the financial reporting framework to determine.
- The proposed revised ISA overlaps with other current projects. Care should be taken to ensure consistency in approaches and terminology. In addition, the impact of the task force’s proposals on the audit of group financial statements, where the allocation of materiality is of particular relevance, was questioned. In a separate session, Mr Grant indicated that the

responsibility for guidance on materiality for the audit of group financial statements lies with the Group Audits Task Force.

It was agreed that the letter from the task force to the Chair dealing with tolerable error, materiality of other information, and the terms “management” and “those charged with governance,” should be filed on the project files of the relevant ISAs and considered when those ISAs are to be revised.

NEXT STEPS

It is envisaged that the proposed revised ISA will be submitted for approval to be issued as an exposure draft at the December 2003 IAASB meeting. The IAASB may be requested to comment on a revised draft in advance of the December 2003 meeting.

10. Accounting Estimates

Mr Ashton presented an issues paper that would confirm the way forward with regard to a number of questions raised by the task force concerning the preliminary draft of a revised ISA 540 that was included within the agenda papers to provide a context for the discussion of the various issues. Mr Ashton referred to the original objectives of the project, and highlighted how these objectives were reflected in the preliminary draft. He noted that comments received from some members and national standard setters confirmed the importance of the project. He noted with respect to the preliminary draft of ISA 540 that a number of editorial and structural matters were still to be addressed by the task force.

The IAASB discussed the inter-relationship of the proposed revised ISA and ISA 545 “Auditing Fair Value Measurements and Disclosures.” The task force was directed to proceed on the basis it had been following. In providing this direction the Board recognized that there will be some inconsistency between the two ISAs and suggested that conforming changes to ISA 545 should be considered when it is conformed to the proposed Audit Risk Standards.

The IAASB discussed the proposed categorization of accounting estimates and the use of the categories to drive the nature and extent of audit procedures. General support for the idea was expressed by Board members, subject to suggested editorial and structural changes. The task force was asked to strengthen the guidance and related examples to help auditors to better understand and identify what would constitute an estimate with significant measurement uncertainty.

Members of the IAASB agreed with the task force’s recommendation that an accounting estimate, which gives rise to a risk of material misstatement because of significant measurement uncertainty, should be regarded as giving rise to a significant risk that requires special audit consideration. The task force was asked to improve the clarity of the guidance on the interrelationship between materiality, the size of the range of possible outcomes and significant measurement uncertainty.

The task force proposed that the requirements relating to risk assessment procedures should be more explicit, specifically requiring the auditor to have an understanding of all those accounting estimates that may give rise to risks of material misstatement of the financial statements. Board members who spoke on the issue did not support the need for the auditor to have a complete list of those accounting estimates that may give rise to a risk of material misstatement of the financial statements. Most Board members considered that a “top-down” approach to identifying estimates would be sufficient. The task force was encouraged to emphasize management’s responsibility for developing, and gathering the necessary support for, estimates with significant measurement uncertainty.

The IAASB considered whether the proposed revised ISA should require auditors to respond to accounting estimates that give rise to significant risks by testing the data used to develop the estimates and ensuring that the estimates have been properly determined from such data and management's assumptions. Those Board members that spoke to the issue considered that there should be such a requirement in circumstances where auditors have been unable to obtain sufficient appropriate audit evidence through the performance of other procedures (e.g. review of subsequent events or the development of an independent estimate). It was suggested that the proposed revised ISA should recognize that such testing could serve more than one purpose (i.e. dual purpose testing).

The task force proposed that auditors should be required to perform retrospective reviews of the outcome of estimates made in previous periods and to evaluate the sensitivity of accounting estimates. Members of the Board who spoke on the issue did not support mandating retrospective reviews, but did support the principle of "follow-up" on the outcome of prior year's estimates that give rise to significant risks. This principle should be supported by guidance that explains that the "follow-up" may take various forms, and that retrospective reviews and sensitivity analysis are powerful audit tools that could be used in this regard.

Members of the IAASB agreed that the development of an independent estimate should not be a mandatory procedure, but rather described as an option among other techniques (such as reviewing subsequent events). However, the auditor should encourage management to establish a reliable process, with related internal controls, for the development of an estimate that may give rise to a significant risk.

With regard to the guidance on the evaluation of the results of audit procedures, the task force was asked to consider the relevant IAASB comments on the proposed revised ISA 320. It was agreed that the Summary of Unadjusted Misstatements in Appendix 3 should be deleted.

The task force presented the proposed guidance on differences in judgment. Board members expressed the view that it may be difficult to use the mid-point of a range in determining a misstatement without infringing on the financial reporting framework. It was suggested that, if there is a difference in judgment, there is a need for the auditor to discuss and explore with management the reasons for the difference.

Members of the Board supported the inclusion of the concept of bias in the proposed revised ISA and to retain the proposal to communicate such bias to those charged with governance. The task force was requested to reconsider the definition of bias, and to consider changing the term which many board members considered to be pejorative. Some Board members suggested that a review of the way in which "neutrality" is described in accounting frameworks may produce a better term.

NEXT STEPS

The task force was asked to prepare a proposed revision to ISA 540 taking account of the comments of the IAASB for presentation at the December 2003 IAASB meeting.

11. Group Audits

Mr Kana provided a report back on the task force's activities since the May 2003 IAASB meeting, and highlighted issues for consideration by the IAASB.

DIVISION OF RESPONSIBILITY

The task force considered and confirmed the IAASB's recommendations made at the May 2003 meeting with regard to sole vs. division of responsibility. That is, the proposed revised ISA 600

“Considering the Work of Other Auditors” should provide for sole and division of responsibility. The introduction to the ISA should refer to both alternatives, indicating that sole responsibility is the preferred alternative. Guidance on division of responsibility should be provided in a separate section at the end of the proposed revised ISA. In addition, the criteria for division of responsibility should be limited to materiality only. Also, the scope of the proposed IAPS should be limited to sole responsibility.

The IAASB was advised that division of responsibility was discussed at the May 2003 CAG meeting, where the EC representative indicated a preference for the group auditor to take sole responsibility for the auditor’s report on the group financial statements. However, should the IAASB agree to retain division of responsibility as an alternative, the explanatory memorandum accompanying the exposure draft should provide the conceptual reason(s) for retaining it.

Although not originally planned for discussion, IOSCO also raised division of responsibility at a meeting of representatives of the IAASB and IOSCO held on June 30, 2003. IOSCO indicated that they considered sole vs. division of responsibility as an important matter to be resolved by the IAASB. If the ISA provides for both approaches, each should be sufficiently developed to provide guidance on how to carry out a high quality audit.

The task force proposed wording for a paragraph to be included in the introduction to the proposed revised ISA 600, dealing with sole vs. division of responsibility. Some IAASB members, who support the division of responsibility approach, did not agree with the proposed wording, which stated that sole responsibility is a more desirable approach. Those IAASB members argued that:

- An auditor’s report that indicates division of responsibility better reflects the facts of the matter, i.e. that another auditor has performed a portion of the audit.
- Do auditors who do not divide responsibility perform sufficient audit work to be able to take sole responsibility for the auditor’s report?
- It is not clear why one approach is considered better than the other, which is what is implied by the term “desirable.” Does the one approach render a better outcome (audit)?

It was suggested that national convergence with ISAs in some countries would be impacted if the proposed revised ISA covers only one approach or presents both approaches as of equal preference.

It was noted that the division of responsibility approach was reconsidered in Brazil four years ago and that it was decided to retain it only because it was acceptable under the existing ISA 600. It was also noted that the division of responsibility approach was deleted from the equivalent Canadian auditing standard in 1981. IAASB staff was asked to research whether the reason for this action is relevant in today’s environment.

In addition, the IAASB confirmed the recommendations made at the May 2003 meeting with regard to sole vs. division of responsibility. (See second paragraph above.)

APPROACH ADOPTED IN ISA 600

The task force recommended that the approach adopted in the proposed ISA should be changed. At present the existing ISA 600 “Using the Work of Another Auditor” (and the proposed revised ISA reviewed at the May 2003 IAASB meeting) requires that, when group financial statements include financial information of components that are audited by other auditors, the group auditor should determine how the work of the other auditor would affect the audit of the group financial statements. The task force believes that the decision as to whether to request an other auditor to

perform work on a component's financial information is made at a later stage in the audit process, i.e. after the group auditor has conducted a group risk assessment and determined the scope of work to be performed on the components' financial information.

STRUCTURE OF PROPOSED IAPS

The task force recommended that the proposed IAPS (reviewed at the May 2003 IAASB meeting) should be restructured and additional practical guidance provided. The IAPS should be a stand-alone document, which incorporates the guidance currently provided in the proposed revised ISA 600.

MATERIALITY

The task force considered that the revision of ISA 320 will impact any guidance on group materiality. As a result, the task force recommended the guidance on group materiality be limited to that included in the proposed IAPS reviewed at the May 2003 IAASB meeting.

Some members did not support the task force's proposal to limit the guidance on materiality to what was presented at the May 2003 meeting, i.e. until finalization of the proposed revised ISA 320. It was concluded that the other guidance included in the proposed IAPS will be useful and that the task force should continue to develop the proposed IAPS. Guidance on materiality should be based on the existing ISA 320 "Audit Materiality" and further developed at a later stage.

TERMINOLOGY

The use of the term "group auditor" as opposed to "principal auditor" was debated. The IAASB concluded that guidance on whether or not to accept appointment as group auditor should be sufficient to clarify that the group auditor has to audit a significant portion of the group financial statements.

NEXT STEPS

The task force indicated that it is aware of the fact that the finalization of the documents is of importance to the EU and IOSCO, and plans to meet the June 2004 deadline for ISAs to be effective January 1, 2005. The task force presented a revised timetable for the project. It is envisaged that the proposed revised ISA 600 and IAPS will be submitted for approval as exposure drafts at the October 2003 IAASB meeting. The IAASB may be requested to comment on revised drafts in advance of the October 2003 IAASB meeting.

12. INTOSAI

Mr Sylph presented the proposed INTOSAI/IAASB Memorandum of Understanding. He noted that IFAC and IAASB representatives met twice with INTOSAI representatives to progress the establishment of a project structure and co-operation process that will enable INTOSAI to use the ISAs as basis for its proposed Guidelines for Financial Audit, and that will provide the IAASB with experts in the field of public sector auditing that will assist with the incorporation of public sector perspectives in the body of ISAs.

The following was noted:

- Allowing INTOSAI representatives to participate in IAASB task forces, may lead to other bodies requesting representation on these task forces. In the past, such requests have been refused. Mr Mertin indicated that the requests were received from regulators, who are represented on CAG.

- The existing approaching to drafting public sector perspectives to ISAs is not satisfactory and an improved approach would be welcomed.
- The IFAC Public Sector Committee – currently responsible for commenting on the public sector perspectives to ISAs – represents a wider group than INTOSAI.
- The proposed memorandum reads as though INTOSAI may not be involved in all the IAASB task forces. Who will provide the public sector perspective to those ISAs developed by IAASB task forces that do not include INTOSAI representation?
- The proposed memorandum should be simplified and shortened.

Mr Sylph indicated that a proposed revised memorandum will be forwarded to INTOSAI representatives for consideration and approval at a meeting of their Council in September 2003. The proposed memorandum will be submitted for consideration at the October 2003 IAASB meeting.

13. Closing

Mr Mertin noted that, due to a very full agenda, the October 2003 IAASB meeting will start at 8:30 on Sunday morning and close at 1:00 pm on the following Friday.

Mr Mertin thanked the members, technical advisors and staff for their input. He thanked Ms Jones for the AICPA's kind hospitality. He then closed the meeting.

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