

**Minutes of the 10th Meeting of the
INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD
Held on April 19-22, 2004**

At the Offices of the Canadian Institute of Chartered Accountants, Toronto, Canada

	Voting Members	Technical Advisors
<i>Present:</i>	John Kellas (Chairman)	Wolfgang Böhm (Mr Ferlings)
	Denise Esdon (Vice Chair)	Cédric Gélard (Mr Trémolière)
	John Archambault	Jon Grant (Mr Plaistowe)
	Philip Ashton	Josephine Jackson (Mr Ashton)
	Roger Dassen (except April 19)	Susan Jones (Mr Fogarty)
	Sukanta Dutt	Richard Mifsud (Mr McPhee) (except April 19)
	Josef Ferlings	Keith Newton (Mr. Archambault)
	John Fogarty	Emilio Palma (Mr Tizzano)
	Rogério Gollo	Greg Shields (Mr Desautels)
	Jan Bo Hansen	Sylvia Smith (Mr Kellas)
	Gen Ikegami	George Tucker (Mrs Esdon) (April 21-22)
	Ian McPhee	Yuichi Yamamoto (Mr Ikegami)
	Ian Plaistowe (April 21-22)	
	Roger Simnett	
	Roberto Tizzano	
	Gérard Trémolière	
	Mowafak Al Yafi	
<i>Apologies:</i>	Denis Desautels	David Kazzi (Mr Yafi)
		Tan Shook Kheng (Mr Dutt)
		Tania Sergott (Mr Hansen)
		Hans Verkruijsse (Mr Dassen)

	Non-Voting Observers
<i>Present:</i>	Thomas Ray
	Hisashi Yamaura

	IFAC Technical Staff	
<i>Present:</i>	Jim Sylph (Technical Director)	
	James Gunn	Michael Nugent
	Sylvia Barrett	Alta Prinsloo (April 22)
	Jan Munro (April 20)	Ken Siong

1. Opening Remarks and Minutes

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

Mr Kellas welcomed Mr Lindsell as the new chair of the task force addressing the topic materiality, and noted that he was replacing Mr Ward since Mr Ward had recently been nominated as Deputy President of IFAC. He also welcomed Ms Jackson and Mr Newton to their first meeting as technical advisors. He indicated the regrets of Mr Desautels for the duration of the week and that Mr Shields was nominated as his proxy, and the regrets of Mr Plaistowe for the first two days of the meeting, with Mr Grant nominated as his proxy during his absence.

The minutes of the public session of the meeting held on February 16-19, 2004 in New York were approved as presented.

Mr Kellas noted that the IFAC Board has commissioned Mr Wong, a past member of the IFAC Board, to study difficulties relating to implementation of international accounting and auditing standards on a national basis. It is anticipated that Mr Wong will report his finding to the IFAC Board in July.

2. Planning

Mrs Esdon provided a summary of the main changes made to the draft revised ISA 300, *Planning an Audit of Financial Statements*, arising from the previous discussion of the IAASB in February 2004. She led the IAASB through a review of the proposed changes to the exposure draft. In addition to editorial changes, the IAASB agreed the following:

Introduction

- The proposed statement that the standard is applicable to audits of entities of all sizes should be deleted, on the grounds that all ISAs are applicable as such.

Preliminary Engagement Activities

- The requirement setting out the preliminary engagement activities to be performed by the auditor should state that the identified procedures are carried out prior to starting, or performing significant audit activities for, the current audit engagement. In addition, activities such as carrying out acceptance procedures and other related considerations (e.g., communication with previous auditors) should be included as part of a separate requirement for initial audit engagements.

The Overall Audit Strategy

- In establishing the overall audit strategy, in addition to the items identified, the standard should guide the auditor to consider information obtained from past experience with, or from experience with other engagements performed for, the entity.
- The list of considerations for the development of the overall audit strategy should distinguish between those that are by nature broad operational planning matters (such as the timing and extent of involvement of experts, resource management considerations, the timing and extent of direction, supervision and review) and those that by nature affect how the audit will be conducted in achieving its objectives(for example, the determination of materiality, key risk areas and planned reliance on internal controls). In doing so, the standard should recognize that the operational and the more technical planning matters influence one another and are interrelated.
- The section should give recognition to the fact that decisions pertaining to the overall audit strategy flow into the decisions to be made in the audit plan, and that their development is closely interrelated and not necessarily discrete or sequential. The standard should include additional guidance that helps bridge the auditor's consideration of overall audit strategy and the auditor's consideration of matters to be addressed in the audit plan.

The Audit Plan

- The standard should emphasize that the development of the audit plan is the outcome of the iterations of a planning process that occurs throughout the audit.

Direction, Supervision and Review

- In addition to the timing and extent, the nature of the direction and supervision of engagement team members should also be considered by the auditor in planning the audit.

Documentation

- The standard should require the auditor to document any significant changes made to the audit strategy and the audit plan during the audit engagement.
- The proposed example in paragraph 25 of how specific audit methodology and technology affect the form and extent of documentation should be deleted, as the explanatory guidance provided is sufficient on its own.

Appendix

- The Task Force should consider revising the structure and organization of the appendix in order to align it with the changes agreed to in the main text of the standard.

The Task Force agreed to seek approval of a final standard at the June 2004 IAASB meeting.

3. Clarity of IAASB Standards

Mr Kellas provided a summary of the background and objectives of the project, the direction being taken by the Task Force and the nature of the material it plans to present to the IAASB in June 2004. In this regard, he noted the following:

- In response to concerns expressed by IOSCO and others over the use of the present tense in the explanatory material of ISAs and the potential ambiguity of the authority of bold versus grey type lettering, the Task Force had presented a proposal to the IAASB in December 2003 to adopt a drafting convention similar to that being proposed by the U.S. Public Company Accounting Oversight Board. While generally supportive, the IAASB concluded at that time that the impact the proposal might have on the existing standards should be fully investigated before agreeing on a way forward, and that additional aspects of clarity should also be further considered.
- In January 2004, the Task Force consulted representatives of national auditing standard setters (NSS) about their views on the clarity of IAASB's standards. This exercise reinforced the need to improve the way in which professional requirements are communicated in ISAs, but also the importance of evaluating how ISAs could be restructured to help improve their usefulness to small- and medium-sized practices and to assist with international convergence.
- Taking account of the views expressed, the Task Force has pursued the development of a plan to improve the clarity of IAASB's standards that comprise the following three elements:
 - A review of sentences using the present tense of selected ISAs (with the assistance of a past IAASB member) to identify whether any represent, in effect, professional requirements that would be better expressed as a "should" statement. Mr Kellas noted that this exercise has given some reassurance that the application of the drafting convention, as proposed in December, would not result in a substantial increase in the number of professional requirements in ISAs.
 - A restructuring of ISAs whereby the professional requirements of an ISA are separated from their related explanatory material, with the latter to be presented separately. Mr Kellas noted that this restructuring would not result in a revision of the standards; as far as possible, existing words of ISAs would be retained. He also noted that attention is being placed on establishing an appropriate mechanism that helps ensure that the repositioned explanatory material cannot be overlooked by the auditor.

- The identification of “fundamental principles of auditing.” Mr Kellas noted that the Task Force is not yet persuaded that these principles can be produced; they are, however, not seen as critical to the furtherance of the project.
- The overall objective of the project is to achieve an outcome that will result in a clearer understanding of what is expected of auditor and what is explanation of how the auditor should fulfill these expectations. Care is being taken to avoid anything that may be perceived as weakening the ISAs.
- The Task Force is conscious of the need for the support of the IAASB and stakeholders early in the project. Accordingly, a discussion paper will be presented to the IAASB at its June 2004 meeting for consideration and possible approval for exposure. It is envisioned that, if the proposals of the Task Force meet with general approval, the issuance of the complete package of restructured ISAs might be ready for exposure by September 2005.

Mr Kellas noted that relevant aspects of the proposal will be discussed with the IAASB CAG and IOSCO in advance of their discussion with the IAASB. Opportunities to inform regulators and others of the direction of the project have also been taken, where available.

4. Materiality

Mr Lindsell provided an overview of the project and of the issues paper, and led the IAASB through a paragraph review of the draft revised standard. In addition to editorial and structural changes, and after discussion, the IAASB agreed the following:

Qualitative Assessment of Materiality when Planning the Audit

- The Task Force should consider how the standard could clarify: (a) that consideration of misstatements of particular items of lesser amounts than the materiality level determined for the financial statements taken as a whole relates primarily to quantitative decisions taken when planning the audit and not to qualitative decisions taken into account at the evaluation stage; and (b) the distinction between these lesser “materiality” amounts and “tolerable error” determined to assess risks at the assertion level.
- The Task Force should reconsider the application of the standard to special purpose financial statements. Of particular relevance is the auditor’s understanding of the needs of specific users. The standard should not give detailed guidance (which should instead be given in specific standards related to those other types of engagement), but could include a statement that the general principles apply equally to other types of engagement.
- The Task Force should consider whether the application of terms such as “the financial statements taken as a whole,” “complete set of financial statements” and “true and fair/present fairly” can be explained early in the document, making application of the document more generic.
- The document need not consider issues specific to reviews, which should be considered in the project on the review of interim financial information and in the revision of ISRE 2400.
- The reference to solvency as an example should be deleted in the paragraph dealing with lowered planning materiality levels due to the specific circumstances of the entity.
- Anomalies, such as missing analysts’ predictions by “a penny” or changing a marginal loss to a marginal profit by virtue of an otherwise immaterial amount, cannot reasonably be taken into account in determining planning materiality, but planning materiality for some items (e.g. directors’ emoluments) should take account of specific qualitative considerations.

Users and their Expectations

- The identification of “users” as the addressees of the auditor’s report should be modified. The Task Force should consider the wording of the Assurance Framework, the ED of ISA 700 and the wording of the IASB Framework in this context.

- As there is not necessarily a shared understanding of materiality across user groups, or indeed across auditors in different jurisdictions, the Task Force should introduce quantitative guidelines/rules of thumb regarding materiality levels, as done in some national accounting and auditing standards.

Misstatements Arising from Differences of Judgment

- The current classification of misstatements arising from differences of judgment as a distinct category from known misstatements and likely misstatements was queried, as it was felt to be more correctly a sub-category. The IAASB, however, acknowledged that distinguishing misstatements arising from differences in judgment from factual misstatements can be useful when communicating with those charged with governance. It was therefore agreed that the Task Force should reconsider how the categorization could be presented and also consider whether a different term could be used that would give more emphasis to the fact that these misstatements relate to the inherent imprecision in accounting estimates.

Relationship Between Materiality and Risk

- The standard should specifically address the relationship between materiality and risk at the assertion level and tie this into the discussion of tolerable error.
- The Task Force should draw upon the guidance in ISA 200 that deals with the relationship between materiality and risk, and also consider whether materiality need always be determined prior to risk assessment.
- A paragraph referring to fraud should be added making clear that normal materiality considerations do not apply when an actual or suspected fraud is identified.

Definition of Materiality

- The IAASB considered the implications of having a different definition in the draft standard than in the financial reporting framework used for the preparation of the financial statements. The Task Force was asked to consider retaining the proposed definition in the draft standard, but noting that it would not apply if, in a particular engagement, the financial reporting framework included a different definition.

Allocation of Materiality/Tolerable Error

- While expressing some concern that “tolerable error” should not be read to imply that misstatements due to fraud should be excluded, nor that there is a level of error or fraud that should be tolerated, the IAASB expressed a preference for having one term (“tolerable error”) throughout the draft standard rather than having two terms (“tolerable error” and “tolerable misstatement”). The IAASB did not consider that there would be a difficulty in applying the term “tolerable error” more broadly than just to statistical tests.

Groups

- The word “ordinarily” should be deleted in paragraph 20 as its retention would require an auditor who finds one error in one component of a group, to do additional work in all components, which is neither reasonable nor practical.

Communications

- The Task Force should continue to develop the section dealing with communication to those charged with governance, and should liaise with the Task Force addressing the revision of the ISA on communication with those charged with governance as appropriate to determine the ultimate content and disposition of paragraphs 28 to 41.
- The standard should make clear that, in communications with those charged with governance, there is recognition that there may be undetected misstatements.

Representations

- As the issue of who written representations should be obtained from will be considered in the project to revise ISA 580, it was suggested that paragraphs 42 and 43 should not be exposed in the proposed revised ISA 320 and that the Task Force should liaise with the Task Force revising ISA 580.

Possible management bias

- The Task Force should continue to liaise with the Task Force addressing the topic of the audit of accounting estimates in the consideration of management bias, and how it may be measured and taken into account when evaluating the effect of misstatements.

Other matters

- Noting that the paragraphs dealing with the “nature and causes of misstatements” do not exclusively relate to materiality, the Task Force was asked to consider whether this material is adequately covered elsewhere and, if so, whether it should be retained in the standard on materiality.
- The standard should require the auditor ordinarily to communicate the materiality level and related planning issues to those charged with governance, with explanatory guidance indicating the circumstances when such communication may not be appropriate.
- The list of circumstances that may affect the evaluation of whether a misstatement is material should continue to be separate from the guidance regarding the determination of materiality when planning the audit.
- The paragraphs dealing with the auditor’s report and legal and regulatory reporting responsibilities should be deleted, but those dealing with documentation should be retained.

The IAASB indicated that it would not expect to see a draft revised standard for approval at the June meeting, but, if possible, a report on the definition of materiality in different financial reporting frameworks.

5. Estimates

Mr Kellas welcome Mr Noonan, a member of the Estimates Task Force, and Mr Leonard, a staff member from the Auditing Practices Board supporting the Task Force, to the meeting.

Mr Ashton provided a summary of the objectives of the project and its relationship with the project on materiality. He thanked those members that had submitted comments on the draft revised standard circulated to the IAASB in February, and noted that these comments will be considered at the next meeting of the Task Force.

Mr Ashton led the IAASB through a review of the draft revised standard. In particular, Mr Ashton drew attention to the linkages with the draft revised standard on materiality (ISA 320), and noted that comments made by the IAASB in the preceding discussion of the project on materiality would, where appropriate, be taken up in the revised draft standard on estimates. In addition to editorial and structural changes, and after discussion, the IAASB agreed the following:

Introduction

- The term “measurement uncertainty” should be replaced by the term “estimation uncertainty.”
- The Task Force should reconsider the drafting of the requirement that the auditor determines “that accounting estimates are both in compliance with the entity’s financial reporting framework and are reasonable in the circumstances.” It was suggested that the expression “and are reasonable in the circumstances” should become “or are reasonable in the circumstances”. The Task Force was also asked to consider whether the rationale for the two-step approach can be more fully explained.

- The Task Force should consider the use of some form of qualifier to the term ‘bias,’ such as “inappropriate bias,” to differentiate it from bias that is inherent in the financial reporting process. Additional explanatory material explaining the difference should be developed within the standard.

Risk Assessment Procedures

- The proposed description of the risk assessment procedures to be performed by the auditor should be revised to capture a conceptual ‘two-stage’ process comprising: (a) procedures that help the auditor gain an understanding of how management identifies and controls risks that may give rise to the need for accounting estimates and how management determines where accounting estimates may be required; and (b) procedures that provide the auditor with an understanding of how those estimates are assessed as giving rise to a risk of material misstatement.
- The purpose of the proposed requirement for the auditor to perform procedures on the outcome or re-estimation of significant accounting estimates made in the prior period should be expanded to include guidance on why these procedures are important and what the auditor does with the findings from the procedures, and to explain the fact that the auditor is not re-auditing prior year’s estimates but rather gaining an understanding of how effective management has been in determining accounting estimates.

Methods and Assumptions Used in Making Accounting Estimates

- The Task Force should reconsider the use of the proposed term “reasonably possible outcomes” and how it might be defined and further elaborated upon, including the consideration of whether the concept of ‘probable outcomes’ would help to narrow possible differing interpretations. It was suggested that it may be useful to restrict the use of the expression to circumstances where each outcome in the range is considered to be equally possible.
- The guidance should recognize that management may determine estimates in different ways, and that a determination by management of a “range of reasonably possible outcomes” is not mandatory. The emphasis of this paragraph should be on using management’s range if they produce one.
- The complexity of the mathematical calculation of an estimate should be connected with the risks of material misstatement, rather than used as an example of the circumstance that may give rise to measurement uncertainty.
- The Task Force should consider whether the proposed statement that the auditor obtains an understanding of the assumptions underlying accounting estimates should be established as a bold type requirement, or, alternatively, linked to the section of the standard addressing the evaluation of the reasonableness of management’s assumptions.

Assessing the Risks of Material Misstatements

- Additional guidance explaining the concept of “assessing the risks of material misstatements at the financial statement level” should be provided, including strengthening how it links to the audit risk standards and explaining which of the factors therein should be taken into consideration (e.g., previous year experience). In particular, it was suggested that the bold type requirement should explicitly cross refer to ISA 315.
- In setting up the three proposed categories of accounting estimates, the standard should give recognition to the fact that there are other aspects of estimates beyond the degree of measurement uncertainty that may give rise to the auditor’s assessment that an accounting estimate is a significant risk. Mr Bohm undertook to provide the Task Force with wording that would overcome the difficulties that he had with the differentiation of the three categories.

Responding to the Risks of Material Misstatement

- The Task Force should consider whether restructuring this section might help improve the drafting of the standard. It was suggested that paragraph 30, which is in grey type, could be set in bold type and that a number of subsequent bold type paragraphs could then be deleted.

Using the Work of an Expert

- Matters that the auditor should consider when determining the need to use the work of an expert, and the auditor's consideration of whether the methods used by the expert are consistent with the requirements of the entity's financial reporting framework, should be included in standard.

Audit Procedures Responsive to the Risks of Material Misstatement at the Assertion Level

- The standard should clarify that the auditor is required to adopt one or a combination of the identified approaches in responding to the risk of material misstatements at the assertion level, as the use of the word "whether" in paragraph 33 may be interpreted as not requiring the auditor to adopt one or a combination of the identified approaches.
- The Task Force should consider how the alternative approach for the auditor to test the "operating effectiveness of the process used to develop the accounting estimate" could be recast to better align it with the comparable provisions of ISA 545, *Auditing Fair Value Measurements and Disclosures*.
- The example used to illustrate how subsequent events might be used as an audit procedure should be clarified and elaborated upon.

Responses to Significant Measurement Uncertainty

- The Task Force was asked to make much more explicit the requirement for the auditor to reduce the range of reasonably possible outcomes.

The Auditor Independently Develops a Range of Reasonably Possible Outcomes

- The standard should emphasize the idea that the auditor may independently develop a range of reasonably possible outcomes where such a range acts as a useful tool in identifying possible management bias and the auditor is otherwise not satisfied (a) with the process followed by management in determining the estimate, or (b) that there is not inappropriate bias. In doing so, the Task Force should consider developing guidance that explains the objective of independently developing a range and how that information is to be used.
- The standard should explicitly consider the possibility of both auditor and management developing best estimates (that differ) without either developing a range of reasonably possible outcomes.

Evaluating Compliance with the Recognition Criteria of the Financial Reporting Framework

- The Task Force should consider whether the bold type paragraph is sufficiently robust to enable the auditor to challenge management's evaluation, and whether a requirement is needed for the auditor to evaluate the appropriateness of management's conclusion in those circumstances where, on the basis that the recognition criteria have not been met, a transaction or event has not been recognized.
- The standard should clarify that the auditor evaluates management's assessment of whether the recognition criteria have been met, rather than being presented as the auditor's responsibility to do so. The Task Force was asked to consider whether the requirement to evaluate compliance with the recognition criteria should be extended beyond significant risks.

Misstatements Arising from Differences in Judgment

- If management's point estimate falls within the auditor determined range of reasonably possible outcomes, and if the outcomes within that range have an equally possible chance of occurrence, then there is not a misstatement. Accordingly, the substance of the draft standard should remain unchanged in this regard. However, the drafting should be improved to emphasize that the relevant circumstances are a range of reasonably and equally possible outcomes.

Possible Management Bias

- The standard should use the mid-point within the range of reasonably possible outcomes in determining an indication of possible bias where each point in the range is considered to be an equally possible outcome.
- If management moves its best estimate figure within the range from one period to the next in the absence of a change in circumstance or new information, then the auditor should consider the impact of this change as a misstatement. Consequently, the standard should revise the definition of misstatement to include unsupported swings in point estimates within the range of reasonably possible outcomes. The IAASB noted that the measurement of the misstatement is the total change in management's best estimate from the previous period.

Appendices

- The appendices should be updated to reflect changes to the standard for purposes of IAASB discussion; whether the appendices should form part of the exposure draft is to be determined after further consideration.

Noting that the proposed revised standard will create significant differences with ISA 545, the IAASB agreed that the Task Force should formulate a recommendation as to how ISA 545 should be dealt with.

The Task Force agreed to seek approval of a proposed exposure draft at the September IAASB meeting.

6. Documentation

Mr Dassen introduced Ms Anerud from INTOSAI as a participating member of the task force, and indicated that Mr Gollo has joined the Task Force. He noted that the Task Force will liaise with the US Auditing Standards Board as it develops its own project on documentation.

Mr Dassen summarized the major issues and recommendation of the IAASB at the last meeting, explained the proposed treatment by the Task Force as presented in the agenda material, and led the IAASB through a review of the proposed standard. In addition to editorial and structural changes, and after discussion, the IAASB agreed to the following matters:

Scope of the Revised Standard

- The scope of the revised standard should focus on documentation of matters relating to the audit of financial statements, and a new ISRE addressing documentation for review engagements should be developed separately.

Introduction

- The proposed requirement for the auditor to prepare and maintain audit documentation that supports the auditor's opinion should be clarified to state that the auditor must be able to identify where that information has been retained. The standard should also address the documentation of information that is not necessarily supportive of the opinion, but which has been used by the auditor in formulating an opinion on the financial statements.

Definitions

- The Task Force should reconsider whether it is appropriate to define the terms "contemporaneous evidence" and "experienced auditor."
- The Task Force should consider developing a definition for the term "audit documentation." In doing so, the footnote stating that the auditor may support the auditor's report by other means in addition to audit documentation should be revised, or deleted, as it may appear to weaken the overall standard.

Form, Content and Extent of Audit Documentation

- The requirements of the standard regarding the extent of audit documentation should be closely aligned with the requirements of ISQC 1.
- The Task Force should reconsider whether the proposed criteria for sufficiency of audit documentation are suitable as part of the professional requirements of the standard, and if so, how they may relate to, and be applied particularly in, the circumstance of sole practitioners.
- The guidance supporting the requirements on the content of audit documentation should be expanded to: (a) explain that the evidencing of the review of audit documentation is for the purpose of indicating that a review was conducted (and not for purposes of agreeing on the resolution of an issue), and (b) explain that each document reviewed should be signed-off and dated at the time the review is conducted.
- The Task Force should consider aligning the list of factors affecting the form and content of audit documentation to those contained in US SAS 96, *Audit Documentation*.

Documentation of Specific Items Tested

- Additional guidance should be provided explaining the objectives and importance of the requirement for the auditor to document specific items tested. In addition, the Task Force should consider aligning the matters that should be considered for documentation with those identified in US SAS 96.

Subsequent Changes to Documentation After the Date of the Auditor's Report

- The Task Force should consider the definition of “audit evidence” as used in ISA 500, *Audit Evidence*, in determining whether information that comes to the attention of the auditor after the date of the auditor's report constitutes evidence, or whether it is to be considered additional information.
- The standard should recognize that the determination of whether information that has been received after the date of the auditor's report represents (a) evidence that has been requested by the auditor before the date of the auditor's report, or (b) a subsequent event, is important in determining how the information is to be considered by the auditor and how it should be documented. In this regard, the Task Force should consider guidance as to the auditor's responsibilities to retain such information as an identifiable part of the audit file and the need to document when the information was received and how it has affected the auditor's conclusions.
- The Task Force should determine whether information that has been requested by the auditor before the date of the auditor's report, but received subsequently, represents audit evidence or the documentation thereof.
- The standard should require completion of the documentation of contemporaneous evidence after a certain specified period of time after the audit report has been signed and dated.

Retention of Documentation

- The standard should set a five year minimum retention period extending from the date of the auditor's report (for group audits, the date of the group auditor's report), and should explain that an extended retention period should be considered taking account of the objectives and purpose of the audit documentation and national requirements.
- The standard should require audit documentation to be in such a form that enables (a) the identification of the corpus of audit evidence supporting the auditor's opinion on the financial statements, and (b) access and retrieval in a coherent manner.
- The Task Force should consider guidance on the retention of original documents taking account of digitalization practices being adopted by many firms.

Confidentiality

- The standard should recognize that confidentiality should always be observed by the auditor unless specific authority has been given to disclose information or there is a legal or professional duty to disclose.

Rebuttable Presumption

- The principle of a rebuttable presumption that work that is not documented was not performed should not be adopted.

The Task Force agreed to submit a proposed exposure draft for approval at the June 2004 IAASB meeting.

7. Interims

Mrs Esdon introduced the topic, noting that thirty-one comment letters had been received on the exposure draft issued in June 2003, and indicated that the Task Force was seeking the IAASB's concurrence on the resolution of significant issues arising from the exposure process before proceeding to redraft the proposed ISA. Mrs Esdon led the IAASB through the issues in the agenda paper, and after discussion, the IAASB agreed the following matters:

- *Need for a separate ISA on review of interims.* The Task Force should continue to develop this ISA and, at the same time, use what it has learned from this project to comprehensively identify the issues (and tentative solutions) that are likely to arise in the revision of ISRE 2400. In arriving at this decision, the IAASB noted that issuing the proposed ISA without reviewing ISRE 2400 may lead to unreconciled differences between the two documents, and that issues with ISRE 2400 identified through this project would not be promptly addressed unless the review thereof was carried out as this project progressed. In addition, the report issued under the proposed ISA may not be sufficiently different from that issued under an ISRE 2400 engagement for the user to be aware of the different work effort required and the consequent difference in the nature of the assurance obtained by the practitioner. In this regard, the IAASB noted the need to consider further whether the differences in the work effort should be reduced or eliminated or whether the difference in the reports should be reduced or eliminated. It was also noted that the differences between the proposed ISA and ISRE 2400 should be identified and analyzed and, depending upon the nature of the differences, it might be appropriate to merge the two documents. Further, it was suggested that the regulatory environments in jurisdictions where reviews are common differ, and the effect of this on both the proposed ISA and ISRE 2400 need to be addressed.
- *Interims issued under legislation.* The requirement that the entity is required or permitted to issue the interim financial information should be deleted.
- *Requirement to file.* The Task Force should reconsider the requirement that the annual financial statements be publicly available, particularly when the interims are: not condensed; not publicly available; prepared for a non-listed entity, and/or prepared in accordance with a recognized framework
- *Listed entities.* The auditors of non-listed entities should not be precluded from using the proposed standard. In addition, the Task Force should further consider whether the approach outlined in the agenda paper whereby ISRE 2400 is not to be used for a listed entity is appropriate, particularly when there is little distinction in the report under the proposed ISA compared to ISRE 2400.
- *Audit-based knowledge.* The standard should require the same level of understanding of the entity as that required to perform an audit
- *Reporting.* The Task Force was asked to consider further the use of "true and fair/present fairly," taking into consideration: (a) whether interim financial information (whether a full set of financial

statements or condensed) can be “true and fair/presented fairly” when, because of the timeframe in which they are prepared, the use of more estimation is required than in the preparation of annual financial statements; (b) whether there is any evidence of misunderstanding in those countries where legislation or practice requires use of “true and fair/presented fairly” for interims; and (c) the use of “true and fair/presented fairly” in existing ISRE 2400 and ISA 800.

- *Objective of a review.* The Task Force was asked to consider whether both the alternatives identified (i.e. expanded description of procedures and guidance on the level of assurance obtained) should be implemented in the proposed standard, taking into consideration whether: (a) it might be confusing to describe the level of assurance in positive terms when a negative expression of conclusion is required in the report, and (b) the phrase “plausible in the circumstances” is appropriate given the difficulty experienced with this expression in drafting the Assurance Framework.
- *Inability to complete a review.* The Task Force was asked to reconsider the appropriateness of providing a qualified report on an incomplete review, particularly when a limitation is imposed by circumstances rather than by management.

8. Modifications to the Independent Auditor’s Report

Mr Hansen provided background to the project and led the IAASB through the issues identified by the Task Force and its proposals to address the issues. The following issues were discussed.

- *Project Objectives and Scope.* The IAASB agreed with the proposed objectives of the project and the scope of the revised standard, and with the idea of moving away from the term “modifications” for both qualifications and emphasis of matter paragraphs. It was noted, however, that the revised standard should make clear that the principles relating to qualifications are applicable to special purpose engagements (while recognizing that the revised standard is not intended to address specific special purpose engagement reporting matters). In addition, it was noted that if emphasis of matter guidance is placed into ISA 700 as proposed, this change would constitute more than a conforming change and that the proposed guidance and placement into ISA 700 need also to be exposed for comment.

- *Emphasis of Matter Paragraphs.* The proposal to expand the requirements for emphasis of matter paragraphs was generally not supported by the IAASB, as doing so may widen the expectation gap.

The IAASB agreed that emphasis of matter paragraphs should not be the norm; industries with inherent uncertainties and the use of the true and fair view override are not so unusual as to warrant further emphasis, the nature of uncertainties that are common to certain industries are generally understood by readers, and financial reporting frameworks that permit the override ordinarily contain disclosure requirements when the override has been invoked. In this regard, the IAASB agreed that: (a) the existing requirements for emphasis of matter in proposed ISA 701 and other ISAs should be retained; and (b) although it may be difficult to articulate, emphasis of matter paragraphs should also be required if the auditor judges that it is necessary so that the reader is not misled or misunderstands information in the financial statements.

- *Types of qualifications.* In response to the issue of whether it is necessary to expand the existing framework to address conflicts between regulatory requirements and generally accepted accounting principles (applicable accounting framework), the IAASB recommended that the Task Force not create a third category of qualification. The Task Force was requested to try to link the issue to the guidance introduced in IAPS 1014 and to relate such circumstances to the existing two types of qualifications (disagreement with management and scope limitations).
- *Communicating Imposed Scope Limitations* The IAASB agreed that, in principle, the auditor should not tolerate limitations imposed by management. It was noted that the Task Force needs to consider

the difficulty in distinguishing between limitations imposed by management as opposed to the circumstance and, therefore, if guidance is to be developed, it should start with the premise of the need for professional judgment.

- *Strengthen the Guidance Relating to Acceptance of, or Withdrawal From, an Engagement.* The IAASB agreed with the proposal to strengthen the guidance relating to acceptance of, or withdrawal from, an engagement. It was noted, however, that the guidance may be better placed in ISA 210.
- *Seriousness of the Qualification to the Auditor's Opinion.* The IAASB agreed with the proposal to retain the term "pervasive" and to expand the definition of the term as it applies to disclaimers of opinion and adverse opinions, and to the Task Force's proceeding with the approach of developing general guidance instead of guidance relating to specific circumstances.
- *Multiple Uncertainties and Disclaimer of Opinion.* The IAASB generally agreed with the concept that multiple uncertainties may require a qualified opinion, but noted that it will be difficult to develop guidance to determine at what point multiple uncertainties result in a disclaimer of opinion instead of requiring an emphasis of matter. In addition, it was noted that:
 - Where there are multiple uncertainties, an unqualified opinion with an emphasis of matter paragraph may not be sufficiently effective in communicating the possible effect of the uncertainties. The auditor needs to consider whether the cumulative effect starts to have a pervasive effect on the financial statements.
 - Some practitioners consider that a stronger response, such as a qualification of the auditor's opinion, is required in such circumstances.
 - Obtaining sufficient audit evidence where there is uncertainty is always difficult given that it is not possible to know the outcome of uncertainties. However, the auditor should obtain sufficient appropriate audit evidence with respect to the entity's disclosures about the uncertainties (such as its estimates and assumptions).
 - Generally, the auditor is able to obtain audit evidence for routine, general uncertainties and, therefore, developing a requirement to disclaim an opinion should be more related to the unusual, complex uncertainties.
- *Form and Content.* The IAASB supported the overall principle that the auditor's report should not be a substitute for information that is required to be included in the financial statements. There were mixed views about the use of subheadings, with members noting that the benefit of drawing readers' attention to the qualification by a subheading needs to be considered in light of the effect of breaking up the flow of the report.
- *Quantifying the Effect of the Matter.* The Task Force noted that it intends to retain the existing guidance but to expand it to clarify that the auditor's responsibility does not extend to that of management or result in including disclosures that management has a responsibility to include in the financial statements. The Task Force will consider developing guidance based on the U.S. standard AU Section 508, *Reports on Audited Financial Statements*.
- *Other matters.* The Task Force should consider the treatment of the following situations: (a) if one of the financial statements (for example, cash flow statement) has been omitted, what information should the auditor include in the qualification; and (b) where the opinion for the current period differs from that on the prior period (although this matter is addressed in ISA 710). The IAASB also agreed that "piecemeal opinions" should not be explicitly permitted (although the IAASB recognizes that certain specific circumstance in initial engagements require reporting similar to piecemeal opinions), and that the illustrative reports should be moved into an appendix instead of being retained in the body of the text.

9. Communications

Mr McPhee introduced Ms Myklebust from INTOSAI as a participating member of the task force, and led the IAASB through the issues in the agenda paper. The IAASB, after due consideration, agreed the following:

Communication “from” versus “between”

- The IAASB will not attempt to provide guidance for communication *with* the auditor *by* those charged with governance. It was suggested, however, that IFAC should consider producing, in partnership with a representative body(ies), guidance for those charged with governance that could perhaps be released at the same time as the revised standard.
- The revised standard should present formal requirements in the context of the auditor “communicating with” those charged with governance, and specifically note that communication is a two-way process, a fact that is also to be reflected in the tone and content of the revised guidance.
- The Task Force should consider any relevant issues related to representation letters from those charged with governance.

The Auditor’s Responsibility to Communicate

- Reporting to those charged with governance should not necessarily be characterized as only a by-product of the obligation to form an opinion, as communication with those charged with governance, for example about the quality of accounting policies, can directly affect the quality of the audit.
- The articulation of responsibilities per the table in the agenda papers should be incorporated into the standard.
- Regarding members of the firm other than the audit team, matters should only be required to be communicated to those charged with governance if they have a direct and major bearing on the financial statement audit. It was noted however that those charged with governance may choose to agree with the auditor that findings from other services provided by the audit firm are to be reported to them – discussion of this matter would be an important part of establishing expectations.
- Regarding matters relevant to aspects of governance other than overseeing the financial reporting and disclosure process, it was noted that the risk factors in the revised ISA on fraud may help frame appropriate guidance. While potential difficulties such as lack of criteria and lack of specific training and competence were noted, it was agreed that the auditor cannot ignore “looting the company.” The requirement with respect to such matters should be a passive one (rather than an active duty to detect), and the Task Force should consider the relationship of this guidance with that to be considered by the Task Force addressing the project on related parties.

Reporting to Others

- It would not be practicable to attempt to provide definitive guidance, beyond a general discussion of the alternatives and that it may be appropriate to consult legal counsel, for situations such as when the auditor is dissatisfied with the actions those charged with governance have taken on significant matters communicated to them.

Other Engagements

- The scope of the standard should be restricted to financial statement audits only, but the Task Force should specifically consider, at least towards the end of the project, what action the IAASB should take (if any) to cater for other assurance engagements.

Terminology

- The current terminology (i.e., “those charged with governance”) should continue to be the predominant term used. This will necessitate use of other terms in some circumstances, for example “those who are responsible for approving and issuing the financial statements,” because it

is likely that some of the communication responsibilities of the revised standard will be aimed at different people or subgroups, depending on the functions they perform.

- The Task Force should undertake a review of all instances where terms such as management, directors and audit committee are used in the existing ISAs, and recommend (a) a series of definitions or protocols that refer to the relevant functions performed, rather than the people or body within any particular form of organization who perform those functions, to allow a consistent terminology regime to be implemented regardless of jurisdiction or organizational structure, and (b) conforming changes for other ISAs.

Identifying Those Charged with Governance

- The key functions of those charged with governance, as that term is used in ISA 260, should be (a) to oversee the strategic direction of the entity, and (b) to discharge accountability obligations. In addition, the standard should recognize that, while it will vary from jurisdiction to jurisdiction and entity to entity, those charged with governance can ordinarily delegate some functions to others, e.g. an audit committee.

Other Matters

- The guidance contained in IAPS 1005 should be included, amended as appropriate, in the revised standard.
- The revised standard should have an appendix that identifies all instances in other ISAs where communication requirements appear.
- The Task Force should seek to develop further guidance to assist auditors with the timeliness of communication.
- The revised ISA should not have different requirements for different types of entity.

10. Project Proposal – Revision to ISA 580, *Management Representations*

Mr Sylph introduced the project proposal, as presented in the agenda material. The IAASB noted the following:

- The project should give consideration to, and address the purposes of, obtaining representations (for example, whether for risk management, confirmation of management assertions, corroborative evidence or other), the quality of management representations as evidence and the role such representations play in corporate governance. Consideration should also be given to ISA 210, *Terms of Audit Engagements*, in terms of how these ISAs will interrelate.
- Representations should only be for matters of management's intent, and not to act as a substitute for audit evidence.
- With regard to representations that should not be obtained, it was suggested that caution should be exercised because representations do contain information that may be evidence, even if such representations appear obvious.

The IAASB approved the project proposal.

11. Next Meeting

The next meeting of the IAASB is scheduled for June 14-17, 2004 in Copenhagen. Mr Kellas reminded task forces to endeavor to ensure all agenda materials are ready by the submission deadline of May 19th so that sufficient time is available for due consultation on the papers before the meeting.

12. Closing Remarks

Mr Kellas thanked Mr Shields and the Canadian Institute of Chartered Accountants for hosting the meeting and for assisting with the necessary arrangements.

Mr Kellas closed the meeting.

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