

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

**Held on December 8-12, 2002  
At the Hyatt Regency, Miami, FL**

**Members**

*Present:* Dietz Mertin (Chair)  
L Denise Esdon (Vice Chair)  
John Archambault  
Philip Ashton  
Roger Dassen (December 8-11)  
Denis Desautels  
Ana Maria Elorrieta (December 10-12)  
Jan Bo Hansen  
Gen Ikegami  
Suresh Kana  
John Kellas  
Ian McPhee  
Edmund R Noonan  
Ian Plaistowe  
Roger Simnett  
Roberto Tizzano  
Gérard Trémolière  
Yang Zhiguo

**Technical Advisors**

Wolfgang Böhm (Mr Mertin)  
John Fogarty (Mr Hansen)  
Cédric Gélard (Mr Trémolière)  
Jon Grant (Mr Plaistowe)  
Diana Hillier (Mr Ashton)  
Susan Jones (Mr Noonan)  
Karen Lauf (Mr Kana)  
Paul Lohnes (Mr Desautels)  
Emilio Palma (Mr Tizzano)  
Robert Sharma (Mr McPhee)  
Sylvia Smith (Mr Kellas)  
George H Tucker (Ms Esdon)  
Hans Verkruijsse (Mr Dassen)  
Yuichi Yamamoto (Mr Ikegami)

*Absent:* Xi Wu (Mr Zhiguo)

**By Invitation**

*Present:* Steve Leonard (December 10-11)

**IFAC Technical Staff**

*Present:* James Sylph (Technical Director)  
Sylvia Barrett (December 10-11)  
James Gunn  
Jan Munro (December 8-11)  
Michael Nugent  
Alta Prinsloo  
Victoria Rand (December 12)  
Ken Siong  
Gill Spaul (December 12)

## 1. Chair's Greeting and Opening Remarks

Mr Mertin opened the meeting. He noted that this was the IAASB's last meeting for 2002 and commented on a successful year.

Mr Mertin welcomed Mr Verkruijsse, Technical Advisor for Mr Dassen, and Mr Sharma, acting Technical Advisor for Mr McPhee, to the meeting. He also introduced Ken Siong, IAASB technical staff member, to the members and technical advisors. Mr Mertin noted that Mr Wu, Technical Advisor for Mr Zhiguo, was unable to attend the meeting due to visa difficulties, and that Ms Elorrieta would attend the meeting from Tuesday, December 10.

The minutes of the meeting of the IAASB held on September 23-27, 2002 in Cape Town, South Africa were approved as circulated.

## 2. Small Entity Update and IAPS 1005

The IAASB reviewed a Small Entity Update, indicating how ISAs issued since March 1999 impacted IAPS 1005, as well as a proposed revised IAPS 1005. The IAASB was requested to consider whether or not the proposed revised IAPS 1005 should be issued for public comment.

The IAASB agreed 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.
- Once approved, the proposed revised IAPS 1005 should be exposed for public comment.

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 IFAC Ethics Committee.

The IAASB agreed that:

- The IFAC Ethics Committee should be requested to consider developing guidance for auditors with regard to the application of the revised section 8 of the Code to the services provided to small entity audit clients.
- The Small and Medium Practices (SMP) Task Force should be informed of the above and requested to consider the possibility of the IAASB issuing a proposed revised IAPS 1005 without the section on the provision of accounting services to small entity audit clients.
- Should the IFAC Ethics Committee and SMP Task Force agree to the above, an exposure draft of the proposed revised IAPS 1005 (excluding the section as suggested above), should be submitted for approval at the March 2003 meeting.

### 3. Review of Interim Financial Information

The IAASB discussed the issues outlined in the agenda papers and reviewed a first draft of a proposed ISA on Review of Interim Financial Information. In addition to clarification, structural and editorial changes, the IAASB agreed that:

- The proposed Standard should cover interim financial information that was allowed (but not required) by legislation or regulation (or equivalent authority) and that was publicly available.
- The previous annual financial statements of the entity should have been audited (or are in the process of being audited) and should be publicly available.
- An engagement letter should be required for the engagement.
- The proposed Standard should cover materiality in relation to interim financial information. The Task Force should consult with the Audit Materiality Task Force.
- The auditor should be required to append a summary of uncorrected misstatements to the management representation letter.
- Oral reporting should not be allowed.
- Guidance should be provided with regard to the presentation of pro forma financial information.

A proposed exposure draft will be submitted for approval at the March 2003 meeting. A comparison with national standards will also be provided as background information.

### 4. Assurance Engagements:

Mr Dassen presented a summary of action undertaken by the Assurance Task Force in response to previous decisions made by the IAASB, and provided a summary of the “building blocks” used by the Task Force to develop the draft Framework for Assurance Engagements. Mr Dassen noted that the draft Framework does not use criteria as a variable, as criteria has to be suitable before accepting an assurance engagement.

The IAASB discussed whether it is appropriate to use the terms “review-level” and “audit-level” to describe the nature of assurance services, and how the public normally associates these terms. After debate, the IAASB concluded that the terms proposed in the draft ISAE 2000 are appropriate, and should not impact the branding of services by the profession.

The IAASB discussed whether the table in the draft Framework, summarizing the distinction between review-level engagements and audit-level engagements, makes it clear whether a conclusion in the negative form could be expressed when audit-level procedures have been undertaken. The IAASB also considered whether including guidance on the nature, timing and extent of procedures is relevant to the level of assurance risk.

The IAASB discussed the rationale and purpose of the “Three Party Relationship,” its relevance as an element of an assurance engagement, its impact on the ability to conduct certain engagements, and its effectiveness in excluding consulting services from the scope of assurance engagements.

The IAASB discussed whether it may be more appropriate to include the proposed requirement for disclosure of independence in the IFAC Code of Ethics for Professional Accountants in order to heighten the awareness of this proposed requirement, as it significantly expands the requirements of professional accountants not in public practice.

The IAASB discussed the provision stating that it is not appropriate to change an audit-level engagement to a review-level engagement to avoid a qualified audit-level report. The IAASB debated whether this provision is too restrictive, and whether it appropriately captures the circumstances that could influence such a decision.

The IAASB discussed the use of another practitioner or expert in an assurance engagement, and questioned whether it should be addressed in the proposed documents.

Concern was expressed that a framework for assurance engagements is being developed in advance of gaining experience of the practical aspects of developing guidance applicable to specific subject matter.

In addition to clarification, structural and editorial changes, the IAASB agreed that:

- The paragraph introducing the terms “review-level” and “audit-level” in the draft ISAE 2000 should be moved to the Framework.
- The description of the nature, timing and extent of procedures should be amended.
- The Task Force should reconsider the “Three Party Relationship” in the light of the IAASB’s concerns.
- The proposed requirement for disclosure of independence should be discussed with the IFAC Ethics Committee.
- The Task Force should reconsider the wording of the provision stating that it is not appropriate to change an audit-level engagement to a review-level engagement to avoid a qualified audit-level report, taking into account corresponding wording contained elsewhere in the draft Framework.
- The Task Force should reconsider its decision not to cover the use of another practitioner or expert in an assurance engagement in the proposed documents.
- The draft Framework should be compared to other models for assurance engagements.

An exposure draft of the proposed Framework and ISAE 2000 will be submitted for approval at the March 2003 meeting.

## **5. Group Audits – Considering the Work of Other Auditors**

Mr Kana presented a summary of actions undertaken by the Group Audits Task Force in response to decisions made by the IAASB during its September 2002 meeting, and the framework and related principles on which the revision of ISA 600 was based. The IAASB reviewed the proposed revised ISA 600 and commented on the issues raised in the accompanying explanatory memorandum.

The IAASB discussed whether the proposed procedures to be conducted by the group auditor in the absence of a framework providing for division of responsibility constitute audit evidence. It was concluded that they do constitute audit evidence.

The IAASB discussed whether a network firm should be considered as part of the group auditor, e.g. the group auditor’s consideration of the significance of components audited by him/her should not be limited to the group auditor, but should include network firms.

Concern was expressed with regard to requiring the group auditor to assess/obtain information about the quality control process of a non network firm. It was questioned whether obtaining such information is sufficient and appropriate, to what extent assessing or obtaining information

about quality control processes is practical, and whether the group auditor should direct his/her assessment/information at the engagement and/or firm level.

In addition to clarification, structural and editorial changes, the IAASB agreed that:

- The IFAC Code of Ethics definition of network firm should be used.
- The Task Force should consider the appropriateness of including network firm in the definition of group auditor.
- The Task Force should reconsider the requirement for the group auditor to assess/obtaining information about the quality control process of a non network firm.
- The paragraph relating to the group auditor's participation in the audit process of the other auditor should be a black lettered paragraph and include a related documentation requirement.
- The paragraph relating to documentation should be a black lettered paragraph.

An exposure draft of the proposed revised ISA 600 and the IAPS on The Audit of Group Financial Statements will be submitted for approval at the June 2003 meeting. It was recognized that this is an ambitious timetable.

## **6. The Auditor's Report on Financial Statements**

Mr Ashton presented an overview of the Task Force activities since June 2002, requested the IAASB to confirm the scope of the project and to agree on preliminary views regarding the approach and key principles for key issues identified by the Task Force. The Task Force had obtained input on the scope of the project from CAG and European national standard setters.

The project proposal identified ten issues to be addressed and the Task Force was presenting its views on six of these issues. The issue relating to compliance with IFRSs was dealt with in a separate exposure draft (approved September 2002).

The proposed revision of ISA 700 is to cover the auditor's report on the audit of financial statements, providing standard wording for a "clean" audit and focusing on the definition of the objective of an audit in ISA 200 "Objective and General Principles Governing an Audit of Financial Statements." The IAASB noted that a need for additional guidance on modified auditor's reports exists, but that it might be preferable to do so in a separate project. At a minimum, there might be a need for conforming changes. However, some members were of the opinion that there is a need for additional guidance on how to apply the principles in the existing ISA, and questioned the guidance on multiple uncertainties in the existing ISA. The Task Force was requested to reconsider the manner of addressing modified auditor's reports.

The key overarching aims are to increase consistency in reporting and the understandability of the auditor's responsibilities and of the auditor's report. The Task Force proposed a two part report that separates the auditor's report on the financial statement audit from other reporting responsibilities. Other reporting responsibilities are limited to those involving a requirement to report to shareholders.

Some members were not clear as to how and when the proposed guidance on other reporting responsibilities would apply, as practice in some countries is to report separately on such responsibilities rather than to include them in the auditor's report on the financial statements. The IAASB also debated whether it was necessary to describe the auditor's responsibilities in terms of ISA 720 "Other Information in Documents Containing Audited Financial Statements" in the auditor's report, as the auditor has other responsibilities under ISAs that are not mentioned in the

auditor's report. Some members also expressed the view that the auditor's other reporting responsibilities should be referred to in the auditor's report, even when the auditor does not perform additional procedures or only has to report on an exception basis.

The proposed revised ISA 700 is to be written from the perspective of an audit in accordance with ISAs. Guidance will be provided on how the auditor should report if the audit was conducted in accordance with both ISAs and national auditing standards.

The Task Force's preliminary views with regard to the content of the auditor's report on the financial statement audit was presented and debated. The preliminary views are based on the results of a comparison of more than 30 countries' auditor's reports. It was noted that, should the proposed reference to accounting estimates and the choice and application of accounting policies in the scope paragraph be retained, consideration should be given to including similar references in the responsibilities of management paragraph. The Task Force was advised to carefully consider the advantages and disadvantages of discussing the auditor's responsibility with regard to fraud in the auditor's report. The Task Force was requested to consider the reference to "true and fair" and the financial reporting framework in the opinion paragraph. The IAASB did not support the Task Force's proposal to use the auditor's report to enhance disclosure and awareness of compliance with IFRSs.

Referring to the dating of the auditor's report, the IAASB supported the list of alternative dates discussed in the agenda papers and noted that conforming changes to ISA 560 "Subsequent Events" and ISA 580 "Management Representations" should be processed at the time the proposed revision to ISA 700 is completed.

The IAASB agreed that:

- The Task Force should consider the comments it has received and amend its papers accordingly.

The remaining issues will be brought to the March 2003 meeting, and a proposed exposure draft is scheduled for consideration at the July 2003 meeting.

## **7. Fraud**

Ms Esdon noted that the IAPC approved revisions to ISA 240 "The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements" in March 2001. The IAASB also accepted an invitation to participate in a US Fraud Task Force with the view to developing common basic principles and essential procedures. In June 2002, the IAASB responded to the US ASB exposure draft on Consideration of Fraud in a Financial Statement Audit. The US SAS 99 "Consideration of Fraud in a Financial Statement Audit" was issued in October 2002.

CAG had discussed the scope of the project at its October 2002 meeting, where there was consensus that ISA 240 should be updated to converge with the US SAS 99 and to align with the proposed Audit Risk Standards.

The IAASB reviewed and commented on the issues paper. The IAASB agreed that:

- The revision of ISA 240 should be built from the existing ISA, and not based on the US SAS 99, as the latter is very detailed and does not follow an ISA structure.

- The basic principles and essential procedures contained in the US SAS 99 should be incorporated as appropriate into the revised ISA 240.
- Elements of fraud and error should be dealt with separately. ISA 240 should only deal with fraud. Guidance on the auditor's responsibility for the detection of errors should be covered in other existing Standards.
- The proposed revised ISA 240 should provide guidance on aggressive earnings management.
- The exhibit appended to the US SAS 99 should not be appended to the proposed revised ISA 240.

An issues paper will be considered at the March 2003 meeting.

### **8. Audit of Estimates Involving Measurement Uncertainty**

Mr Ashton provided an overview of the benefits, goals and issues relating to the project, as well as the project timetable. This is a joint project of the IAASB and the UK Auditing Practices Board.

The proposed revision will:

- Introduce greater rigor and skepticism into the audit of estimates involving measurement uncertainty
- Provide a framework for analyzing misstatements and evidence of bias and communication of findings to those charged with governance.
- Provide an overarching ISA addressing the general principles of measurement uncertainty; with ISA 545 "Auditing Fair Value Measurements and Disclosures" becoming an IAPS.

The IAASB reviewed and commented on the issues paper. There was general support for the direction being taken by the Task Force; however, questions were raised concerning:

- How the concept of the zone of reasonableness would work in practice and whether auditors need to determine a zone of reasonableness for all estimates involving measurement uncertainty.
- Whether the auditor should have a detection responsibility for management bias within the zone of reasonableness.
- Under what circumstances, if any, measurement uncertainty should be disclosed in the auditor's report on the financial statements.

The IAASB discussed whether or not (and if so, when) ISA 545 should become an IAPS, as recommended by the Task Force. Reference was made to the fact that the US ASB was in the process of converging to ISA 545.

The IAASB agreed that:

- ISA 545 should remain a Standard and that the Task Force should proceed to revise ISA 540 as a framework document.

The Task Force is to work in tandem with the Audit Materiality Task Force and intends to finalize a proposed exposure draft at the end of 2003.

## 9. Audit Materiality

Mr Ward (Task Force chair) sent his apologies as he was unable to attend this meeting. Mr Grant presented the issues paper on behalf of the Task Force. This is a joint project of the IAASB and the UK Auditing Practices Board.

The Task Force considers ISA 320 to be conceptually sound, as it recognises both planning materiality and evaluation materiality, acknowledges the quantitative and qualitative aspects thereof, and provides for different materiality levels for different aspects of the financial statements. However, a number of national standard setters have issued additional guidance – some of which is useful in the context of the auditor's approach to aggressive earnings management.

The Task Force proposed a holistic approach to the proposed revision, materiality levels for individual components reflecting perceived significance to users, a better understanding of user needs, and an approach that is more judgmental and less formulaic. The Task Force also proposed linking the project with the Accounting Estimates Project, and to work with the International Accounting Standards Board. In the latter regard discussions had been held with Sir David Tweedie (chair of the IASB).

The IAASB reviewed an issues paper and suggested that:

- The Task Force should consider the danger of creating an expectation gap by requiring the auditor to consider qualitative factors during planning. The results of implementing the related Australian requirements in practice should be investigated.
- When defining the term “users of the financial statements,” the Task Force should focus on those to whom the auditor owed a duty of responsibility, bearing in mind the objective of an audit. Possible legal liability issues were highlighted.

Mr Grant indicated that the non auditor member on the Task Force suggested that it would be useful to prepare guidance for users of financial statements. Reference was made to a guide that was issued by IFAC early in 1990. It was suggested that consideration should be given to updating the guide.

The timetable for this project will be coordinated with the timetable for the Accounting Estimates Project.

## 10. Audit Risk Conforming Changes

Mr Kellas presented an overview of the Audit Risk Task Force's deliberations with regard to conforming changes arising from the proposed Audit Risk Standards. To date, the Task Force has focused on developing an approach for addressing confirming changes and on the scope of the changes.

The IAASB agreed to the following recommendations of the Task Force:

- Although some of the IAPs require extensive conforming changes, the initial focus should be the ISAs.
- Conforming changes should be defined as changes necessary to align the underlying ISA to the principles, requirements, guidance and terminology of the proposed Audit Risk Standards.



- Conforming changes should be finalized and effective at the time the proposed Audit Risk Standards become effective. However, some of the more significant changes might require more time.
- The following approach will be adopted:
  - (1) Where minor conforming changes have to be processed to an ISA, which is not currently under revision as a separate project, the Audit Risk Task Force should deal with these changes.
  - (2) Where minor or major conforming changes have to be processed to an ISA, which is currently under revision as a separate project, the Task Force responsible for the related project should deal with the changes.
  - (3) Where major changes have to be processed to an ISA, which is not currently under revision as a separate project, the ISA should be referred to the Revisions Committee for consideration.
- Minor conforming changes (see (1) above) should be considered and approved by the IAASB outside IAASB meetings (i.e. minor changes do not have to be debated at IAASB meetings). Major changes (see (2) and (3) above) should follow due process, and should be exposed for public comment.
- How conforming changes are to be addressed should be clearly communicated to the users of ISAs.

It was noted that 28 ISAs and the Preface exist and that 10 ISAs and IAPS 1005 are currently included on the IAASB work program. 14 ISAs and the glossary will be covered by the Audit Risk Task Force. Five more ISAs remain, which might require major changes, i.e. ISA 250 "Consideration of Laws and Regulations in an Audit of Financial Statements," ISA 402 "Audit Considerations Relating to Entities Using Service Organizations," ISA 520 "Analytical Procedures," ISA 530 "Audit Sampling and Other Selective Testing Procedures," and ISA 550 "Related Parties."

It was questioned how the process for addressing conforming changes is related to the process for addressing the IOSCO comments, and whether they should be addressed at the same time. It was suggested that the reason for conforming changes and the approach to be followed should be communicated in the IAASB response to the IOSCO comment letter.

An update on audit risk conforming changes will be provided at the March 2003 meeting.

## 11. Project proposals

The IAASB considered the following project proposals:

- Proposed revision of ISA 230 "Documentation"
- Proposed revision of ISA 620 "Using the Work of an Expert"
- Proposed new Standard on Comfort letters.

The proposed revision of ISA 230 and ISA 620 was approved. However, the starting dates for these projects are subject to the results of the reprioritization of the IAASB work program.

With regard to the Comfort Letter Project, it was noted that significant challenges exist in addressing various legal and regulatory issues and at this time it is unknown whether the output will be in the format of an ISA, IAPS or other. The IAASB agreed that it is willing to approve this project subject to the following:

- Mr Trémolière should take responsibility for the project and that very little IAASB member and staff resources should be devoted to the project at this time.
- Mr Trémolière should establish a team of experts, which include representatives from national standard setters and key international stakeholders, to support him with the project.
- The project proposal should be revised for purposes of public record and to include the decisions noted above.

It was proposed that, as a next step, consideration should be given to preparing a “white paper” seeking the views of key stakeholders on issues highlighted by the Task Force. Should such paper be prepared, it should be submitted for consideration by the IAASB before its distribution to key stakeholders.

Of the 18 IAASB members present at the meeting, two members (Ms Esdon and Mr Archambault) voted against the Comfort Letters Project.

## **12. Quality Control**

Ms Elorrieta presented an overview of the activities of the Quality Control Task Force since the last IAASB meeting, the background of the project and significant issues identified by the Task Force. The Task Force had been reconstituted to include two non IAASB members with quality control experience. The Task Force has been liaising with the IFAC Board Task Force responsible for revising International Professional Practice Statement (IPPS) 1 (to be renamed Statement of Membership Obligation (SMO) 1).

Ms Rand (TAC Technical Manager) provided an update on SMO 1. SMO 1, International Standard on Quality Control (ISQC) No. 1 and the revised ISA 220 “Quality Control for Audit Engagements” will be exposed for public comment at the same time.

The IAASB was requested to comment on the scope and interrelationship of the documents. There was general support for the approach that had been taken by the Task Force; however, it was noted that in some instances it appears that the proposed revised ISA 220 does not allow the audit engagement partner to take credit for elements of the firm’s system of quality control.

The IAASB also commented on the requirements (at engagement level) relating to engagement team independence.

It was noted that CAG expressed concerns with regard to the term “independent review,” the definition of “independent review” and the scope of the independent review requirements. After debate, the IAASB concluded that the term “independent review” is not appropriate. There was generally support for the proposed scope of the independent review.

The IAASB reviewed the proposed ISQC and revised ISA 220. In addition to clarification, structural and editorial changes, the IAASB agreed that the Task Force should consider the following:

- Providing for the audit engagement partner to take credit for elements of the firm’s system of quality control.
- Whether the requirements placed on the audit engagement partner are too onerous.
- Removing the requirements for the audit engagement partner to obtain written confirmations of independence from the members of the engagement team.
- The term “independent review.”

- The description of entities for which an independent review is mandated.

Drafts of the documents will be distributed to the IAASB for final review before March 2003 and an exposure draft of the proposed documents will be submitted for approval at the March 2003 meeting.

It was debated whether the comment period should be five months. The IAASB concluded that three months were sufficient. The IAASB agreed that:

- Should the IFAC Board agree a different comment period for SMO 1, the comment period for the ISQC and revised ISA 220 should be reconsidered by the chair of the IAASB.

### **13. IAASB Work Program**

The IAASB was requested to consider the projects on the work program and to provide the chair with an indication of how the projects should be prioritized. It was agreed that the members' recommendations with regard to prioritization should be discussed by the Planning Committee after the IAASB's meeting and a revised work program distributed to the members shortly.

### **14. Closing**

Mr Mertin thanked the members, technical advisors and IAASB technical staff for their efforts and adjourned the meeting.

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