



**Approved Minutes of the Public Session of the Meeting of the  
INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD  
CONSULTATIVE ADVISORY GROUP (CAG)**

**Held on September 12–13, 2016**

**New York, USA**

**PRESENT**

**Members**

Matthew Waldron	Chairman
Myles Thompson	Accountancy Europe (AE)
Vânia Borgerth	Associação Brasileira de Instituições Financeiras de Desenvolvimento
Nicolaas van der Ende	Basel Committee on Banking Supervision (Basel Committee)
Mohini Singh	CFA Institute (CFA)
Juan-Maria Arteagoitia	European Commission (EC)
Erik Bradbury	Financial Executives Institutes (FEI)
John Kuyers	Information Systems Audit and Control Association (ISACA)
Paul Sobel	Institute of Internal Auditors (IIA)
Michael Stewart*	International Accounting Standards Board (IASB)
William Hines	International Actuarial Association (IAA)
Sanders Shaffer	International Association of Insurance Supervisors (IAIS)
David Rockwell	International Bar Association (IBA)
Anne Molyneux	International Corporate Governance Network (ICGN)
Atsushi Iinuma	International Organization of Securities Commissions (IOSCO)
Jim Dalkin	International Organization of Supreme Audit Institutions (INTOSAI)
Mauro Bini	International Valuation Standards Council (IVSC)
Kazuhiro Yoshii	Japan Securities Dealers Association (JSDA)
Gaylen Hansen	National Association of State Boards of Accountancy (NASBA)

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\* Views expressed by the IASB Representative represent his views and do not necessarily reflect the view of the IASB.

Lucy Elliott	Organisation for Economic Cooperation and Development (OECD)
Gayani Perera	Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB)
Irina Lopez	World Bank (WB)

**Observers**

Francis Nicholson	IIA
Dawn McGeachy-Colby	International Federation of Accountant (IFAC) Small and Medium Practices (SMP) Committee
Simon Bradbury	International Monetary Fund (IMF)
Barbara Vanich**	United States Public Company Accounting Oversight Board (PCAOB)
Henri Fortin	WB

**IAASB**

Prof. Arnold Schilder	IAASB Chairman
Chuck Landes	IAASB Deputy Chair
Fiona Campbell (Agenda Item D)	IAASB Member and Working Group (WG) Chair
Rich Sharko (Agenda Items E)	IAASB Member and Drafting Team Chair
Megan Zietsman (Agenda Item G)	IAASB Member and WG Chair
Karin French (Agenda Item G)	IAASB Member and WG Chair
James Gunn	Managing Director of Professional Standards
Kathleen Healy	IAASB Technical Director
Beverley Bahlmann	IAASB Deputy Director
Jasper van den Hout	IAASB Manager, Standards Development and Technical Projects
Bradley Williams (Agenda Item D)	IAASB Principal
Vijyata Kirpalani (Agenda Item D)	IAASB Manager, Standards Development and Technical Projects
Brett James (Agenda Item E)	IAASB Deputy Director
Natalie Klonaridis (Agenda Item G)	IAASB Principal
<b>Public Interest Oversight Board (PIOB)</b>	Karel van Hulle

**APOLOGIES**

**Members**

Noémi Robert	AE
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Kristian Koktvedgaard	BUSINESSEUROPE
Marie Lang	European Federation of Accountants and Auditors for SMEs (EFAA)
Dr. Obaid Saif Hamad Ali Al Zaabi	Gulf States Regulatory Authorities (GSRA)
Jean-Luc Michel	International Association of Financial Executives Institutes – Europe, Middle East, and Africa Region (IAFEI-EMEA)
Nigel James	IOSCO
Huseyin Yurdakul	IOSCO
Jaseem Ahmed	Islamic Financial Services Board (IFSB)
Yospeh Asmelash	United Nations Conference on Trade & Development (UNCTAD)
Wei Meng	World Federation of Exchanges (WFE)
<b>Observers</b>	
Norio Igarashi	Japanese Financial Services Agency (JFSA)

**September 12, 2016<sup>1</sup>**

**Welcome and Approval of Minutes of Previous Meetings (Item C)**

To *APPROVE* the minutes of the March 2016 CAG public session.

OPENING REMARKS

Mr. Waldron welcomed the Representatives, including new Representatives Mr. Sobel (IIA) and Mr. Fortin (WB). He also noted Ms. Vanich (PCAOB) would be attending in place of Mr. Baumann this meeting.

Mr. Waldron also welcomed Mr. van Hulle from the PIOB as well as the IAASB Chairman and Deputy Chair, the IAASB Task Forces and WG Chairs, and Staff, as well as the observers.

MINUTES OF THE PREVIOUS MEETING

The minutes of the March 2016 meeting were approved as presented.

**ISA 315 (Revised) (Item D)<sup>2</sup>**

To *UPDATE* Representatives and Observers on the progress of the ISA 315 (Revised) project since the March 2016 IAASB CAG meeting and to *OBTAIN* Representatives' and Observers' views on the project proposal for revisions to ISA 315 (Revised) (**Agenda Item D.1**) and Working Group recommendations (**Agenda Item D.2**).

Ms. Campbell provided information on the background to the IAASB's project to revise ISA 315 (Revised) and summarized the work of the ISA 315 (Revised) Working Group (the ISA 315 (Revised) WG) since the March 2016 IAASB CAG meeting, including the outreach that has been conducted. Ms. Campbell drew Representatives and Observers' attention to **Agenda Item D.1**, the draft project proposal to revise ISA 315 (Revised), which is to be discussed with and considered for approval by the IAASB at its September 2016 meeting. Ms. Campbell noted that the major issues to be addressed outlined in the project proposal have not substantially changed from the issues discussed with the IAASB CAG at its March 2016 meeting. Ms. Campbell provided an overview of the proposed project timeline, noting the planned approval of an exposure draft by the IAASB at its March 2018 meeting and approval of a final standard at its March 2019 meeting. The Representatives and Observers were supportive of **Agenda Item D.1** and provided the following comments:

- Mr. linuma noted that, with the developments in technology, and particularly the widespread use of cloud computing, it was important to consider whether ISA 315 (Revised) sufficiently addressed the auditor's consideration of technology in gaining the required understanding of the entity's information system. Mr. linuma added that, in his view, the requirements in ISA 315 (Revised) are sound; however, the standard would benefit from simplification in language where possible and the addition

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<sup>1</sup> The minutes present the discussions in the order that they were taken. This may not be the same as that indicated on the agenda.

<sup>2</sup> ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

of diagrams to assist auditors to better understand the intention of the standard. Ms. Campbell noted that the project includes plans for revisions to ISA 315 (Revised) to integrate the consideration of the impact of technology on the auditor's risk assessment throughout the standard, as well as possible restructuring of the standard to address concerns regarding ease of application.

- Mr. van der Ende stated that he believed the scope of the project should also consider the possibility for revisions to ISA 260 (Revised).<sup>3</sup> Mr. van der Ende explained that his view is based on a requirement in the Netherlands for auditors of financial institutions to communicate with those charged with governance when the auditor's audit approach does not rely on tests of controls, and explain the reasons for that approach. Ms. Campbell noted that such reporting might be viewed as related to the auditor's response to the effect of the auditor's obtaining an understanding of internal control and therefore possibly be outside of the scope of the project. However, she noted that, depending on the revisions to ISA 315 (Revised), there may be a need for consequential amendments to other ISAs. Ms. Healy added that, as part of the IAASB's auditor reporting project, revisions were made to the requirement in ISA 260 (Revised) for the auditor to communicate an overview of the planned scope and timing of the audit, to require the auditor to communicate with those charged with governance regarding the significant risks identified by the auditor. Application material associated with this requirement in paragraph A13 of ISA 260 (Revised) that explains that the auditor may communicate the auditor's approach to internal control relevant to the audit may be worth further consideration by the ISA 315 (Revised) WG, including whether to incorporate this more directly within this requirement.
- Messrs. Bini and Yoshii suggested that the project proposal clarify, or state that the project will explore, whether the auditor is required to obtain an understanding of the entity's business model and clarify how the auditor may respond to risks arising therefrom.
- Mr. Dalkin noted that there has been a continued focus on fiscal sustainability of governments and, accordingly, ISA 315 (Revised) should address this topic within the sections of the standard that address considerations for audits of public sector entities.

Ms. Campbell provided a summary of the issues and recommendations detailed in **Agenda Item D.2**, noting that the same issues and ISA 315 (Revised) WG recommendations were to be discussed at the following week's IAASB meeting, and that the IAASB had not yet had an opportunity to provide input to the ISA 315 (Revised) WG's recommendations. Representatives and Observers provided the ISA 315 (Revised) WG with input on the matters as summarized below.

#### INTERNAL CONTROL RELEVANT TO THE AUDIT

Representatives and Observers commented as follows:

- Mmes. Elliott and McGeachy, and Messrs. Fortin and Hansen were in agreement that obtaining an understanding of internal control informs the auditor's assessment of inherent risk, as well as the auditor assessment of control risk (including informing the auditor regarding whether a controls-reliant audit approach might be taken). They also supported efforts to clarify the purpose of the auditor obtaining an understanding of internal control. Ms. Elliott further noted that ISA 315 (Revised) would need to be made clear which parts of the auditor's understanding of the components of internal control inform inherent risk, as well as being clear as to what is meant by "relevant to the audit", as

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<sup>3</sup> ISA 260 (Revised), *Communication with Those Charged with Governance*

in her view a high-level understanding of internal control is needed in all audits.

- Ms. Vanich noted the auditor is required to understand internal control sufficient to assess risks of material misstatement and plan the audit. As such, she was unsure whether the requirement in ISA 315 (Revised) lends itself to being able to obtain less understanding or more understanding. Understanding of internal control is an area of judgment for the auditor and should be scalable in itself, as a less complex entity will have less to internal controls about which an understanding would need to be obtained. Ms. Vanich also noted that the ISA 315 (Revised) WG should be careful not to imply that there may be instances where auditors may not need to understand some of the components of internal control, as this may send the wrong message to auditors of smaller entities who may not be doing enough in this area currently.
- Ms. McGeachy commented that, in audits of small- and medium-sized entities (SMEs), the assessments of inherent risk and control risk are often performed on a combined basis due to the challenges of distinguishing between inherent risk and control risk in an SME audit. Mr. Fortin noted that the ISA 315 (Revised) WG should be careful of blurring the lines between inherent risk and control risk, as these are concepts that have been in place for a long time and are well-understood. Ms. Campbell responded that it is not the ISA 315 (Revised) WG's intention to revise the definition of inherent risk, but the ISA 315 (Revised) WG does need to make sure that the definition is appropriate after clarifying the purpose of obtaining an understanding of internal control.
- Ms. McGeachy suggested that the effect of a dominant owner manager should be recognized in ISA 315 (Revised), and the ability for this arrangement to, for example, potentially increase inherent risk and control risk, but also potentially decrease inherent risk and control risk. Ms. McGeachy also noted that all businesses have some level of controls covering various aspects of the business, but the controls may not be adequate for audit purposes in some circumstances, for example in micro businesses.
- Mr. Hanson asked whether the basis for the components of internal control in ISA 315 (Revised) would be based on the five components in COSO's<sup>4</sup> Internal Control-Integrated Framework (2013) (COSO Framework). Mr. Dalkin noted the COSO Framework is a universally known framework. Another framework relevant in audits of governmental entities is the US Government Accountability Office's Standards for Internal Control in the Federal Government, which states that all five components of internal control need to be operating effectively for effective internal control. Mr. Dalkin was of the view that all five components of internal control are relevant in every audit. Ms. Campbell noted that the linkage to the revised COSO Framework had not been fully discussed by the ISA 315 (Revised) WG yet, but would be a matter to be discussed with the IAASB as the project progresses.
- Mr. van der Ende added that, while he supports the ISA 315 (Revised) WG's exploration of scalability of ISA 315 (Revised), the ISA 315 (Revised) WG should consider the proposed revisions to ISA 315 (Revised) in the context of the requirements in ISA 210<sup>5</sup> regarding the preconditions for an audit (in other words, there is a minimum level of internal control that needs to be present in order for the preconditions for an audit to be met).
- On whether all five components of internal control are always relevant to all audits or whether only

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<sup>4</sup> Committee of Sponsoring Organizations of the Treadway Commission

<sup>5</sup> ISA 210, Agreeing the Terms of Audit Engagements

some of the components may be relevant to the audit in some circumstances, Representatives and Observers commented as follows:

- While agreeing that the entity’s control environment is relevant in every audit, Ms. Elliott questioned whether the information system component is relevant in every audit, as it might still be possible to audit around the information system in some circumstances. Mr. Sobel agreed, noting that in the vast majority of cases the information system component would be relevant to the audit, but there would be occasions where it may be more efficient for the auditor to audit around the information system. Mr. Stewart suggested that the ISA 315 (Revised) WG consider clarifying in ISA 315 (Revised) that the information system itself could be a source of material misstatement, and is, therefore, relevant to the audit. Ms. Campbell summarized the comments on the scalability of the ISA 315 (Revised) WG's proposals by noting that the views of some Representatives and Observers indicated the importance of flexibility of approaches so that the auditor can audit around the information system when appropriate.
- Ms. McGeachy noted that, in her view, control activities are relevant to the audit only if they relate to a significant risk or to an area of the audit where substantive procedures alone do not provide sufficient appropriate audit evidence. Monitoring of controls may not be relevant to the audit in all circumstances, and in those instances the auditor would not need to obtain an understanding of the monitoring of controls. Ms. McGeachy added that an additional challenge for auditors of SMEs are the documentation requirements to evidence the understanding of internal control obtained by the auditor.
- Mr. Fortin highlighted the role that internal audit, if present, can play in the auditor’s risk assessment, and suggested this might be made clearer in the revised standard, particularly as it relates to the auditor’s understanding of the information system.
- Mr. Sobel noted that, if an entity does not have a risk assessment process, this in itself tells the auditor something about the control environment.

#### SIGNIFICANT RISK

Representatives and Observers commented as follows:

- Messrs. Dalkin, Nicholson, Rockwell, Thompson and van der Ende agreed with the ISA 315 (Revised) WG’s view to retain the concept of significant risk within the ISAs, regardless of whether the standard continues to refer to the highest risks of material misstatement as “significant risks” or not. However, Mr. Rockwell stated that having the concept of significant risk does not mean that those risks that are not significant risks are automatically low risk. Mr. Nicholson agreed with the factors to consider when evaluating the relative likelihood and magnitude of the related risk and that another aspect to consider might be the auditor’s relative confidence in their knowledge about the risk (i.e., the less confident the auditor is about a certain aspect, the more information the auditor would need to be able to design the audit procedures to be performed).
- Mr. van der Ende inquired whether the IAASB would look further at whether significant risks should continue to be a subset of inherent risks, or whether control risk should be factored into the determination of significant risks. Ms. Campbell noted that the ISA 315 (Revised) WG was seeking further input from the IAASB on this matter.
- Mr. Rockwell agreed with the ISA 315 (Revised) WG's observation from the outreach that the definition of significant risk could be seen to be circular and that this should be revisited as part of the

ISA 315 (Revised) project.

- Ms. Elliott and Messrs. Fortin and van der Ende were supportive of the ISA 315 (Revised) WG's thinking related to the application of filters to the highest inherent risks to assist auditors with the identification of significant risks. On the proposal to apply filters to the highest inherent risks, Mr. Rockwell noted that the two filters described in **Agenda Item D.2** should be applied to the same population of high inherent risks, and not applied in a two-step process. Ms. Campbell clarified that was the intention of the ISA 315 (Revised) WG. Ms. Elliott noted that it would be useful to have the filter regarding items that are difficult for management to control, as it would help auditors focus on the challenging and interrelated risks. On the filter related to failure to control, Ms. Elliot requested the ISA 315 (Revised) WG to clarify whether this was whether the entity did not attempt to control, or whether there was an attempt to control but that attempt failed.
- Ms. Vanich and Mr. Hansen suggested the ISA 315 (Revised) WG explore further how the application of the proposed filters would work with fraud risks, particularly that fraud risk is presumed under the ISAs to be a significant risk, and that it would likely be helpful for the ISA 315 (Revised) WG to think about what specifically the auditor would need to do to address the significant risk (i.e., think about what the auditor would need to do differently in assessing how to clarify the identification of significant risks).
- Ms. Vanich noted that the auditor's identification of significant risks could be enhanced by explicitly adding disaggregation to the auditor's identification of the risks of material misstatement. Having a more granular understanding of the risks of material misstatement at a disaggregated level would drive a more tailored response from the auditor. Ms. Campbell noted that this was an area on which the ISA 315 (Revised) WG has had some preliminary discussions, although the challenge is likely to be in defining what an appropriate level of disaggregation may be.

SPECTRUM OF RISK

Representatives and Observers commented as follows:

- Messrs. Thompson and van der Ende and Ms. Elliott were supportive of the ISA 315 (Revised) WG exploring explicit introduction of the concept of a spectrum of risk into the ISAs, specifically within ISA 315 (Revised). Mmes. Elliot and Vanich cautioned against introducing more complexity in the standard, as a spectrum of risk has the potential to do that (especially if a certain number of categories of risk were introduced into ISA 315 (Revised)). Mr. Linuma asked if there was a specific number of risk categories the ISA 315 (Revised) WG had in mind. Ms. Campbell responded that the ISA 315 (Revised) WG is not intending to specify a certain number of risk categories, but rather to emphasize the concept of a range of risks.
- Ms. Vanich suggested that further exploration of what is occurring in practice be considered by the ISA 315 (Revised) WG. Ms. Vanich also noted that lower risk items could aggregate to something that may be material.
- Messrs. Thompson and van der Ende asked how the proposals in the project to revise ISA 540<sup>6</sup> regarding identification of risks that are considered lower fit into the project to revise ISA 315 (Revised). Ms. Campbell explained the coordination process that is in place between the

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<sup>6</sup> ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*



ISA 540 Task Force and the ISA 315 (Revised) WG. She noted that the ISA 315 (Revised) WG's proposal to further explore a spectrum of risks in ISA 315 (Revised) may remove the need for similar material to be repeated in other standards. She added that, if something more specific is needed in the other ISAs, such as ISA 540, then clarification of the application of the requirements in ISA 315 (Revised) could be added to those standards.

#### PIOB OBSERVER'S REMARKS

Mr. van Hulle added a concern regarding the audits of financial institutions and the expectation that certain aspects of internal control should exist at these types of entities. As an example, he was of the view that for a financial institution the auditor should always have an expectation that the entity has a risk management function and, if it does not, then the auditor needs to highlight that, for example, with those charged with governance. He further noted that he was concerned about using the concept of significant risk when dealing with financial institutions, as a risk that may not appear to be significant could lead to an audit failure because of the nature of the business.

#### WAY FORWARD

Ms. Campbell thanked the Representatives and Observers for their feedback and noted that ISA 315 (Revised) WG would take these comments in account, together with the IAASB's comments from its September 2016 meeting in moving forward on the topic.

#### **ISA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures (Agenda Item E)**

To *REPORT BACK* on the March 2016 meeting; and

To *OBTAIN* Representatives' and Observers' views on issues identified related to ISA 540 (Exposure Draft planned for December 2016)

Mr. Sharko introduced the topic by explaining the Task Force's activities since the March 2016 CAG meeting. He noted that the Task Force continued its outreach efforts and that the Task Force had meetings with, among others, the IAIS, the International Forum of Independent Audit Regulators (IFIAR), the Basel Committee and the World Bank. Mr. Sharko then highlighted the anticipated timeline and the key areas in the issues paper as presented in **Agenda Item E.1** and noted that the Task Force acknowledged that a number of areas required further work, including in relation to external data sources and professional skepticism. He then asked the Representatives and Observer's comments on the Task Force's proposals.

In terms of the broader project goals and timeline, the Representatives and Observers commented as follows:

- Mr. Waldron asked when ISA 540 (Revised) would come into effect if the standard is approved by the IAASB in December 2017. Mr. Sharko explained that after approval by the IAASB, the PIOB has to consider whether due process was followed in the development of the standard and that, while the IAASB has not yet discussed the possible dates, the usual implementation period for standards is 18-24 months from approval of the final standard. He noted that the standard would therefore be effective for 2019 year-end audits.
- Ms. Vanich was of the view that the proposed timeline is challenging and that audit firms may need more time to fully understand the implications of the revised standard, both with regard to considering

the exposure draft as well as implementing the final standard. She also questioned whether firms would be required to change their risk assessment twice in a short period of time given the activities of the ISA 315 (Revised) WG.

- Mr. van der Ende supported the timetable and the ambition of the Task Force to meet it. He noted that it would be helpful to have an exposure draft out in 2017 as that would give banks and auditors an indication of the Task Force's direction. He also welcomed the GPPC's publication on the implementation of IFRS 9<sup>7</sup> impairment requirements by banks. Mr. van der Ende noted Ms. Vanich's concerns but added that delaying the implementation would be counter to the view of banking regulators and others who believe a revised ISA 540 is necessary in the near term.
- Ms. Molyneaux noted it was important for the IAASB to be clearly communicating about the nature of the project and how it will achieve its intended objectives. While the prime users of ISA 540 will be the auditors, she noted the issuance of the proposals may result in CFOs, those charged with governance and others needing further guidance on implementation.

#### SCALABILITY

The Representatives and Observers commented as follows:

- Ms. McGeachy, speaking in her own capacity, supported the Task Force's proposals in paragraph 12A as she believed that the Task Force's approach would help differentiate the risks arising from accounting estimates more clearly. She noted that non-authoritative material such as the flowchart handed out in the meeting was particularly helpful to SMPs.
- Mr. Thompson noted that it would be useful to include application material that explains that paragraph 12A, which requires that accounting estimates with "lower" risk of material misstatement should be addressed by ISA 330<sup>8</sup> and that no specific work effort response is required by ISA 540. He also suggested clarifying that the concept of risks of material misstatement that are assessed as "lower risk" excludes accounting estimates that give rise to a significant risk. Mr. Iinuma added that it would be useful to include a reference in paragraph 12A to the paragraphs in ISA 330 that are specifically relevant, as a general reference to the standard could be confusing.

#### DEFINITIONS

The Representatives and Observers commented as follows:

- Mr. Hines noted that actuaries also had difficulties in defining the difference between data and assumptions and therefore used the term "input". He suggested that the Task Force could do the same given that the procedures an auditor would perform over data and assumptions would be similar. Mr. Sharko noted that, given the difficulty to articulate the difference between data and assumptions, the Task Force decided to explain these terms in the application material. He added that the term "input" has been used in the past, but the Task Force did not support its continued confusion due to the level of specificity needed for the work effort.
- Mr. Rockwell noted his view that some definitions are fundamental to the scope and application of the ISA, such as the definitions of an accounting estimate and estimation uncertainty, and that they

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<sup>7</sup> International Financial Reporting Standard (IFRS) 9, *Financial Instruments*

<sup>8</sup> ISA 330, *The Auditor's Responses to Assessed Risks*

should be fully defined without needing application material that could be interpreted as a further definition. He therefore questioned whether the application material to these definitions should be included in the definition section instead of the application material to that section. Mr. B. James explained that the application material provides guidance how the definition should be interpreted and applied in practice. Prof. Schilder added that the way application material is written makes it clear that it is not a definition. Mr. Sharko noted that the use of the header “Definitions” in the application material was a clarity convention but the Task Force will consider alternative approaches to ensure that the balance and placement of the material is appropriate.

- Mr. Stewart questioned the authority of application material in the ISAs, as for IFRS standards the application guidance is also part of the requirements. Ms. Healy explained that the application material provides guidance on how the requirements should be applied in practice but that the application material is not intended to extend the requirements. Mr. Landes added that the structure currently applied in the ISAs (Scope, Objectives, Definitions, Requirements, Application Material) has been used since the clarity project, so auditors are familiar with the current structure, and are aware of their obligation to have an understanding of the entire text of the ISAs, including the application material.

#### RISK ASSESSMENT

The Representatives and Observers commented as follows:

- Ms. Vanich noted that paragraph 8A seems to repeat ISA 315 (Revised) instead of building on it. Mr. Sharko responded by noting that repeating this subsection of ISA 315 (Revised) specifically for accounting estimates helps to direct the auditor in performing appropriate risk assessment procedures related to the entity’s internal control and also highlighted that the majority of the Task Force supported the lay out of this paragraph. Mr. van der Ende noted that the Basel Committee supported the addition of paragraph 8A and that the risk assessment is moving in the right direction.
- Mr. Hines questioned what the difference is between the first sentence of paragraph 8(aA) and 8(a). With respect to the application material related to paragraph 8A, Mr. Hines questioned whether all factors listed in paragraph A38H should be taken into account or that they are mutually exclusive as suggested by the ‘or’ at the end of third bullet. He also questioned whether the third bullet of A38Q should make it clear that all changes to the model should be taken into account and not just changes in market conditions. Ms. McGeachy added that application material that discusses the consideration to smaller entities could be enhanced and suggested further consideration be given to paragraph A49G. Mr. Sharko explained that paragraph 8(a) requires the auditor to obtain an understanding of the financial reporting framework while paragraph 8(aA) brings in concepts other than the financial reporting framework, such as the complexity in making the accounting estimate, estimation uncertainty and judgment. Mr. Sharko also noted that the Task Force will consider how the application material related to paragraph 8A can be enhanced.
- Mr. Thompson agreed with the addition of the first sentence in paragraph 9, which requires the auditor to determine whether reviewing previous accounting estimates will assist in identifying and assessing the risks of material misstatement in the current period, but noted that the second sentence in that paragraph should be adjusted, as it still suggest that a retrospective review should be performed in all cases. Because of the changes made to paragraph 9, Ms. Vanich questioned if amendments will

be made to the paragraphs in ISA 240<sup>9</sup> that also discuss the retrospective review of prior accounting estimates.

- Ms. Vanich supported the addition of paragraph 9A, which requires the auditor to assess whether an expert is needed in the risk assessment and noted that in the US the use of experts in the risk assessment was very successful when obtaining an understanding of complex accounting estimates.
- Mr. van der Ende noted that the Basel Committee supported the linkage between the factors that need to be considered in the identification and assessment of the risk of material misstatement, as included in paragraph 10, and the work effort, as included in paragraph 13. With respect to the application material to paragraph 10, he noted that it currently mainly addresses inherent risk but not control risk, while paragraph 13 does include references to control risk. Mr. Sharko agreed that the linkage between paragraph 10 and 13 should be clear and noted the linkage with the work of the ISA 315 (Revised) WG as well.
- Mr. Iinuma supported paragraphs 10 and 10A and asked the Task to include in the application material to paragraph 10 an example that includes long- and short-term interest curves.

#### WORK EFFORT

The Representatives and Observers commented as follows:

- Ms. Borgerth supported the Task Force's proposed approach in paragraph 13, noting that further prescription would make the list of procedures look like a checklist that must be followed. Mr. van der Ende noted that financial regulators usually preferred more prescriptive requirements as such requirements aided regulators in overseeing the work of auditors. However, in his view, more prescriptive requirements may not be needed if the principle is clear enough, such as the principle that the auditor needs to obtain more evidence until sufficient appropriate evidence has been obtained. Messrs. Dalkin and Hansen and Ms. Singh did not support further prescription of procedures. Mr. Dalkin noted that paragraph 13 could be seen as an audit program, which may reduce the auditor's flexibility and judgment, and that the Task Force should investigate why the IAASB has traditionally not included such detailed procedures in the ISAs. Mr. Fortin suggested that the detailed procedures in paragraph 13 should be retained in the requirement but that the columns indicating which procedure applies to which factor could be moved to the application material to avoid the perception of a checklist.
- Mr. van der Ende noted that, while he supports the direction of paragraph 13, he believed that the linkage with the identification of the risks of material misstatement needs to be enhanced. He also questioned how different the revised work effort would be compared to the extant work effort.
- Mr. van der Ende emphasized that it is management's responsibility to make the accounting estimates and that when discussing the audit implications in the Basel Committee two relevant elements were discussed. He noted that the auditor needs to consider whether (a) the translation from management's broader views into the operational data and assumptions is adequate; and (b) the organization is adhering to the management's broader views. He highlighted that the auditor needs to consider whether these two elements lead to reliable numbers in the financial statements. Mr. van der Ende then noted that these audit implications highlight the relationship between the

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<sup>9</sup> ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

project on ISA 540 and ISA 315 (Revised) and that some elements should be taken into account by the ISA 315 (Revised) WG. Given the different timeline of the projects he would be in favor of including some material in ISA 540 that could, at a later stage, be moved to ISA 315 (Revised).

- Mr. van der Ende noted that auditing management overlays is often difficult for auditors and he asked the Task Force to address this in ISA 540 (Revised). Mr. Sharko noted that the Task Force had noted this point in the outreach previously but that it is largely specific to financial institutions and is difficult for those without experience in dealing with management overlays to understand. He noted that the Task Force will address this point further.
- Ms. Vanich noted that the procedures with respect to models seem mainly focused on the inputs and not the model itself. The PCAOB's outreach indicated that testing models could increase audit costs especially for models obtained from external sources. Mr. Sharko explained that outreach indicated that it will be hard to audit around a model and not the model itself. He noted that experts informed the Task Force how they get comfortable with certain models and that this is often through testing the model itself or by developing your own model. Mr. van Hulle noted that ISA 540 (Revised) should address the audit of complex models given the importance of the topic and that the PIOB will not approve a standard that shies away from difficult issues. He noted that complex models are not only used for IFRS 9 but also extensively in the accounting for insurance contracts.
- Mr. Hansen questioned whether the issue of testing a model from an external source has been addressed by the Task Force and noted his view that this will be a very important component of the revised standards. Mr. Sharko noted that the Task Force had some preliminary discussions on this topic and that the Task Force had discussed the matter with the IAASB at its July 2016 teleconference. Mr. Linuma questioned whether there should be stricter auditing requirements for management's own model instead of an external model. Mr. Sharko noted that some Task Force members and IAASB members believe that there should be no difference in the work effort over internally or externally developed models. Mr. Hines added that actuaries use a lot of models and that actuaries are expected to understand how the model works irrespective whether they are internally or externally developed.
- Mr. Hines questioned what the difference is between the stand back requirement in ISA 540 (Revised) and the stand back requirement in ISA 330.<sup>10</sup> Mr. Sharko explained that the proposed requirement in ISA 540 (Revised) is more granular and that this requirement would require the auditor to take a step back and assess whether sufficient and appropriate audit evidence has been obtained regarding the riskier accounting estimates. He noted that the stand back requirement is a necessary component of the work effort that draws the various risks of material misstatement together to ensure that the overall assessment of the accounting estimate is appropriate.
- Ms. Vanich noted that the work effort required in accordance with extant ISA 540 is not broken, but that there are opportunities for the work effort to be enhanced. In that respect she questioned if auditor would get to the right risk assessment in the absence of a revised ISA 315, as it is unclear where the ISA 315 (Revised) project will lead.
- With respect to the procedures in paragraph 13, Ms. Vanich noted that it would be useful if the Task Force takes into account how the more granular work effort would work for firms that perform audits

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<sup>10</sup> See paragraphs 25–27 of ISA 330.

under both the ISAs and the PCAOB standards. She also noted that some of the procedures in paragraph 13 look similar and that it would be difficult in practice to differentiate them.

#### SIGNIFICANT RISKS

The Representatives and Observers commented as follows:

- Mr. Thompson noted that changing the nature of the procedures performed on significant risks, not just the extent of procedures, was important to some regulators. Mr. Sharko noted that relocating some procedures from being applicable only to accounting estimates that are assessed as significant risks to being applicable to all risks meant that there may be less of a need to have requirements specific to significant risks.

#### EXTERNAL DATA SOURCES

The Representatives and Observers commented as follows:

- Mr. Hansen asked if it was possible for an auditor to use multiple external data sources to test the validity of one in particular. He noted that obtaining audit evidence about the internal workings of some external sources could be difficult, but looking at the differentiation with other external sources may provide a solution. Mr. Sharko noted that this approach had been raised at the IAASB but it was noted that it may not necessarily be helpful as there may not be a variety of alternative sources, including when sources that purport to be different are actually based on the same data, assumptions or methods. Mr. Sharko also highlighted that the Task Force believed that an auditor who could not obtain access to the internal workings of the model may have a scope limitation if the auditor is not able to perform a valuation. He added that the Task Force will consider this further.

#### PROFESSIONAL SKEPTICISM

The Representatives and Observers commented as follows:

- Mr. Linuma highlighted that the IAASB should be emphasizing the need for application of professional skepticism through the requirements, not the application material. He also noted that a regulator had noted that there should be additional required audit procedures when indicators of management bias are present, and that extant paragraph 21 did not require procedures to be performed if such indicators are present (unlike paragraph 32(b) of ISA 240). Mr. Sharko noted that the Task Force and the IAASB were still debating whether management bias should, in general, be addressed elsewhere in the ISAs (e.g., by giving it more prominence in ISA 315 (Revised)), as it may have broader application.

#### COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

The Representatives and Observers commented as follows:

- Mr. van der Ende supported the new paragraph addressing communication with those charged with governance but noted that it could further address considerations related to professional skepticism. He also supported the new application material addressing communications that may take place with regulators and noted that such communications can inform the regulator's assessment of the quality of the audit.

#### MANAGEMENT BIAS

The Representatives and Observers commented as follows:

- Ms. Vanich noted that the Task Force should consider how indicators of management bias interact with the auditor's assessment of fraud risk.

#### IMPLICATIONS FOR DISCLOSURES REGARDING ACCOUNTING ESTIMATES

The Representatives and Observers commented as follows:

- Mr. Hines noted that addressing disclosures will be a significant component of the auditor's effort. He added that companies have to track some information that is not recorded in the general and subsidiary ledgers, such as keeping tracking a portfolio of financial instruments that may not need to be recorded in the current period, but that may need to be recorded in a future period if circumstances change. Mr. Sharko agreed, and noted that the Task Force had intended to capture this aspect in paragraph A11B of draft proposed ISA 540 (Revised).

#### INSURANCE CONTRACTS

The Representatives and Observers commented as follows:

- Mr. Dalkin did not support addressing insurance contracts specifically in ISA 540, as doing so would make the ISA too long if that approach were taken for other accounting issues. Mr. Sharko agreed and noted that the Task Force has tried to put in examples to show how ISA 540 can be applied to different industries. Mr. Fortin questioned whether other IAASB projects will also use the same approach. Mr. Fortin also asked what whether IAPS 1004<sup>11</sup> was still being used. Mr. Sharko noted that it made sense for ISA 540 to include banking and insurance examples because of the subject matter of ISA 540, but it is not clear if the same approach would be warranted for other standards. He also noted that IAPS 1004 had been withdrawn in 2011, and that decision was part of the rationale for the banking focus in early work of the ISA 540 Task Force.

#### DOCUMENTATION

The Representatives and Observers commented as follows:

- Mr. Thompson suggested that the documentation requirement related to the decision to use an expert could be improved by focusing on how the auditor obtained the specialized skills and knowledge in accordance with paragraphs 9A and 11A.

#### OTHER MATTERS RAISED BY REPRESENTATIVES AND OBSERVERS

In the course of discussion Representatives and Observers also made the following additional comments:

- Mr. Dalkin provided several suggestions to enhance the considerations specific for public sector entities. For paragraph A44A, he noted that this paragraphs states that a retrospective review may not be relevant for certain public sector specific accounting estimates and questioned whether application material can override a requirement. He noted that paragraph A125B makes reference to Courts of Accounts, which is a function specific to European Union's regulations and that the inference of this material may not be more widely applicable in relation to the possibility of civil and

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<sup>11</sup> International Auditing Practice Statement (IAPS) 1004, *The Relationship Between Banking Supervisors And Banks' External Auditors*

criminal charges. He further questioned if paragraph A11 should say that, in some rare cases, measurement at fair value might not be possible in public sector entities.

- Mr. Iinuma noted that the JFSA had performed a root cause analysis on the issues identified with auditing accounting estimates in their jurisdiction. This analysis indicated that many of the issues relate to the incorrect application of ISA 540. He therefore asked the Task Force to make sure the standard is written clearly and in such a way that it is understandable. Prof. Schilder agreed that the accessibility of ISAs generally is important and that the Board will consider to establish an implementation working group, similar to the Auditor Reporting Implementation WG, when ISA 540 (Revised) is finalized.
- Mr. E. Bradbury noted that clearer requirements and application material would lead to a more efficient audit, as an auditor who is unsure of what is required may continue seeking information from management beyond what is needed to obtain sufficient appropriate audit evidence. Mr. Sharko noted that this issue was not unique to ISA 540, and that the IAASB is considering a project on ISA 500.<sup>12</sup> Ms. Healy also noted that part of the IAASB's work going forward would be how to take the concept of a critical assessment of audit evidence from the definition of professional skepticism and bring it to life in the ISAs.
- Mr. Iinuma suggested to add application material in ISA 540 (Revised) that explains that the recoverable amount has a significant impact on the estimation of intangibles and the going concern assessment. Mr. Bini added that application material could explain the effect of the valuation basis on the audit of the accounting estimates, highlighting that the use of a certain valuation basis impacts the complexity in making the accounting estimates or the estimation uncertainty.
- Mr. Stewart noted that the IASB has a project underway to clarify the difference between changes in accounting estimates and changes in accounting policies, but that this project will not necessarily have an impact on the project to revise ISA 540. However, the ISA 540 Task Force might be interesting in following the IASB's project. He also noted that this draft of ISA 540 (Revised) is, recognizing the ISAs are framework neutral, in some areas inconsistent with IFRS 9 and IFRS 13.<sup>13</sup> For example, the current draft of ISA 540 (Revised) uses the term 'provision for doubtful debts' which under IFRS 9 is referred to as "impairment of receivables". Mr. Stewart will provide IAASB Staff with other inconsistencies he noted offline. He also questioned why ISA 540 (Revised) uses fair value in some instances as this could be seen as providing advice on interpretations.
- Mr. Hansen questioned whether there is a need for a conference call to update the CAG on the progress of the project. Mr. Sharko noted that the Task Force will schedule another informal call after the IAASB's September 2016 board meeting to update the CAG on the discussions in the Board.

Mr. Sharko thanked the Representatives and Observers for their comments, and noted that the IAASB's meeting in September 2016 would take these comments into account.

## Issues Relevant to Small and Medium Practices in Connection With Both Audits and Other

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<sup>12</sup> ISA 500, *Audit Evidence*

<sup>13</sup> IFRS 13, *Fair Value Measurements*



## Services Provided to Small and Medium-Sized Entities (Item F)

To *INFORM* Representatives' and Observers' about the efforts of the IFAC's SMP Committee and *OBTAIN* views on the issues relevant to SMPs and SMEs and what the IAASB and others could do to address these issues.

### SMP COMMITTEE

Ms. McGeachy introduced the topic, as set out in **Agenda Item F**, and explained the purpose, composition and function of the SMP Committee, including their three main focus areas. Importantly, she noted the extensive work of the SMPC in supporting and promoting the adoption of the IAASB's International Standards. Ms. McGeachy also explained how the SMPC provides robust and regular input on key projects, including through their direct involvement on the IAASB Quality Control WG, Agreed-Upon Procedure WG and the ISA 315 (Revised) WG, and the regular discussions with the task force chairs as projects progress.

Ms. McGeachy noted that the greatest difficulties experienced by SMPs relate to the volume of standards, the level of complexity and the speed of change. She discussed the key publications of the SMP Committee and mechanisms for communication with SMPs, which are important to supporting the adoption of the IAASB's International Standards.

The Representatives and Observers commented as follows:

- Mr. Nicholson questioned what the thresholds are for SMPs and audits of SMEs and whether it is a fair assumption that SMEs engage SMPs to perform their engagements. Ms. McGeachy indicated that there is no single definition and that jurisdictions define SMPs and SMEs differently. She explained that SMPs tend to serve SMEs because they understand the challenges faced by SMEs and the service is more personalized with more dialogue between the engagement partner and the entity. However, she highlighted that the larger firms sometimes also serve SMEs.
- Mr. Hansen questioned whether it is appropriate to presume that SMPs relates to those performing services for privately held entities. Mr. Landes confirmed that the focus of the discussion at the CAG is on SMPs serving small or medium privately held entities, rather than those that audit financial statements of listed entities.
- Ms. Elliott emphasized the long standing recognition of the importance of SMEs to the economy. She noted that the OECD has performed comparative work regarding the status of SMEs in various jurisdictions. She also noted that the OECD website has a wealth of information on this topic.

Mr. Waldron thanked Ms. McGeachy for the presentation. In addition, Prof. Schilder thanked the SMPC for their work, and recognized their efforts in providing comments to the IAASB, noting that their feedback is always considered by the WGs and task forces.

### ISSUES RELEVANT TO SMPs AND SMEs AND ACTIONS TO ADDRESS THESE

Mr. Landes highlighted the output from the recent meeting in June 2016 of the National Auditing Standard Setters (NSS), whereby it was decided that a conference for SMPs would take place in January 2017 in France. He explained the purpose of the meeting would be to explore in more depth concerns from SMPs across the world and what the IAASB and others could do to address these concerns. Mr. Landes further noted that the IAASB would share some of these views with the CAG following the meeting.

Mr. Landes provided feedback to the CAG from the breakout sessions in which Representatives and

Observers discussed the issues related to SMPs in the context of both audit and other services performed, set out in [Agenda Item F.1](#). He indicated that some of the points raised go beyond what is in the control of the IAASB, and are more relevant to IFAC. Mr. Landes highlighted the following:

- SMPs are experiencing a changing landscape with differential accounting standards, for example, IFRS and IFRS for SMEs, different accounting standards in the US, and more extensive use of special purpose frameworks (e.g., cash basis and tax basis of accounting). This therefore has implications for discussions on how the auditing standards could be more scalable.
- A question has arisen as to whether there is a gap in the IAASB's International Standards in terms of services other than audits that may be valuable and cost-beneficial to the user. Mr. Landes provided examples, such as preparation services in the US and agreed upon procedures, which is a current project of the IAASB.
- Further exploration is needed about the tensions between independence and the type of advisory and consulting services SMPs often provide to the entity, in light of their familiarity. To a certain extent SMPs being seen as the “trusted business advisor” is a credit to the profession and its expertise; however, when performing audits or other assurance engagements for which independence is required, this can cause a conflict.
- There is a perception that SMEs do not have very effective controls; however, there is an often an implicit reliance on high-level controls. For example, the COSO Internal Control – Integrated Framework includes controls such as client integrity and tone at the top, which do actually exist at SMEs.
- The Nordic Federation's Auditing Standards for Smaller Entities proposes simpler auditing standards for audits of SMEs. Mr. Landes noted any efforts to simplify standards would need to take into account whether the objective of an audit would be different for audits of smaller entities.
- The IAASB and others (including IFAC and NSS) may need to do more to advertise and promote the benefits of other types of professional services where an audit is not required or requested.

#### WAY FORWARD

Mr. Landes thanked Ms. McGeachy for her participation, and appreciated the CAG recognizing the importance of the SMP community and the usefulness of the IAASB's International Standards for SMPs. He noted the CAG would hear more in the future after the January 2017 conference on SMP issues, as well as within topics on the Board's agenda.

#### September 13, 2016

#### Enhancing Audit Quality (Agenda Item G)

To *DISCUSS* possible options for a way forward on quality control and group audits based on the responses to the IAASB's Invitation to Comment, *Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits* (ITC). Input from the CAG and IAASB will help inform the development of the project proposals on quality control and group audits for approval at the December 2016 IAASB meeting.

Ms. Zietsman introduced the topic, explaining the actions by the IAASB and the various WGs to date to arrive at the possible actions set out in [Agenda Item G.1](#). She explained that, notwithstanding that this had

not yet been discussed with the IAASB, the Audit Quality Enhancements Coordination Group (Enhancements WG) was exploring ways to address the diverse views of stakeholders expressed in response to the matters set out in the ITC. She also added that, on many of the issues, that the responses had been divergent, both between stakeholder groups and in some instances within stakeholder groups. Ms. Zietsman explained that the purpose of discussing the high-level input from the responses to the ITC was to obtain CAG Representatives' and Observers' views to further inform the IAASB on these directional matters.

#### QUALITY CONTROL AT THE FIRM LEVEL

Ms. Zietsman explained that the possible actions to address the needs of different stakeholders relating to quality control at the firm level were not necessarily a result of input from stakeholders, but rather the views of the Enhancements WG in considering how best to respond. Ms. Zietsman noted that, even with the proposal to split ISQC 1<sup>14</sup> into three parts, the intent would also be redrafting the standards in line with a quality management approach (QMA), which focuses on setting out quality objectives, risks to quality and appropriate responses. She noted, however, that respondents to the ITC were not fully clear on how a QMA approach would be implemented, which led the Enhancements WG to consider other alternatives to supplement the plans for a QMA. Finally, she noted the tension between developing a robust (and likely more prescriptive) ISQC.

CAG Representatives and Observers broadly welcomed the IAASB's exploration of possible ways to address the input received from the responses to the ITC. CAG Representatives and Observers further commented as follows:

- Ms. Molyneux encouraged the IAASB to move forward in the proposed direction, cautioning that any changes should be thoroughly considered so that they would be effective and appropriate. She highlighted the importance of audit quality, noting that the investor's trust in the audit process is impacted by the outcomes of the audit. She emphasized the importance of addressing the behaviors of auditors throughout the audit process and understanding the impact of this behavior on audit quality. She added that consideration should be given to the incentives of the individuals involved in an audit, as well as the impact of external inspections on the individuals, both of which significantly impact behavior. She noted that a number of firms are establishing policies and procedures, including related to sanctions for audits of poor quality, and suggested some of these best practices should be embedded in the revised requirements in the quality control standards. Mr. Hansen also emphasized the importance of considering auditor behaviors in developing changes to the standards. Ms. Zietsman welcomed the comment, noting that respondents to the ITC had told the ITC to focus on the tone at the top and tone at the middle at both the firm and engagement levels.
- Mr. van der Ende also noted his support for the Enhancements WG's possible actions in light of the diverse needs of different stakeholder groups, recognizing the difficulties in setting standards that would be appropriate to address the different needs. However, he encouraged that this thinking also be extended to other areas of quality control and the IAASB's various projects more broadly to look for innovative ways to solve the issues that had been noted.

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<sup>14</sup> International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements*

- Mr. Dalkin supported the concept of bifurcating the quality control standards in some way, recognizing that one standard may be difficult to develop to address the needs of various stakeholder groups, in particular as the environment becomes more complex for some of these stakeholder groups (e.g., those firms subject to increasing audit regulation dealing with public interest entities (PIEs)). He stressed that, if this approach is to be pursued, then auditors who perform services covered by all three standards should only have to demonstrate compliance with ISQC 3, as it would be the most comprehensive. Ms. Zietsman agreed this would be the intent of the structure, but that would need to be made clear within the revised ISQCs.
- Mr. Stewart noted that the possible actions were a clear way forward to address the issue that one standard would be longer and more complex for some firms that may have simpler requirements. However, he questioned whether the advantages of having three standards would outweigh the challenges of one longer standard.
- Ms. McGeachy expressed appreciation for seeking solutions to address scalability of ISQC 1. However, she added that the IFAC SMP Committee was still considering the consequences of the possible actions, but encouraged the IAASB to continue to explore these matters.
- Ms. Vanich noted the importance of the quality control standards in an audit, as it sets the tone for the auditor's behavior. She noted that the PCAOB has the topic of quality control on its agenda and is following the developments of the IAASB's quality control closely, as it was important for the IAASB and PCAOB's quality control standards to be aligned as much as possible. With regard to scalability, she questioned the need for three standards rather than one standard that could be scalable to firms performing different types of services, noting that three standards could potentially be confusing. Instead, Ms. Vanich highlighted that she could see merit in combining proposed ISQC 2 and ISQC 3 to focus on quality control for firms performing audits. She also questioned whether the approach to the principles in the COSO Framework had been considered as a basis for how the changes to ISQC 1 could be presented.
- Mr. Rockwell recognized the many advantages of three different standards to respond to the disparate views that had been addressed, but cautioned that more exploration is needed to fully understand the consequences for different types of stakeholders, in particular what the most appropriate split would be between the three standards. He suggested ISQC 3 should focus listed entities, as well as broker-dealers and banks. Mr. Iinuma noted that the possible actions may address the scalability issues, but cautioned that further consideration be given to which types of engagements were allocated to each standard. In particular, he urged that further consideration be given to the types of entities that are included in ISQC 3, agreeing with Mr. Rockwell that ISQC 3 should include all entities that had a public interest aspect, not just listed entities. Mr. Thompson understood the need for a "building blocks" approach, but urged that the unintended consequences be further explored, as he was concerned that making the split could be viewed as the IAASB making a distinction between standards for PIEs and all other entities, which is a wider approach than just ISQC 1. Mr. Thompson questioned whether it would be preferable to further consult on the possibility of splitting ISQC 1 into multiple parts before moving towards an exposure draft.
- Mr. Ilumna and Ms. Singh recommended that further consideration be given to the perceptions about the quality of the engagement by users of the financial statements if different quality control standards were to be used, in particular because it may result in perceived lower quality services if not operating under the same standard. She cited work of the Financial Accounting Standards Board in establishing a private company council and CFA Institute's work in this area. Ms. Healy noted that the intent of

the proposal to split ISQC 1 into three standards was to allow an appropriate focus on quality depending on the engagement, and that by making ISQC 1 more scalable and easier to understand, there could be benefits to quality. However, she agreed that further consideration should be given to how best to engage with stakeholders about these possible perceptions if the IAASB were to move forward in this manner.

- Mr. Hansen noted that three standards may be confusing for many stakeholders, in particular for firms that only do a limited number of audits and would be subject to a new ISQC 2. He suggested the IAASB should rather focus on the behavior and functionality of the firms, emphasizing the need to strengthen quality control systems for firms that perform audits. In his view, every firm regardless of size makes decisions about client acceptance, independence, and technical resources. He suggested in revising ISQC 1, the IAASB should focus on function vs size, and highlight the need for an appropriate structure and tone at the top.

Ms. Zietsman thanked the CAG for supporting further exploration of possible actions to address the many needs of the IAASB's stakeholders, including scalability, but acknowledged the importance of the need to further understand the consequences of these actions through targeted outreach with those stakeholders who would be most affected (e.g., firms and audit oversight bodies).

Prof. Schilder asked CAG Representatives and Observers for views on whether further consultation is needed on these matters before moving forward, in light of the ongoing discussions of speed of standard setting and the time needed for fulsome consultation on areas of significant change. The Representatives and Observers commented as follows:

- Messrs. Fortin acknowledged the need for changes made to ISQC 1 to be made on a timely basis, but added that further consideration, including some further consultation, was likely needed to fully understand the consequences of these actions. He was of the view that the discussion should focus on whether audit and assurance should be subject to a higher level of scrutiny from a quality perspective.
- Mr. van der Ende encouraged the IAASB to support the possible actions set out in the agenda material, but added that it would be necessary for the IAASB to deliberate the consequences of these possible actions before moving forward. In his view, because the proposal to split out ISQC 1 represented a more innovative approach, he believed the IAASB should take the time considered necessary to fully explore the implications of doing so. Mr. van der Ende also added that the PIOB would also need to be consulted on these matters.

#### *PIOB Observer's Remarks*

Mr. van Hulle emphasized the importance of addressing issues that have been identified through enhanced, comprehensive and clear requirements, in particular the question of whether there is a higher public interest concern for audits of listed entities. In his view, problems with audits are generally found to have a public interest nature. He suggested to look at the level of public interest concern, which would clearly be lower when dealing with a small company audit. Mr. van Hulle was of the view that, if the IAASB wishes to retain the concept of an audit as a valued service, there is likely to need to be more robust requirements relating to systems of quality control and in specific ISAs. He encouraged further debate on these matters, including consideration of the balance to make the changes on a timely basis versus more time spent comprehensively considering the changes. Mr. van Hulle was of the view that the CAG had a role to play in the wider debate about the public interest and what is needed for audits of PIEs. Mr. Waldron agreed

that consideration of this was important and that this would be more extensively discussed by the CAG in the future.

#### QUALITY CONTROL AT THE ENGAGEMENT LEVEL

Ms. Zietsman explained the background to the possible actions to revise ISA 220,<sup>15</sup> as well as the proposal to develop a new standard to address quality control for situations where other auditors are used. CAG Representatives and Observers commented as follows:

- Ms. Vanich explained that the PCAOB was currently working on changes to its standards for other auditors. She noted that the comment period for input to the consultation on other auditors had closed, with the PCAOB receiving 23 comment letters, and that it would be further considering its proposals in this area. Ms. Zietsman noted that the various IAASB WGs would continue to monitor the work of the PCAOB in this area.
- Mr. Thompson questioned the applicability of the new standard to component auditors. Ms. Zietsman clarified that the standard would apply in all cases when other auditors are used, and then if the other auditors are also component auditors, these auditors would also look to ISA 600<sup>16</sup> for additional specific requirements to be applied in group audit situations. He suggested alignment with the PCAOB would be appropriate where possible.
- Mr. Inuma supported the proposals relating to other auditors, noting the importance of addressing issues around evolving firm structures and the way that audits were being conducted.
- Ms. Perera suggested for IAASB to use appropriate titles for the proposed standards to clearly communicate its intention.

#### POSSIBLE PROJECT TIMELINES

Ms. Zietsman explained that the timelines set out in **Agenda Item G.1** were intended to present the development of the changes and new standards for all the IAASB's significant projects so that CAG Representatives and Observers, and the IAASB, could consider these matters fully. She added that, although the timelines were very ambitious, this represented a possible way forward based on the expectations that the IAASB would complete the current projects on a timely basis. She added that this timeline did not allow for slippage or any significant additional consultation beyond the typical 120 day comment period for an exposure draft. Prof. Schilder noted the ongoing discussions about the need to accelerate the standard-setting process, and asked the CAG to help identify areas where either the process could be accelerated or, conversely, where the CAG believed more time may be needed to take a more innovative and holistic approach to addressing the topics under consideration.

CAG Representatives and Observers further commented as follows:

- Mr. van der Ende emphasized the importance of the link between ISA 540 and ISA 315 (Revised) and suggested that the timeline be revised so that potential changes arising from these two projects were considered in a closer time period. He acknowledged that this would likely result in some projects having to be delayed or at least slowed down in the near future. Ms. Molyneux agreed that the timelines for ISA 540 and ISA 315 (Revised) should be better aligned, noting that the CAG

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<sup>15</sup> ISA 220, *Quality Control for an Audit of Financial Statements*

<sup>16</sup> ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

discussion had indicated there is still major issues to be resolved with significant discussion needed on the proposed changes to ISA 540 that will delay that project by a quarter or more. In Ms. Molyneux's view, the ITC-related matters will need a longer timeframe to allow for more learning.

- Ms. Vanich had the view that the timeline was reflective of the IAASB making targeted changes to the standards, but that many of the possible actions being tabled are more than targeted changes and should therefore require more time for proper consideration and discussion. In her view, the timelines were very aggressive. Ms. Vanich suggested the IAASB needed to more fully consider the scope of particular projects before setting out a timeline. If the IAASB were to pursue a more innovative approach vs. incremental requirements, she was of the view that more outreach would be necessary to understand the effects of potential changes in practice to determine whether such changes would meet their intended objectives.
- Ms. Molyneux questioned whether the resources were available to meet the targeted deadlines. Prof. Schilder noted that it would require significant effort of the Board, and Staff, but that in his view the targeted deadlines would be able to be met. He added that the possible timeline is still subject to change because of the significance of the issues being discussed and the Board's ability to give these proper consideration. He also added that it was important to have support from the many IAASB stakeholders to be able to progress the significant efforts that would be required to meet the deadlines. Ms. Healy further explained that the capacity would be increased by using more Board teleconferences and also likely a fifth IAASB meeting in 2017, which would increase the amount of time needed from the volunteer members and have implications on Staff workload.

Mr. Yoshii emphasized the importance of addressing transparency reporting, noting the agenda papers did not clearly describe how this would be addressed. Ms. Zietsman explained that this would be dealt with by the Quality Control Working Group (QCWG), noting that the responses to the ITC had encouraged the IAASB to further explore what could be done in the standards relating to this. She added that this was not specifically addressed in these agenda papers, but would be discussed with the CAG and the IAASB once further consideration had been given about how to move forward.

Ms. Zietsman thanked the Representatives and Observers for their comments, noting that further discussion about how to proceed would be needed with the IAASB, CAG and other relevant stakeholders.

### **Quality Control (Agenda Item G.2)**

To *OBTAIN* Representatives' and Observers' views on certain quality control issues in relation to aspects of engagement quality control (EQC) reviews, which will help inform the development of the project proposal for presentation to the IAASB at its December 2016 meeting, and will assist the QCWG in moving forward on all matters relating to EQC reviews.

#### **EXTENDING EQC REVIEWS BEYOND LISTED ENTITIES**

Ms. French introduced the topic of EQC reviews by explaining that one of the more contentious aspects of the quality control project relates to whether the requirement for an EQC review should be extended beyond listed entities. She noted that respondents to the ITC were supportive overall of strengthening the requirements for entities that should be subject to EQC reviews. However, while some respondents were supportive of a more prescriptive approach (for example, by extending the requirement to PIEs or other entities of particular public interest), others were less supportive of the IAASB establishing prescriptive

requirements and instead suggested the IAASB promote the firms to consider whether EQC reviews should be performed for other engagements.

With regard to the possible actions and questions 1 and 2 set out in **Agenda Item G.2** relating to extending the EQC review beyond listed entities, the CAG generally agreed that the EQC review process should be strengthened. However, the Representatives and Observers had different views on how this should be done as follows:

- Mmes. Molyneux and Singh highlighted the importance of the EQC review for audit quality and added that, from an investor perspective a quality audit is absolutely critical to maintaining trust. Mmes. Molyneux and Singh noted a focus on PIEs would be appropriate. Ms. Molyneux supported extending EQC reviews to entities defined as a PIE. She acknowledged that there is disparity in definitions across jurisdictions, but noted the IAASB should clearly define what it believes to be a PIE, and then extend the definition to include “any entity that is deemed to be a PIE in the jurisdiction.”
- Mr. Arteagoitia noted that in the European Union, the requirement for an EQC review for PIEs is mandatory, and therefore supported shifting the focus from listed entities to PIEs. While he understood the challenge of defining PIEs at the global level, focusing only on listed entities ignores an important part of the evolving market.
- Mr. Rockwell suggested that consideration be given as to why the IAASB had previously decided that listed entities should be subject to EQC reviews, and whether that principle has become relevant to other types of institutions warranting an extension beyond listed entities. He explained that potentially the requirement to have an EQC review applied to listed entities because their members have put their funds in trust, and therefore questioned whether it should be extended to banks who take deposits or certain types of insurance contracts, as well as brokerage firms.
- Mr. van der Ende agreed that Mr. Rockwell’s point about trust by shareholders is quite relevant, however, he was reluctant to extend the requirement for EQC review to all PIEs. Rather, he was supportive of the risk-based approach with robust criteria, as this would provide a mechanism for regulators to further consider how to apply the principle of EQC reviews and make it more relevant in their jurisdiction. He added that many jurisdictions have their own regulations and definitions, and accordingly it is difficult to indicate whether or not it would be appropriate for the requirement for an EQC review to be extended to PIEs. He suggested further input from IFIAR in this regard would be quite helpful.
- Mr. Hansen indicated that the focus should be on listed entities where the greatest risk exists, suggesting that a more prescriptive focus will be needed on how the individual is assigned and their relative stature. For other entities of particular public interest, Mr. Hansen suggested a risk-based approach tailored to the nature of the firm and the services it provides would be more appropriate. In his view, banks and other PIEs are highly regulated, which is an important aspect to promoting quality that may fill the void if an EQC review is not required.
- Mr. Iinuma highlighted the difficulties in developing a global definition of PIEs, and noted he supported the risk-based approach. He suggested that application material in extant ISQC 1 that sets out possible criteria for firms to consider to determine which engagements beyond listed entities should have an EQC could be elevated to a requirements. However, he cautioned against requiring an EQC review for all entities, as this would be burdensome.
- Mr. Fortin noted his support for an improved risk-based approach, with robust criteria that makes it clear that there are other circumstances where an EQC review is warranted. Mr. Fortin suggested



that with regards to the application of ISA 701<sup>17</sup> to listed companies, it could be argued that this relates to providing additional information for investors, which is a different purpose than an EQC review, and accordingly could substantiate why those requirements apply to listed entities, and for EQC reviews it applies to PIEs (if that is the direction of these changes).

- Ms. McGeachy noted that, from an SME perspective, there needs to be caution in extending to PIEs, and consideration needs to be given to any unintended consequence of extending the requirements to more than listed entities, such as additional costs without any value added for some entities. For example, a small municipality could be scoped in, but there would be very little value added by an EQC review. She further noted that certain types of entities, for example credit unions, are subject to other types of oversight and safeguards. Mr. Fortin acknowledged the possible implications for SMEs, and encouraged that more consideration be given to the consequences of any changes proposed on these types of entities. He added that other organizations addressing issues relating to SMEs include a paper prepared by AE, and the work done by the IASB in developing IFRS for SMEs. However, he was of the view that it is important for policymakers globally that the standards are consistent.
- Mr. Dalkin cautioned against extending EQC review to PIEs unilaterally, noting that there are many organizations in the public sector that receive federal funding and are required to have a government audit, and may therefore fall within the International Ethics Standards Board for Accountants' definition of PIEs. However, he noted that he was not in favor of a risk-based approach. He noted that EQC reviewers in government audits are sometimes lacking specialized skills or expertise to be able to perform the reviews effectively.

Ms. French noted that the diverse views of the Representatives and Observers were reflective of the debates of the QCWG to date, and that the IAASB would need to consider the matter further.

#### ESTABLISHING AN OBJECTIVE FOR AN EQC REVIEW

With regard to establishing an objective for the EQC review, Ms. French noted that respondents suggested that the objective of the EQC review first be established, because this would help clarify the roles and responsibilities of the EQC reviewer, as well as the depth and timing of the review.

The Representatives and Observers commented as follows:

- Messrs. Hansen and Iinuma and Ms. Molyneux supported the objective of the EQC review being both a firm-level and engagement-level control, since it is not possible to separate the firm level from the engagement level.
- Mr. Dalkin believed that with a risk-based approach, the determination of whether an EQC review is required would be at a firm level, since the risk is with the firm, unless an engagement partner had the ability to request being subject to an EQC review if not otherwise chosen in accordance with the firm's policies.
- Mr. Arteagoitia suggested that consideration also be given to the network level, since in some cases the network firm supports the function of EQC reviewer.

Mr. Hansen added that how the EQC reviewer gets assigned is critical, and that the importance of the role cannot be underemphasized.

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<sup>17</sup> ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

#### EXTENDING THE REQUIREMENTS OF AN EQC REVIEW

With regard to broadening the scope of the EQC review beyond the current requirements, i.e., beyond only considering significant judgments made by the engagement team, Representatives and Observers commented as follows:

- Ms. Molyneux was of the view, that if the EQC reviewer understands and is competent in what they are doing, that there is no reason they should be constrained to only questioning the significant judgments made by the engagement team. In particular, she noted that there could be a circumstance where a significant judgment has been missed, and accordingly it is necessary for the approach to be flexible in order that other issues may be identified.
- Mr. Hansen believed that the focus should be on the engagement level judgments, and was unclear as to direction of the WG regarding a broader scope. He was of the view that it would be inappropriate for the EQC reviewer to engage with the entity since this is the fundamental safeguard (i.e., that the EQC reviewer can perform the review without having an interface with the entity, and is therefore insulated from the entity). Ms. Molyneux agreed.
- Mr. van der Ende noted the importance of the EQC reviewer completing the review in a timely manner, and not just before the audit opinion is finalized. He questioned to what extent the timing issue has already been addressed within the WG and how it affects the objectives. Ms. French noted that the discussions about the objective will help inform further consideration on the nature, timing and extent of the EQC review.

#### TRANSPARENCY IN THE AUDITOR'S REPORT

Ms. French explained that there had been little support in the ITC about providing transparency in the auditor's report that an engagement had been subject to an EQC review or providing other details about what such a review entails. Therefore, the QCWG recommends no further actions in this regard.

With respect to providing transparency in the auditor's report, Representatives and Observers commented as follows:

- Ms. Molyneux and Messrs. Dalkin, Fortin and Hansen supported no further action. In addition, they noted the following:
  - Ms. Molyneux highlighted that it is important that there is not confusion created as to who is responsible for the audit.
  - Mr. Fortin noted that, although transparency is something that is valuable, there is a potential risk that disclosure of the EQC review would divert the auditor's effort on how to explain things rather than focusing on the audit. He believed that this would create more risk than benefit to providing information about the EQC review, which is an internal process.
  - Mr. Dalkin noted that this could result in complicating the report even more, and did not believe that merely knowing that an EQC review had been performed would be of value to users.
- Mr. Rockwell did not agree with no further action being taken. He was of the view that it is inappropriate to withhold information that is relevant to investors, such as EQCR-related information. He reflected on other circumstances where the information is not provided, but noted that in those cases (e.g., call reports by federal depository institutions in the US) the information is withheld for safety or soundness reasons. Mr. Rockwell indicated that perhaps the disclosure in the auditor's

report could be about whether or not there was an EQC review, rather than the actual findings from the EQC review.

- Mr. Yoshii was of the view that users could benefit from knowing that an EQC review had been performed.
- Ms. Singh noted that there were views within her organization that the EQC reviewer should also sign the auditor's report.

With respect to communication between the EQC reviewer and those charged with governance, Representatives and Observers commented as follows

- Mr. Rockwell agreed with the proposals with respect to engagement between the EQC reviewer and those charged with governance. Ms. Molyneux and Mr. Fortin noted that any engagement between the EQC reviewer and those charged with governance could cloud who is responsible for the audit, and audit quality.
- Mr. Hansen also noted that the EQC reviewer is required to complete the review and resolve any discussions with the engagement partner and engagement team before the audit report is issued. Accordingly, there should not be anything further to communicate with those charged with governance because the EQC reviewer is in agreement with the conclusions in the auditor's report.

#### SELECTION OF THE EQC REVIEWER

Ms. French explained that respondents were supportive of the actions set out in the ITC to address the selection of the EQC reviewer. With regard to the criteria set forth in **Agenda Item G.2**, Representatives and Observers commented as follows:

- Mr. Hansen highlighted the importance of ensuring that there is not an inappropriate influence from the entity being audited as to the appointment of the EQC reviewer, for example where the entity becomes aware of a significant issue raised by the EQC reviewer and requests the EQC reviewer to be removed.
- Mr. linuma highlighted the importance of the EQC reviewer being seen to have appropriate authority, noting that the ability to challenge more senior partners is very important because in certain cultures a junior partner is not permitted to challenge a senior partner. Ms. Molyneux was of the view that the authority of the EQC reviewer should not merely be that they have been granted the authority, but should also address their stature within the firm (i.e., that that role of an EQC is recognized and important).
- Ms. Molyneux was supportive of additional requirements as set out in **Agenda Item G.2**. with regards to the competencies of the reviewer, she noted that the firm's policies and procedures regarding the competencies would need to be documented. She indicated some concerns regarding the proposal that the EQC reviewer does not need to possess the same knowledge and competencies of the engagement partner, and cautioned that this be appropriately articulated.

Representatives and Observers also raised the following views:

- Ms. Molyneux further questioned whether EQC reviewers are independent (e.g., the former engagement partner is appointed as the next EQC review partner) and possess the competence to challenge the audit, particularly in certain industries such as banks and insurance companies. She had the view that the effectiveness of the EQC review depends on the importance placed on it by the firm (i.e., the tone at the top and the culture), for example, whether it is seen as a compliance exercise,

or whether it is given prominence and the right people with the appropriate expertise are assigned to perform the EQC review. Ms. Molyneux also questioned at what point the EQC review is undertaken and whether or not this is while the audit is still ongoing, in order that questions raised by the EQC reviewer are properly addressed.

- Mr. Iinuma further recommended introducing a requirement or application material for a system to monitor the effectiveness of the EQC review process within the firm.

Ms. French noted that the QCWG would further consider these comments and agreed that the question of seniority is an issue, as it is necessary that the EQC reviewer is at the right level to be able to challenge the engagement partner. She added that, with regards to the competencies of the EQC reviewer, the QCWG had considered whether the EQC reviewer should possess the same competencies and skills as the engagement partner. She added that the view was that this was not always necessary, however she agreed with Ms. Molyneux that this would need to be articulated very carefully.

#### COOLING-OFF PERIOD FOR EQC REVIEWER

In relation to the cooling-off period for the EQC reviewer, Representatives and Observers commented as follows:

- Ms. Molyneux questioned whether the cooling-off period would apply in both directions, i.e., when an engagement partner becomes an EQC reviewer and when an EQC reviewer becomes the engagement partner. For example, if the EQC reviewer is aware they will become the engagement partner at some point in the future, this could impair their objectivity when conducting the review of the current audit.
- Mr. Dalkin was of the view, although prescriptive requirements are contrary to a principles-based standard, in this case it is necessary to reduce the variability in the cooling-off period that different firms may require.
- Mr. Hansen noted that consideration needs to be given to cases where the industries are highly specialized with a limited number of individuals who could fulfill the role of EQC reviewer. For example, in the US there is no cooling-off period for the EQC reviewer for broker dealers.
- Ms. Borgerth highlighted that in Brazil the prescribed cooling-off period is 3 years.

#### SEPARATE STANDARD FOR EQC REVIEW

Ms. French explained that respondents to the ITC had mixed views regarding introducing a separate standard for EQC reviews, and that the QCWG proposes to revisit this topic at a later stage after considering issues related to EQC reviews and how ISQC 1 will be structured. The Representatives and Observers were in agreement with the QCWG's proposals.

#### **Group Audits (Agenda Item G.3)**

To *OBTAIN* Representatives' and Observers' views on the approach to a group audit, which will help inform the development of the project proposal for presentation to the IAASB at its December 2016 meeting, and will assist the Group Audits Working Group (GAWG) in moving forward on considering changes to ISA 600.

Ms. Zietsman explained that, in the next few months priority would be given to the overarching quality control topics, as many of the underlying concepts relating to the use of other auditors in an audit were anchored in the quality control standards. Once these were sufficiently developed, further consideration would be given to the specific requirements and guidance needed for auditors in group audit situations. She added that the GAWG would continue to work on revisions to discrete aspects of ISA 600 as the changes to the quality control standards are further considered. Further input is therefore needed on how the approach to a group audit, in particular to further consider how assessing the risks of material misstatement in the group financial statements could be enhanced in ISA 600. On this matter, CAG Representatives and Observers further commented as follows:

- Mr. Thompson supported further enhancing the approach to a group audit set out in **Agenda Item G.3**, noting the importance of assessing the risks of material misstatement as well as considering what work is needed at components. He also highlighted the intrinsic link to component materiality, and urged that further consideration be given to what could be done to address the issues identified relating to component materiality.
- Mr. Stewart also supported the development of further enhancements for approaching a group audit, also agreeing with Mr. Thompson's comments relating to component materiality, and adding that it would be important to further consider how aggregation risk could be highlighted. In this regard, he drew attention to the work of the IASB on materiality. Ms. Zietsman acknowledged the intrinsic link to materiality, and noted that this would be further considered by the GAWG as an important part of the project.
- Mr. Dalkin welcomed further consideration for enhancing the approach to a group audit, noting that more guidance in this area was important for public sector audits.

Ms. Zietsman thanked the Representatives and Observers for their comments.

#### **Agenda Item H – IAASB Initiatives**

To *INFORM* Representatives' and Observers' about a number of consultation documents that have been issued since the last CAG meeting and, as a means of encouraging CAG Member Organizations to formally respond and receive *PRESENTATION* from CAG Member Organizations about matters that may be relevant to the IAASB's future work plans.

#### *Update on IAASB's Activities*

Ms. Healy provided the Representatives with an update on the IAASB key initiatives, including the Work Plan for 2017-2018 (the Work Plan), the Data Analytics WG's request for input on "Exploring the Growing Use of Technology in the Audit, with a Focus on Data Analytics", and the Integrated Reporting WG's Discussion Paper, "Supporting Credibility and Trust in Emerging Forms of External Reporting" of the.

The Representatives and Observers commented as follows:

- Ms. Singh noted that CFA Institute will respond to the request for input on Data Analytics and informed the representatives that the CFA Institute has published a study on data and technology: “Data and Technology: Transforming the Financial Information Landscape”. The study explores how technology could transform financial reporting process from the start to the end, how structured data will enhance audit effectiveness, and how this will result in greater transparency for investors, regulators and creditors. In the study, CFA Institute also outlined their vision for the future which involves broader and deeper use of data.
- Mr. Waldron noted that the IAASB survey on the Work Plan can be completed quickly and responses can be short and do not need to be in a formal letter form.

#### *Presentation of the PCAOB*

Ms. Vanich provided the CAG with an update on the PCAOB's activities. Among other matters she noted that the PCAOB has issued several publications recently including a staff inspection brief for its upcoming 2016 inspection program, a staff practice alert on improper alteration of audit documents, a report with observations on how AS 16<sup>18</sup> is being applied in practice, and a formal document to conduct a post implementation review on the PCAOB's standard on engagement quality reviews.<sup>19</sup>

Ms. Vanich also provided the CAG with an update on the PCAOB's main standard setting projects which include:

1. Using the Work of Other auditors (similar to the IAASB's Group Audits standard). The PCAOB Board proposed amendments to the existing standard to strengthen the requirements in situations where the auditor divides its responsibility with another firm. Ms. Vanich noted that the use of other auditors is prevalent in audits of larger US companies. For example, it is used in 55% of the audits completed by the US global network firms and about 30% of the audits performed by affiliate firms not in US.
2. Auditor reporting. The PCAOB is revising its auditor reporting standards including a new standard to report Critical Audit Matters (CAMs). She explained that the concept of CAMs is fairly similar to the IAASB's Key Audit Matters. So far the PCAOB received 85 comment letters. Generally investors were supportive of the enhanced auditor reporting standards. Network firms suggested some revisions such as limiting CAMs to matters that are material to the financial statements as a whole and were concerned about disclosing original information. Smaller firms, state societies and preparers were generally not supportive of reporting on CAMs and expressed concerns that CAMs will increase litigation risk.
3. Auditing accounting estimates and the auditor's use of specialists. Ms. Vanich noted that the IAASB's and PCAOB's projects generally have similar objectives as both have the objective to enhance the application of professional skepticism, require auditors to focus on accounting estimates that have a higher risk of material misstatement and enhancing the standard for use of third party pricing sources.

The Representatives and Observers commented as follows:

- Mr. Hanson questioned whether the PCAOB was planning to change its enforcement for using the work of auditors from China. Ms. Vanich responded that she was not aware of any imminent changes in that area.

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<sup>18</sup> Auditing Standard No. 16, *Communications with Audit Committees*

<sup>19</sup> Auditing Standard No. 7, *Engagement Quality Review*

Mr. Waldron thanked Mrs. Vanich for her presentation.

#### *Presentation of FEI*

Mr. Bradbury provided the CAG with an overview of FEI and its activities. Among other matters he noted that FEI is advocating the views of corporate financial management and that it has more than 10,000 members that hold policy-making positions such as chief financial officers, treasurers and controllers at companies from every major industry in North America.

Mr. Bradbury noted that FEI monitors standard setting activities in the US and internationally and frequently provides comment letters in response to proposals, rules changes, and legislation that reflect the preparer view on issues. Mr. Bradbury noted that while FEI has multiple technical committees with different objectives, its most prominent committee is its Committee on Corporate Reporting (CCR) which represents primarily Fortune 100 controllers and CAOs and his highly influential, especially in the US. The organization represents the views of its members while participating in roundtables, participating in meetings from standard setters, such as the IAASB CAG, and through one on one meetings with regulators and standard setters.

Mr. Bradbury noted a couple key areas of concern for FEI's membership including (a) disclosure effectiveness efforts broadly including growing calls from certain stakeholders for additional sustainability disclosures, and (b) impact of PCAOB inspections on internal control over financial reporting (ICFR) as it relates to FEI's relationship with Securities Exchange Commission (SEC) and PCAOB.

#### Disclosure effectiveness

Mr. Bradbury explained that much of the disclosure improvements are the result of voluntary efforts by companies as companies voluntarily take the initiative to improve their financial disclosure both within the financial statements and through other investor presentations and materials. For some this is as simple as removing redundancies, including graphs, pictures and charts rather than text, using more bullet points and layering concepts where possible, etc. He explained that preparers are asking regulators, standard setters and auditors to remove barriers to these improvement efforts as often auditors use a checklist approach to disclosure without consideration to materiality when determining whether a company is compliant with disclosure requirements.

#### ICFR

Mr. Bradbury noted that FEI's members are generally of the view that changes in auditing standards have a significant impact on preparers who are at the end of the compliance funnel and are therefore indirectly affected by the inspections findings of regulators such as the PCAOB. However, FEI's members feel like they often have little-to-no opportunity for input. Mr. Bradbury noted that some may have heard about the efforts of the US Chamber of Commerce to address this issue. Behind the scenes, FEI is doing the same thing. Based on FEI's internal surveys 70% of FEI's CCR companies continue to believe that the auditor is continuing to go too far, or beyond what is necessary, for management (under SEC management guidance) to come to a reasonable conclusion about the effectiveness of its own internal controls. Over 70% also have seen an increase or significant increase in documentation or "evidentiary" requests from auditors.

Mr. Bradbury noted that FEI recommended the PCAOB and SEC to have an ongoing mechanism that allows for practice issues to be identified and for preparer views to be heard and appropriately considered. This request for expanded communication extends beyond ICFR-related matters and into other areas of the audit (e.g., substantive procedures).

## Audit Reporting – PCAOB Proposal

Mr. Bradbury noted that, FEI's CCR submitted a comment letter on the PCAOB's reproposal of the auditor reporting standards. Mr. Bradbury explained that FEI recognizes the significance of this proposal and identified a number of issues that need to be addressed before the standard is issued. One of the key concerns was the potential for the standard to require the auditor to disclose significant deficiencies which are required to be communicated to the audit committee but not required to be communicated by management in the financial statements. Mr. Bradbury noted that in FEI's view the disclosure of original information by auditors is significant and problematic. He encouraged others to read FEI's comment letter which is on file with the SEC.

The Representatives and Observers commented as follows:

- Messes. Molyneux and Borgerth noted that investors are looking for better information but not necessarily for more information. Mr. Bradbury responded by highlighting that he is seeing growing momentum from preparers to produce more meaningful information to investors and highlighted an upcoming conference FEI is hosting on disclosure effectiveness.. Ms. Molyneux congratulated Mr. Bradbury for his work in this space.
- Mr. Waldron questioned whether FEI's member find that the information that is currently disclosed in the financial statements is sufficient. Mr. Bradbury responded that some companies, like GE, are changing the way they are disclosing information in the annual report by modernizing their disclosures with the content with graphs, charts and hyperlinks. Some are using integrated reporting models to bring together information for investors in a more meaningful way. He noted that in many cases information that was traditionally in narrative form is now being presented in a more clear and summarized way using bullets or charts.

Mr. Waldron thanked Mr. Bradbury for his presentation.

## Closing Remarks (Agenda Item I)

### PIOB OBSERVER'S REMARKS

Mr. van Hulle thanked the CAG Representatives for their enthusiasm, participation, and good and robust discussions on the IAASB's projects. He noted that future CAG meetings would benefit from having more time allocated to discuss strategic matters through, for example, brainstorming sessions about key public interest matters relevant to the IAASB's projects and overall strategy, in particular in relation to meeting public interest expectations about audit and firms that perform them.

Mr. van Hulle further noted that, later in the week, the PIOB will have a workshop to explore the public interest in standard setting and the effects of the changing audit landscape on the standard setting process. He highlighted that the PIOB will report back to the CAG on the results of this workshop and intends to summarize the feedback more broadly.

He concluded by noting that it is important for the IAASB to take time necessary to develop standards that are sufficiently high-quality, giving due consideration of feedback from the CAG and the Board's many stakeholders.

### IAASB CHAIRMAN REMARKS

Prof. Schilder thanked the Representatives and Observers for their comments and suggestions and noted that the CAG provided good input on several of the topics to be discussed in next week's IAASB Board meeting, including ISA 540, ISA 315 (Revised) and Audit Quality Enhancements.



Prof. Schilder explained that the CAG's comments are always considered carefully by the IAASB and emphasized the importance of the CAG meeting to obtain input on the IAASB's standard-setting projects from a wide range of stakeholders. He noted his appreciation for the updates from Mmes. McGeachy and Vanich and Mr. E. Bradbury about their respective Member Organization, and for the breakout session that highlighted the importance of SMPs to the IAASB's work. Prof. Schilder also updated the CAG on the implementation of the IAASB's auditor reporting standards, given that it was not on the agenda. He noted that several countries have early adopted the auditor reporting standards, such as the United Kingdom and the Netherlands, and that others are very active with implementation efforts, such as in South Africa and Colombia.

Prof. Schilder concluded that the key messages he took away from this CAG meeting was that the CAG is supportive of the IAASB's current projects and that the CAG and PIOB encourages the IAASB to take the time to develop high quality standards, despite pressure from some stakeholders to accelerate standard setting on particular topics.

#### IAASB CAG CHAIRMAN REMARKS

Mr. Waldron thanked the CAG Representatives and Observers for their high level of preparation and participation and the quality of comments provided during the meeting. He specifically thanked the leaving CAG Representatives Ms. Lopez, Mr. Nicholson and Ms. Miller, as well as IAASB Technical Director Ms. Healy. He also thanked the Chairman, IAASB members and Staff for their contribution to the success of the meeting. He then closed the meeting.