

**Minutes of the 9th Meeting of the
INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD
Held on February 16-18, 2004**

At the Offices of the American Institute of Certified Public Accountants, New York, USA

	Voting Members	Technical Advisors
<i>Present:</i>	John Kellas (Chairman)	Wolfgang Böhm (Mr Ferlings)
	Denise Esdon (Vice Chair)	Elizabeth Carson (Mr Simnett)
	John Archambault	Cédric Gélard (Mr Trémolière)
	Roger Dassen	Jon Grant (Mr Plaistowe)
	Denis Desautels	Diana Hillier (Mr Ashton)
	Sukanta Dutt	Susan Jones (Mr Fogarty)
	Josef Ferlings	David Kazzi (Mr Yafi)
	John Fogarty	Tan Shook Kheng (Mr Dutt)
	Rogério Gollo	Richard Mifsud (Mr McPhee)
	Jan Bo Hansen	Emilio Palma (Mr Tizzano)
	Gen Ikegami	Tania Sergott (Mr Hansen)
	Ian Plaistowe (except February 17 th)	Greg Shields (Mr Desautels)
	Roger Simnett	Sylvia Smith (Mr Kellas)
	Roberto Tizzano	George Tucker (Mrs Esdon)
	Gérard Trémolière	Yuichi Yamamoto (Mr Ikegami)
	Mowafak Al Yafi	
<i>Apologies:</i>	Philip Ashton	Hans Verkruijsse (Mr Dassen)
	Ian McPhee	Keith Newton (Mr Archambault)

Non-Voting Observers

Present: Thomas Ray
Hisashi Yamaura

IFAC Technical Staff

Present: Jim Sylph (Technical Director) (except February 18th)
James Gunn
Alta Prinsloo
Jan Munro
Michael Nugent
Ken Siong

1. Opening Remarks and Minutes

Mr Kellas opened the meeting to the public and welcomed the public observers.

Mr Kellas welcomed Messrs Dutt, Ferlings, Fogarty, Gollo, and Yafi as new members of the IAASB, and Messrs Kazzi and Shields and Mss Carson, Shook Kheng, and Sergott as newly appointed technical advisors. He indicated the regrets of members Messrs Ashton and McPhee, and noted that Ms Hillier and Mr Mifsud were nominated as their proxies, respectively.

The minutes of the public session of the meeting held on December 8-12, 2003 in Berlin were approved as presented.

Mr Kellas noted that the IAASB approved the issuance of the Assurance Framework and ISAE 3000, *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information*, by ballot vote on December 31, 2003. Dissenting views were expressed by Mrs Esdon and Dr Yang.

Mrs Esdon voted against the assurance framework and standard because, in her view:

- there has been unnecessary confusion created by the introduction of new terminology, for example by the introduction of “subject matter” and “subject matter information,” after the issuance of the exposure draft; and
- the lack of clarity in the standard as it relates to limited assurance engagements, and as it relates to the guidance of what is a meaningful level of assurance in the circumstances of a particular engagement, will lead to inconsistent application of standards providing for negative assurance reports.

Mr Kellas noted that Dr Yang dissented on the Assurance Framework because, in his view:

- paragraphs 8 and 9 are illogical and confusing in their use of the term “subject matter information,” “assertion-based engagements” and “direct reporting engagements.” In particular, the provision of paragraph 8, while appropriate for “assertion-based engagements,” does not make sense for “direct reporting engagements” because it results in the subject matter information being provided by the practitioner and then the practitioner expressing a conclusion on the information provided by the practitioner – which is not an assurance engagement; and
- it was not clear whether the responsible party is responsible for the subject matter, the subject matter information, or both, and that there should not be any difference in responsibility of the responsible party between an assertion-based and a direct-reporting engagement.

It was noted that Dr Yang dissented on ISAE 3000 and the withdrawal of ISAE 100 and ISA 120 for consistency reasons.

Mr Kellas noted the planned review of the proposed revised ISA on Accounting Estimates has been deferred until the April IAASB meeting.

2. Quality Control

Mr Archambault provided a summary of activities undertaken, and main issues addressed, by the Task Force since the December 2003 IAASB meeting, as presented in the agenda material. He also noted the Task Force had issued a letter in January 2004 to the IFAC Ethics Committee outlining matters that the Task Force believed should be addressed in the Code of Ethics based on

issues arising from previous discussions of the Task Force and the IAASB, as well as comments submitted by respondents during the exposure period.

The proposed International Standard on Quality Control (ISQC) 1 and revised ISA 220 were reviewed by paragraph.

For ISQC 1, in addition to editorial changes, the following items were agreed:

Introduction and Definitions

- Consideration of whether a firm is part of a network should be included in the description of factors that will affect the policies and procedures to be developed by firms to comply with the ISQC.
- Reference should be made to the IFAC Code of Ethics for those definitions that have been taken directly therefrom.
- A definition of the term “reasonable assurance” as “a high, but not absolute, level of assurance” should be added to the Standard but specifically noted as being used in the context of the ISQC.

Elements of a System of Quality Control

- A requirement to document and communicate quality control policies and procedures to the firm’s personnel should be established.

Acceptance and Continuance of Client Relationships and Specific Engagements

- The obligation to gather appropriate information about a client during the acceptance process should be made clear, along with the concept that the extent of knowledge a firm has about the integrity of a client grows throughout an ongoing relationship with that client.

Assignment of Engagement Teams

- The explanatory guidance addressing the need for policies and procedures to monitor the workloads and availability of firm personnel should be refocused to the monitoring of the workloads and availability of engagement partners, as the former may be impracticable.
- The required level of supervision of staff should be included as an overall consideration when determining the assignment of engagement teams.

Differences of Opinion

- For clarity, the requirement pertaining to the resolution of differences of opinion and the issuance of the report should be amended to state that the report should not be issued until the matter is resolved.

Engagement Quality Control Review

- The expectation of a modified report should be excluded from the criteria that a firm considers when determining which engagements (other than an audit of financial statements of listed entities) are to be subject to an engagement quality control review, in order to avoid implying that the existence of such an expectation would always result in a need for such a review.
- It should be made clear that the explanatory guidance pertaining to matters to be considered in an engagement quality control review applies to audits of financial statements of listed entities. However, engagement quality control reviews for engagements other than audits of financial statements of listed entities may, depending on the circumstances, include some or all of the listed considerations.

Monitoring

- Requirements should be established for firms to communicate to relevant engagement partners and other appropriate personnel deficiencies noted as a result of the monitoring process, and for recommendations to be developed for appropriate remedial action.
- The proposed statement that an independent external inspection program does not act as a substitute for the firm’s own internal inspection program should be clarified to state that

- such a program does not act as a substitute for the firm's own monitoring program. This change was intended to recognize that firms, particularly small- and medium-sized practices ("SMPs"), should be able to determine the scope of their internal inspection programs having regard to any independent external inspection programs.
- The explanatory guidance addressing the circumstance where firms within a network place reliance on some or all of a monitoring system on a network basis should be clarified to state that the guidance applies where firms within a network operate under common monitoring policies and procedures designed to comply with the ISQC and these firms place reliance on such a monitoring system.
 - The firm's policies and procedures designed to deal with complaints and allegations should also address allegations of non-compliance with the firm's system of quality control. The guidance should also be clear that firms are expected to establish appropriate channels to encourage personnel to raise any concerns without fear of reprisal.

The IAASB agreed that firms should establish systems of quality control in compliance with the Standard by June 15, 2005, and that firms also consider the appropriate transition arrangements for engagements in process at that date.

For ISA 220, in addition to editorial and consistency changes flowing from the amendments to ISQC 1, it was agreed that:

- The explanatory material pertaining to compliance with ethical requirements should be expanded to create a more active tone regarding the engagement partner's responsibility to remain alert for evidence of non-compliance with ethical requirements.
- Explanatory guidance pertaining to differences of opinion should be expanded such that it encourages the engagement partner, as necessary, to inform members of the engagement team that they may bring matters involving differences of opinion to the attention of the engagement partner or others within the firm as appropriate without fear of reprisals.

The IAASB agreed that the revised ISA 220 should be effective for audits of financial information for periods commencing on or after June 15, 2005. The IAASB reviewed and agreed conforming changes to related pronouncements and material.

Subject to certain editorial changes, the IAASB approved the issuance of ISQC 1 and ISA 220. Mr Tizzano dissented to the issuance of ISQC 1 since, in his view, the standard has been written in relation to the organizational structure of large firms and for the audit of financial statements conducted by them and consequently, the nature and extent of obligations may result in compliance and implementation difficulties for small- and medium-sized practices (SMPs). In addition, he believed that the approach taken in the standard conveys the message that the IAASB is not appropriately taking into consideration the needs of SMPs. Mr Tizzano abstained from voting on ISA 220.

3. Fraud

Mrs Esdon provided a summary of activities undertaken by the Task Force since issuance of the revised ISA 240 exposure draft (ED) and of the major comments raised by respondents to the ED, as presented in the agenda material. Mrs Esdon led the IAASB through a paragraph review of the proposed changes to the exposure draft.

Amongst other matters, the IAASB deliberated whether the guidance in the standard adequately communicates the inherent limitations of the audit with respect to detection of fraud such that the

public expectation gap is not inadvertently widened. After due consideration, it was agreed that the standard gives appropriate recognition to the risk of not detecting fraud while establishing the procedures that are necessary to increase its detection. It was further noted that the project dealing with reasonable assurance would consider this matter further.

Mr Kellas invited Ms Koski-Grafer, a representative from IOSCO attending the IAASB meeting as a public observer, to provide additional insight on IOSCO's response to the ED which had been the subject of specific discussion by the IAASB. She noted that IOSCO, while not necessarily in disagreement with the ED, had reached a consensus that the section of the standard on the auditor's responsibilities was somewhat negative as a result of including a discussion of the inherent limitations of an audit, and that separating positive statements about the auditor's responsibilities for fraud detection from the limitations would result in a more balanced document. The IAASB agreed to incorporate, to the extent appropriate, the suggested wording provided by IOSCO and agreed to a revised sub-heading for that section of the standard.

The IAASB deliberated whether the proposed construct of the guidance with respect to fraud resulting from improper revenue recognition is fully consistent with the US Statement on Auditing Standards (SAS) 99. After due consideration, it was agreed that the explanatory material should clarify that the auditor ordinarily presumes that there are risks of fraud in revenue recognition, that the auditor considers whether certain types of revenue, revenue transactions or assertions may be more susceptible to a risk of fraud, and that those assessed risks of material misstatement due to fraud are significant risks to be addressed in accordance with the requirement of the standard. It was also agreed that if the auditor has not identified, in a particular circumstance, improper revenue recognition as a risk of fraud, the auditor should document the reasons supporting the auditor's conclusions.

In addition to editorial, structural and other matters, it was also agreed that:

Introduction

- The introduction to the standard should be amended to convey the intention of the standard to expand on the application of the audit risk standards in relation to the risks of material misstatement due to fraud, and to explain that the standard is intended to be integrated into the overall audit process.

Professional Skepticism

- The discussion of professional skepticism should emphasize that although the auditor cannot be expected to fully disregard past experience, the maintenance of an attitude of professional skepticism is important because there may have been changes in circumstances.

Discussion Among the Engagement Team

- A requirement should be established regarding the engagement partner's responsibility to consider which matters are to be communicated to members of the engagement team not involved in the discussion. In addition, the related explanatory material should be expanded to emphasize that the discussion includes consideration of the audit procedures that might be selected to respond to the susceptibility of the entity's financial statements to material misstatement due to fraud.

Identification and Assessment of the Risk of Material Misstatement Due to Fraud

- The concept of the likelihood of the risk occurring, in addition to the magnitude of the potential misstatement, and the possibility that the risk might give rise to multiple misstatements should be included in the explanatory guidance.
- The standard should recognize that the auditor may conclude that it would not be practicable to design auditing procedures that sufficiently address the risk of material

misstatement due to fraud and that in such circumstances, the auditor may be unable to complete the engagement.

Overall Response

- The standard should include, in relation to the determination of an overall response to address the risk of material misstatement due to fraud, requirements for the auditor to consider the assignment and supervision of personnel and the accounting policies used by the entity, and for the auditor to incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures.

The IAASB agreed that the revised ISA 240 should be effective for audits of financial statements for periods beginning on or after December 15, 2004. The IAASB reviewed and agreed the conforming changes.

Subject to certain editorial changes being made, the IAASB unanimously approved revised ISA 240 for issuance.

4. Planning

Mrs Esdon provided a summary of the history of the project, the comments received on exposure and the results of the Task Force's deliberations thereon, and the major issues that the Task Force is seeking guidance on, as presented in the agenda material.

The IAASB generally supported the need for a standard on planning the audit. In relation to the scope of the standard and the requirement for an overall audit strategy and audit plan, the following was noted:

- The standard should be constructed in a manner that brings together important audit decisions that must be made before a significant amount of work is carried out in an audit. In this regard, the standard should reinforce, and demonstrate a greater interrelationship with, the provisions of the audit risk standards (such as performing risk assessment procedures and developing responses to assessed risks).
- The standard should contain more links with other ISAs (e.g., materiality, use of experts) that have important planning implications. It was noted, however, that the standard should not be duplicative of the guidance contained in other ISAs.
- It is unclear whether requiring the creation of an audit strategy is necessary and therefore, the standard should avoid an emphasis on the need for a specific output. In addition, use of the name "audit strategy" might be misleading given the operational nature of the items addressed in the related explanatory guidance.
- There is merit in the development of an audit plan, particularly in demonstrating that the thought process has taken place, or in specific situations such as audit of group financial statements. However, the standard could perhaps be made simpler than currently presented and recognize that planning occurs at different stages of the audit and at different levels.

The IAASB also noted the following comments on the proposed draft standard:

Introduction

- The original wording contained in the exposure draft for the introductory bold type lettered requirement should be retained.
- There may not be a need to retain the requirement for the auditor to plan the audit with an attitude of professional skepticism, as this requirement is established in another ISA.

Planning Activities

- The explanatory guidance pertaining to planning activities might usefully be expanded to include the thought that such activities can help contribute to the overall effectiveness of the audit. However, the guidance should avoid suggesting that the overall audit strategy relates to the development of an effective response to the overall risk of material misstatement as such activities may occur at a later stage in an audit than when audit planning actually takes place. Notwithstanding these suggestions, it was also suggested that further consideration be given to the necessity of that paragraph as the related bold type paragraph (paragraph 10) is reasonably self explanatory.

The Audit Plan

- Consideration should be given to explaining that the audit plan emerges from completion of the work required by the audit risk ISAs.
- Consideration should be given to indicating that in some jurisdictions, there is a requirement to communicate the audit plan to those charged with governance of an entity.

Direction, Supervision and Review

- The standard might usefully include a reference as to when the timing of the engagement quality control review occurs.

Documentation

- Consideration should be given as to whether the guidance sufficiently conveys the intended message that it is the nature of the matters documented, rather than the form, that is important, and that it is not the intent of the documentation requirements to duplicate the documentation of the audit process.

Way Forward

The Task Force agreed to seek approval of a final document at the next IAASB meeting.

5. Documentation

Mr Dassen introduced the members of the task force, explained why it was important for the IAASB to revise ISA 230, *Documentation*, and provided background to the issues highlighted in the Issues Paper, as presented in the agenda material. He noted that, subsequent to the finalization of the Issues Paper, the U.S. PCAOB issued an exposure draft on audit documentation, and that the Task Force as a whole had not yet had the opportunity to consider the PCAOB's proposals. The following issues were discussed:

- *The scope of the revised ISA.* The Task Force proposed that the scope should be limited to audit documentation, and that the title of the revised ISA should be amended to reflect that. Some IAASB members were of the view that documentation for review engagements should also be covered. It was agreed that the Task Force should consider documentation for both the audit and review of financial information, determining whether there are in fact differences.
- *The structure of the revised ISA.* The Task Force proposed that the revised ISA should be principles-based, and that specific documentation requirements should be covered in the ISAs to which they relate. The IAASB agreed that the revised ISA should be an "overarching" standard and that it should contain an appendix with references to other ISAs that contain specific documentation requirements. The periodic updating of the appendix could be managed by IAASB Staff.
- *Validation of existing requirements and guidance in other ISAs.* The Task Force proposed that it should not be responsible for validating existing documentation requirements and guidance in other ISAs. Mr Kellas suggested that the IAASB should reserve judgment on

this matter until such time as the principles have been agreed. It was agreed that the task of validating documentation requirements and guidance in other ISAs need not be carried out for the purposes of having a first draft of the ISA 230 exposure draft ready for the next IAASB meeting.

- *Small entity audit considerations.* The Task Force proposed that the existing guidance in IAPS 1005, *The Special Considerations in the Audit of Small Entities*, should be incorporated in the revised ISA without amendment and that the relevant paragraphs in IAPS 1005 should be withdrawn when the revised ISA becomes effective.
- *Retention of documentation.* It was debated why an auditing standard should deal with retention of documentation and the reasons for having a minimum period of retention. A majority of the IAASB supported having guidance on a minimum period as opposed to just generic guidance on how firms should determine retention periods.
- *Definition of documentation.* The IAASB agreed with the Task Force's proposal to revise the definition of documentation, since the existing definition does not distinguish between relevant and irrelevant / valid and invalid material.
- *Significant matters for documentation.* ISA 230 currently contains reference to significant matters for documentation, but does not indicate what they are. The IAASB was reminded that having a list of specific matters to consider for documentation would have the dual purpose of assisting the auditor in practice as well as providing a frame of reference in drafting other Standards. However, the IAASB cautioned that a legalistic definition should be avoided.
- *Should documentation be sufficient to enable reperformance of procedures?* The task force believed that documentation sufficient to enable reperformance would not be practicable. The meaning of such a requirement, and the view that the ability to reperform is key to accountability and supervision, were debated. It was also questioned whether an increase in documentation, which would lead to an increase in cost, would increase the quality of an audit.
- *Electronic documentation.* The IAASB agreed that there is merit in strengthening the guidance on electronic documentation.
- *Subsequent changes to documentation.* The Task Force noted the importance of balancing practical needs against the risk of inappropriate modification to documentation after issue of the auditor's report. The Task Force proposed that evidence documented subsequent to the issue of the auditor's report should be contemporaneous, i.e. it should have been obtained before the issue of the auditor's report. The IAASB agreed that the concept of documenting only contemporaneous evidence subsequent to the issue of the auditor's report should be further considered. It was also agreed that the PCAOB's requirement to document evidence obtained after the issue of the auditor's report, who filed it and who reviewed it, was one possible way to approach the issue but the auditor should not represent such evidence as forming part of the audit documentation supporting the audit opinion.
- *Should there be a limitation on the time for assembling the working papers?* It was noted that the PCAOB proposed 45 days for this purpose. The IAASB agreed that the revised ISA should not be prescriptive in this regard, but that it could contain guidance.
- *Multi-location audits.* While the IAASB did not agree with the PCAOB requirement that other auditors' documentation should be copied or sent to the group auditor, the IAASB

requested the Task Force to consider the recent exposure drafts on the work of other and related auditors and the audit of group financial statements.

- *Rebuttable presumption that if work is not documented then work was not performed.* It was noted that this concept was somewhat legalistic in nature and while it was appropriate from a regulatory point of view, it would not necessarily be so from an audit standards perspective. The IAASB asked the Task Force to consider the arguments for and against this presumption and report back to the IAASB.

The Task Force agreed to submit a proposed exposure draft for a first read at the next IAASB meeting in April 2004.

6. Project Proposal – Revision to ISA 800, The Auditor’s Report on Special Purpose Audit Engagements

It was noted that the main driver for this project was the revision of ISA 700, “The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements.” The IAASB noted the following:

- Some of the matters listed in the appendix for consideration at a later stage might not be separable from the three priority areas identified in the proposal, for example, limitation of use and distribution of the report.
- Although the project proposal suggested possible approaches to the issues, it was noted that the task force would still need to exercise judgment in determining how best to tackle the matters under consideration. In addition, it was noted that the task force should consider whether it would be in a position to address all three priority areas at the same time or whether it should divide its work with another task force.
- Care should be exercised in determining when an engagement to report on the financial information of components would fall under ISA 800 (i.e., when the report is external) and when it would not (i.e., when the engagement involves internal clearance memoranda from related auditors).
- The International Accounting Standards Board may be another group that may be affected by this project.

The IAASB approved the project proposal.

7. Next Meeting

The next meeting of the IAASB is scheduled for April 19-22, 2004 in Toronto, Canada.

8. Closing Remarks

Mr Kellas thanked the AICPA for hosting the meeting and with assisting with the necessary arrangements.

Mr Kellas closed the meeting.

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