



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

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Agenda Item 10

Committee: IAASB
Meeting Location: Melbourne
Meeting Date: March 17-21, 2003

Proposed Revised IAPS 1005

Objectives of Agenda Item

To review a proposed revised IAPS 1005, "The Special Considerations in the Audit of Small Entities" and a related explanatory memorandum.

Background

IAASB DELIBERATIONS

At the September 2002 IAASB meeting it was agreed that IAPS 1005 should be revised to take account of all ISAs issued subsequent to its publication in March 1999. At the December 2002 IAASB meeting, members reviewed a proposed revised IAPS 1005 and requested that:

- The proposed revised guidance should be expanded with regard to the application of ISA 240, "The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements," and ISA 260, "Communications of Audit Matters With Those Charged With Governance."
- Guidance should be provided on the application of ISA 545, "Auditing Fair Values Measurements and Disclosures."
- The section dealing with the provision of accounting services to small entity audit clients should be revised to reflect the requirements of the revised section 8 of the IFAC Code of Ethics for Professional Accountants.

After considering the above, staff reported to the IAASB that addressing the issue of the provision of accounting services to small entity audit clients would require further detailed study and consultation with the Ethics Committee and the SMP Task Force, as the basis for the guidance in the IAPS was not in line with the conceptual framework presented in section 8 of the Code.

ETHICS COMMITTEE

The Ethics Committee was requested to consider developing guidance for auditors with regard to the application of section 8 of the Code to the services provided to small entity audit clients. The Ethics Committee considered the request at its January 2003 meeting and concluded as follows:

- Section 8 of the Code should provide sufficient guidance to the auditors to identify, evaluate and respond to threats to independence when rendering other services to small entity audit clients.

- That is was not necessary to develop an interpretation of section 8 for the auditors of small entity audit clients.
- Should the SMP Task Force be of the opinion that circumstances specific to small entity audit clients are not covered in section 8 of the Code, these should be brought to the attention of the Ethics Committee.

Proposed Revised IAPS

As requested by the IAASB, the guidance in the proposed revised IAPS was expanded with regard to the application of ISA 240 (see paragraphs 35 to 39) and ISA 260 (see paragraph 42). Paragraphs 81 and 82 of the proposed revised IAPS now provide guidance on the application of ISA 545, and paragraphs 21 and 22 deal with the auditor's responsibility to obtain representations from management with regard to fraud and error and fair valuations.

The title of the section dealing with the provision of accounting services to small entity audit clients has been changed to "The Provision of Other Services to Small Entity Audit Clients," as section 8 of the Code is not limited to the provision of accounting services.

Paragraphs 104 to 108 of the proposed revised IAPS cover paragraphs 8.155 to 8.162 of the Code, while paragraphs 110 to 115 focus on the preparation of accounting records and financial statements of small entity audit clients (covering paragraphs 8.163 to 8.170 of the Code). Paragraph 109 of the proposed revised IAPS reminds auditors that section 8 of the Code applies to all other services rendered to a small entity audit client and clarifies why the remainder of the guidance is focused on the preparation of accounting records and financial statements.

Paragraph 116 of the proposed revised IAPS indicates that the "Commentary on the Application of ISAs When the Auditor Also Prepares the Accounting Records and Financial Statements of the Small Entity Client" is relevant only where the auditor is legally and professionally permitted to prepare accounting records and financial statements for a small entity audit client.

An explanatory memorandum, explaining the proposed changes to the IAPS and requesting commentators to focus their comments on the proposed changes, has been prepared. The intention is for the explanatory memorandum to accompany the exposure draft of the proposed revised IAPS.

SMP Task Force

The SMP Task Force Rapid Response Team has reviewed the agenda papers. (A copy of IAASB staff's disposal of the team's comments has been posted to the IFAC Leadership Intranet (Working Drafts / IAASB).) The IAASB is requested to consider the following comments:

- A respondent suggested that the discussion on independence should be expanded to deal with conflict of interest situations. Reference was made to potential conflicts of interest that may arise if the auditor's immediate family, partner or employee has a vested interest in the organization being audited.

IAASB staff's proposed disposal of comment: Paragraphs 104 to 115 of the proposed revised IAPS were included as an introduction to the commentary on the application of ISAs when the auditor also prepares the accounting records and financial statements of a small entity – which is common for small entity audit clients. Conflict of interest provisions apply

irrespective of whether the audit client is a large or small entity, and there should not be any particular small entity considerations.

- A respondent was not in favor of including the paragraphs relating to ethics and was of the opinion that the “ethics material has been shuffled in as ‘rules,’” stating that “there was a danger of reproducing and summarizing something that must really be understood in its own context.”

IAASB staff's proposed disposal of comment: This matter was also debated by the IAASB staff. Initially, for the same reason stated by the respondent, staff considered it more appropriate to delete the paragraphs dealing with the ethics requirements, as well as the commentary on the application of ISAs when the auditor also prepares the accounting records and financial statements. However, after further debate it was agreed that the guidance provided in the commentary is very relevant to the auditors of small entity audit clients, and that it was important to retain the guidance.

- A respondent indicated that the statement in paragraphs 37, 38 and 82 that a refusal to provide a representation constitutes a scope limitation was wrong. The respondent argued as follows: “The word ‘required’ presumably means required by the ISA and not required by the auditor. Only if truly required by the auditor, i.e. no other evidence would do, could it be considered to be a scope limitation within the meaning of the reporting standard. The requirement in ISA 240 is one for the auditor to obtain a representation. The auditor can ask management, but cannot force management. If the auditor does not receive a representation, it is a breach of auditing standards and not a scope limitation. Only if it is needed to form a view on the financial statements is it a scope limitation. This is a fundamental flaw in procedural auditing standards such as ISA 240.”

Material Presented

Agenda Paper 10-A Proposed revised IAPS 1005 (Mark-up)
(Pages 309–330)

Agenda Paper 10-B Proposed explanatory memorandum
(Pages 331–332)

Action Requested

The IAASB is requested to consider the comments from the SMP Task Force Rapid Response Team highlighted above, as well as the proposed revised IAPS 1005 and the related explanatory memorandum for approval to be issued as an exposure draft.

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