

**Minutes of the 17th Meeting of the
INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD
Held on October 19-21, 2005 in New York, USA**

Voting Members*Present:*

John Kellas (Chairman)
Denise Esdon (Deputy Chair)
Inga-Britt Ahlenius (October 19)
Philip Ashton
Craig Crawford
Josef Ferlings
John Fogarty
Rogério Gollo
Jan Bo Hansen
Gen Ikegami
Will Rainey
Bodo Richardt
Roger Simnett (October 19, 21 via
telecommunications link)
Roberto Tizzano
Apologies: Sukanta Dutt
Ian McPhee
Gérard Trémolière
Mowafak Al Yafi

Technical Advisors

Kelly Ånerud (Ms Ahlenius)
Gerhard Gross (Mr Ferlings)
Cédric Gélard (Mr Trémolière)
Jon Grant (Mr Rainey)
Diana Hillier (Mr Ashton)
Sharon Walker (Mr Fogarty)
Richard Mifsud (Mr McPhee)
Jennifer Haskell (Mr Hansen)
Makoto Shinohara (Mr Ikegami)
Sylvia Smith (Mr Crawford)
George Tucker (Ms Esdon, October 19)

Non-Voting Observers*Present:*

Thomas Ray/Jennifer Rand

Apologies:

Hisashi Yamaura
David Damant

Public Interest Oversight Board (PIOB) Members and Staff Observers*Present:*

Aulana Peters, Member, PIOB (October 19, 20)

IFAC Technical Staff*Present:*

Jim Sylph (Technical Director), James Gunn, Michael Nugent, Alta Prinsloo (October 20,
21), Ken Siong, Jan Tyl

1. Opening Remarks and Minutes

WELCOME AND INTRODUCTIONS

Mr. Kellas noted that Ms Peters, a member of the Public Interest Oversight Board (PIOB), would observe portions of the IAASB meeting.

Mr Kellas introduced Ms Haskell, new technical advisor to Mr Hansen, Ms Walker, representing Mr Landes who was unable to attend the meeting and Mr Gross, attending in place of Mr Boehm who was unable to attend the meeting.

Proxies were noted as follows: Ms Ånerud for Ms Ahlenius for October 20 and 21, Mr Mifsud for Mr Mc Phee, Mr Gélard for Mr Trémolière, and Mr Kellas for Messrs Al Yafi and Dutt.

MINUTES OF PREVIOUS MEETING

Certain amendments and editorial changes were proposed to the minutes of the previous meeting. Following integration of these changes in the minutes, the minutes of the previous IAASB meeting were approved.

2. Clarity of IAASB Standards

Mr Kellas introduced the discussion of the agenda papers on the clarity of IAASB standards, consisting of an explanatory memorandum, proposed amendments to the Preface to international standards and five revised exposure drafts of ISAs. During the discussion, the following matters arose.

Guidelines for determining requirements

The IAASB deliberated the proposed guidelines for use by the IAASB in determining the need to specify a requirement. The IAASB agreed the following:

- A requirement should be necessary to achieve the objective stated in a Standard, rather than simply being important in fulfilling the objective.
- It is unnecessary to refer to requirements as being either an action or a procedure; the important matter is whether the requirement in any form is expected to be applicable in virtually all engagements to which the Standard is relevant.
- The guideline referring to the objective as unlikely to have been met by other requirements should be clarified to explain that it refers to the requirements of other Standards.

IMPLEMENTATION AND TIMETABLE

Mr Kellas referred the Board to a letter from the European Commission (EC) and its view on the need to accelerate the revision and redrafting of certain ISAs. The IAASB acknowledged that it may be necessary to give priority to those ISAs identified by the EC as important to its endorsement of the ISAs. However, for the purposes of the consultation document it was agreed that the proposed timetable should be retained as presented, and that the EC's comments should be taken into account in conjunction with the responses to the consultation on the proposed implementation timetable. Mr Kellas noted that the Steering Committee will be considering, for recommendation to the IAASB, the

likely revisions required to the older ISAs and the priority of such revisions. He also noted that he will respond to the EC on the matters raised in its letter.

The IAASB discussed the process for applying the new drafting conventions to those proposed ISAs that at present are under revision and exposure. Some members suggested a two-step process, whereby a proposed ISA is first revised under the existing drafting conventions to respond to the comments received on exposure and then redrafted under the new drafting conventions. This was seen as providing a clear way of both demonstrating how respondents' comments were addressed and distinguishing those changes from the effects of redrafting. Other members, however, believed that a two-step process may be inefficient. After further deliberation, the IAASB agreed that it may not be appropriate at this stage to commit to a single method, and that flexibility should be permitted in the way in which task forces proceed. However, where a task force does not intend to follow the two-step process, it should be satisfied that the process will be understandable and capable of demonstrating how comments received on exposure have been addressed.

In addition, the IAASB agreed the following:

- The explanatory memorandum should clarify that for those proposed ISAs which are currently under exposure, the IAASB will consider comments arising from exposure, including whether changes as a result of the IAASB's deliberations thereon give rise to the need for re-exposure; and that, before the proposed revised ISAs are finalized, they will be redrafted to reflect the new drafting conventions and re-exposed for comment on the redrafting.
- The implementation timetable should make it clear that it relates only to the ISAs, and that application of the new drafting conventions to other International Standards will be determined by the IAASB at a future date.
- The implementation timetable should indicate that the IAASB will consider ISQC 1 when applying the new drafting conventions to ISA 220.

PROPOSED AMENDMENTS TO THE PREFACE

Mr Kellas summarized the main changes to the proposed amendments to the Preface arising as a result of the Board's discussions in September and the subsequent deliberations of the Task Force. He referred the Board to an analysis of those changes prepared by staff. He then led the IAASB through the proposed amendments to the Preface.

The IAASB discussed the obligation that the proposed Preface imposed on an auditor to meet an objective of a standard. In particular, the IAASB deliberated the proposed change (as compared with the version reviewed during the September meeting) in the wording from "...deemed appropriate" to "are necessary", and the proposed deletion of reference to "...and based on the ISAs," in the paragraph dealing with the auditor's consideration of whether to perform other audit procedures to achieve the stated objective. Some members were of the view that it is necessary to include such wording, or wording of similar effect, to provide context in which such considerations are expected to be made. After further deliberation, the IAASB agreed to retain the wording proposed by the Task Force to avoid making the paragraph unduly complicated and obscuring the key message being communicated. It was agreed, however, that the wording should be revised to clarify that it is *other* procedures beyond those specified in the ISAs that the auditor considers performing in the circumstances of the engagement.

The IAASB discussed the references to the relevance of requirements. It was suggested that, while it was possible to understand that a standard as a whole may or may not be relevant, it was more difficult to accept that where a standard was relevant, nevertheless some of its specific requirements may not be. It was agreed that the proposed amendments to the Preface should describe the requirements as being applicable in all cases where they (as opposed to the Standard) are relevant in the circumstances of the engagement. It was also agreed that it would be important to ensure that auditors did not misunderstand the circumstances when requirements may not be relevant, so as to ensure that all requirements were properly considered. Accordingly, the notion of relevance should be discussed further, particularly in relation to the applicability of requirement to the audits of smaller entities, and amplified by examples, as appropriate, in ISA 200 when it is redrafted to incorporate the provisions of the Preface.

In addition to editorial suggestions, the IAASB agreed the following:

- With respect to procedures or actions described in the application material, it should be emphasized that the decision whether to carry out such procedures or actions is based on the auditor's professional judgment.
- It should be made clear that the need for an auditor to depart from a requirement is expected only where the requirement is for a specific procedure to be performed and that procedure would be ineffective in the circumstances. Alternative procedures are required to be performed in such cases.
- The reference to applicability of the International Standards on Auditing to engagements in the public sector should reflect the current practices of the IAASB of including additional guidance appropriate for the public sector entities within the body of a Standard, as appropriate. References to INTOSAI and the IFAC's International Public Sector Accounting Standards Board are unnecessary and should be removed.

PROPOSED REDRAFTED ISAS

Mr Kellas noted that a number of editorial changes have been made to the objectives stated in the proposed redrafted ISAs to enhance their consistency. He also noted that the Task Force has reconsidered the proposed objectives both in relation to the ISAs to which they relate and together as a whole, and has made certain amendments to deal with the concern raised at the last meeting that there was some overlap of objectives, specifically in relation to the evaluation of the sufficiency and appropriateness of audit evidence in redrafted ISA 500 and redrafted ISA 330. He indicated that for the purposes of exposure, the Task Force considers the position to be satisfactory. However, the final solution may involve some transfer of material dealing with "evaluation" from some ISAs to another, possibly new, ISA in which "evaluation" could be comprehensively dealt with. This possibility has been highlighted in the proposed explanatory memorandum

For each redrafted ISA, the Task Force summarized, and led the IAASB through, the main changes to the proposed redrafted ISA as a result of the Board's discussions in September.

Redrafted ISA 500

The IAASB expressed some concern about whether aspects of the proposed redrafted ISA 500 had, inadvertently, changed fundamental requirements of extant ISA 500. In particular, the IAASB questioned:

- The separation of requirements related to the auditor's consideration of appropriateness of evidence from those related to its sufficiency, and whether this could imply a two-step process, which might in turn imply separate documentation requirements.
- The appropriateness of converting some statements of fact in the extant ISA 500 (e.g.: "Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability ...") into requirements (e.g.: "The auditor shall consider the appropriateness of audit evidence in relation to its relevance and its reliability ...").

The IAASB also asked the Task Force to reconsider whether the definition of "audit evidence" should allow for audit evidence that is not "appropriate", or whether information that is not appropriate should not be referred to as "audit evidence."

In consideration of these matters, and the uncertainty about whether an ISA that comprehensively deals with "evaluation" will be developed, the IAASB agreed not to issue the redrafted ISA 500 as an exposure draft at this time.

Redrafted ISA 315

In addition to editorial suggestions, the IAASB agreed the following:

- The material in the requirements section explaining that an audit does not require an understanding of all the control activities, which was abbreviated in the proposed redrafted ISA, should be made consistent with that of the extant ISA to avoid any confusion about the scope of the auditor's responsibilities.
- The guidance dealing with considerations specific to smaller entities in relation to internal control should be redrafted to clarify that the owner-manager may be in charge of more than one process or component and that, accordingly, such processes or components may not appear to be clearly distinguished within smaller entities.
- Appendix 3 of the extant ISA should be reinstated, rather than being incorporated in the body of the application material.
- As a result of the decision not to issue proposed redrafted ISA 500 for exposure at this time, reference should be made by way of footnote to the plan to move certain material in extant ISA 315 to ISA 500 when it is redrafted.

Redrafted ISA 240

The IAASB discussed whether an introduction section to the ISA was necessary to describe the context in which the auditor applies the ISA. The IAASB agreed that the section "Fraud in the Context of an Audit of Financial Statements" provides such context and should be included in the ISA.

The IAASB revisited the issue of whether it is appropriate to require the auditor to presume that there are risks of fraud in revenue recognition. After further deliberation, it was agreed to retain the proposed requirement, as not doing so may result in a real or perceived weakening of the ISA.

In addition to editorial suggestions, the IAASB agreed, as a result of the decision not to issue proposed redrafted ISA 500 for exposure at this time, that:

- The proposed ISA should include a requirement (based on the material in the extant ISA) for the auditor to investigate further when conditions are identified during the audit that cause the

auditor to believe that a document may not be authentic or that terms in a document have been modified.

- Material pertaining to the auditor's consideration of the reliability of the information used as audit evidence that was to be positioned in redrafted ISA 500 should be reinstated in the proposed redrafted ISA 240.

Redrafted ISA 300 and ISA 330

In addition to editorial suggestions, and the reinstatement of certain material in ISA 330 as a result of the decision not to issue proposed redrafted ISA 500 for exposure at this time, the IAASB agreed the changes to proposed redrafted ISAs 300 and 330.

PROPOSED EXPLANATORY MEMORANDUM

Mr Kellas led the IAASB through the proposed explanatory memorandum that is to accompany the proposed ISA exposure drafts. In addition to editorial suggestions, the IAASB agreed that:

- Greater prominence should be given to:
 - The discussion of, and request for comments on, the issue pertaining to whether or not there is a need to repeat the requirements at relevant points within the application material to further enhance context and reference.
 - The matters on which respondents' views are sought.
- The section pertaining to drafting improvements should include an explanation of IAASB's decision to retain in the proposed redrafted ISA 240 certain material that exists in other ISAs for purposes of context and understandability of that ISA. In addition, respondents' views should be sought on whether an appropriate balance has been achieved between eliminating duplicative material and retaining some repetition in the proposed ISAs to help users understand a particular ISA or how the ISAs interrelate.
- The preliminary mark-up of ISA 200 should be excluded from the proposed staff supplements to the exposure drafts, as further changes to that ISA will be required.

Mr Kellas explained why the IAASB is publishing a basis for conclusions with the explanatory memorandum, instead of publishing it with the final ISAs. As the exposure drafts now being issued for comment apply the proposed approach to improving the clarity of the standards which was subject to an earlier consultation, it therefore seemed the appropriate point at which the basis for the IAASB's conclusions on that approach should be explained. Subject to editorial changes, the IAASB agreed the content of the proposed basis for conclusions.

VOTING

Mr Kellas asked first that the IAASB vote separately on the issue of the structure of the redrafted ISAs. The reason for this was that the structure is the one aspect of the proposals on which there were some dissenting views expressed at the last meeting. A separate vote would allow members who have concerns about the restructuring to have their views on record, and to allow for subsequent votes on future exposure drafts and final standards to be carried out on their content, setting aside the issue of structure.

The IAASB voted in favor of the structure of the proposed redrafted ISAs by 15 votes to 3. Ms Esdon and Messrs Crawford and Fogarty voted against the structure of the proposed ISAs because of the lack of presentation of the requirements and the related application material together in any form. In their opinion, the proposed ISAs may not be as effective as they would be if the requirements and related application material were presented together and therefore are concerned about the loss of context when reading the requirements and application material and the potential effect this may have on the consistency in which the ISAs are applied.

The IAASB voted unanimously in favor of the issue of the exposure drafts on the proposed amendments to the Preface and the proposed redrafted ISAs 240, 300, 315 and 330, and the proposed explanatory memorandum.

Mr Kellas reported that there have been some further editorial suggestions to the explanatory memorandum from a member of the Task Force and from IFAC's plain English specialist. The IAASB agreed to consider these editorial suggestions and to indicate whether they agree with the changes by correspondence. It was agreed that if any member of the IAASB was concerned that a proposed editorial change had a substantive effect on the meaning of the explanatory memorandum such that it differed from that of the text agreed at the meeting, that particular change would not be adopted in the final version.

Mr Sylph commended Mr Kellas on his leadership of the project and the Task Force and staff on their efforts.

3. Materiality

Ms. Esdon introduced the agenda item. She noted that forty-eight comment letters were received on the exposure draft of the proposed revised ISA 320, "Materiality in the Identification and Evaluation of Misstatements," which was issued in December 2004. Respondents were generally supportive of the revision to ISA 320, "Audit Materiality" and the proposed requirements and guidance in the Exposure Draft.

AN ISA FOR MATERIALITY AND A SEPARATE ISA FOR MISSTATEMENTS

The Task Force concluded that, in response to the comments on the interaction of the guidance on materiality and misstatements, the clarity of the requirements and guidance, and flow thereof, would be enhanced by addressing materiality and misstatements in separate ISAs, i.e., an ISA on materiality in planning and performing the audit and an ISA on evaluating misstatements. The IAASB agreed with the recommendation to split the requirements and guidance into two separate ISAs.

In the discussion of the Clarity Project at the September 2005 IAASB meeting, it had been suggested that the IAASB consider consolidating all the requirements and guidance relevant to forming an opinion on the financial statements in one new ISA. This could include (a) requirements and guidance on evaluating misstatements, (b) the guidance in ISA 700 (Revised), "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements," including the auditor's "stand-back" responsibility, and (c) requirements and guidance on concluding on the appropriateness and sufficiency of audit evidence. The IAASB agreed that requirements and guidance in other ISAs may be better placed in the proposed ISA on evaluating misstatements.

The IAASB discussed the effect that this may have on the finalization of the proposed ISAs. Mr Hansen was of the view that both proposed ISAs should be finalized at the same time in accordance with the previously agreed timetable. Other IAASB members were of the view that it may be worthwhile to delay the finalization of the proposed ISA on evaluating misstatements in order to incorporate the related requirements and guidance from other ISAs. The IAASB requested the Task Force to identify the requirements and guidance in other ISAs that could be placed in the proposed ISA on evaluating misstatements, and to report back to the IAASB at the December 2005 meeting.

SIGNIFICANT COMMENTS AND TASK FORCE'S RECOMMENDATIONS

Ms Esdon asked the IAASB members whether, based on their reading of the individual responses to the Exposure Draft, they agree with the list of significant comments identified by the Task Force. There was general agreement that the Task Force had identified all the significant comments. Mr Kellas asked whether the Task Force had considered the issue of conforming amendments, which was raised by two respondents. Ms Esdon responded that the Task Force (and the IAASB) had not considered any conforming amendments necessary at the time of approving the exposure draft. The IAASB requested the Task Force to consider whether, based on comments received, conforming amendments are necessary.

The Application of the Proposed ISA to Audits of Small Entities, Public Sector Entities, and in Special Purpose Audits

Several respondents commented on the application of the Exposure Draft to audits of small entities, public sector entities, and in special purpose audits.

The IAASB agreed with the Task Force's treatment of comments relating to the audit of small entities.

The IAASB requested that the proposed ISAs to be considered at the December 2005 meeting incorporate the revised public sector considerations in the body of the ISAs. It was noted that the revised public sector considerations will be finalized with the relevant group of INTOSAI.

The IAASB agreed that the proposed ISAs apply to audits of financial statements and audits of other historical financial information but that the guidance in the ISAs may need to be adapted in the case of the latter. The IAASB agreed that the ISAs should be described as applying to the audits of financial statements and that their wider application (and adaptation) should be addressed in proposed ISA 701, "The Independent Auditor's Report on Other Historical Financial Information." As a result, the related sentence in the first paragraph of the Exposure Draft should be deleted.

Mr. Kellas noted that, in the case of financial statements prepared for a special purpose, the auditor should consider the needs of the specific users in the context of the purpose for which the financial statements have been prepared. As a result, he asked the Task Force to consider retaining the paragraph providing this guidance in the proposed ISA on materiality in planning and performing the audit.

Management's Responsibility for Determining Materiality and Tolerable Misstatement for Financial Reporting Purposes

Some respondents were of the view that the auditor, when determining materiality for planning and performing the audit, should consider either management's process for determining materiality and tolerable error for financial reporting purposes or the materiality and tolerable error determined by management for financial reporting purposes. On balance, the IAASB agreed with the Task Force's recommendation not to require a separate consideration of management's materiality in the proposed ISAs, because the concept is already covered in ISA 315, "Obtaining an Understanding of the Entity and Its Environment and Assessing the Risks of Material Misstatement." However, the IAASB requested the Task Force to consider whether an explicit reference to management's consideration of materiality should be included by way of a conforming amendment in the requirements and guidance in ISA 315.

The Definition of Materiality

Many respondents were of the view that the definition of materiality should be revised. The Task Force recommended a revised definition of materiality.

The IAASB requested the Task Force to:

- Consider the structure of the definition. The guidance on users and the consideration of their needs would be better placed after the definition of materiality, as was the case in the Exposure Draft. Furthermore, the text in the Exposure Draft that limited the meaning of "could ... influence" in the IAS 1 definition should be reinstated.
- Consider reinstating the word "economic," i.e., use the term "economic decisions," because the term "economic decisions" is well established and assists in describing the extent of the auditor's responsibility to consider the needs of users when determining materiality.
- Consider reinstating the guidance that the collective needs of investors as a group is an appropriate frame of reference when determining materiality. The IAASB was of the view that without this guidance the ISA may be interpreted as requiring the auditor having to determine the differing views of materiality held by individual investors.
- Develop guidance for circumstances where the applicable financial reporting framework does not provide a definition of materiality.

Some IAASB members were of the view that the definition should not be linked to the IAS 1 definition since this definition could change. It was noted that the current IAS 1 definition could be adopted as the definition of materiality in the context of an audit, i.e., without reference to IAS 1. Future changes to the IAS 1 definition would then have no effect on the ISA definition. Other IAASB members were of the view that it is important that the definition is linked to the definition in the applicable financial reporting framework.

The Users of Financial Statements

Many respondents were of the view that the guidance on the characteristics of users of the financial statements in the Exposure Draft needed to be revised. Ms. Esdon explained that the purpose of the guidance in the Exposure Draft was not, as suggested by some respondents, to define users but rather to define the context in which users make decisions. Since the auditor considers the materiality of a misstatement based on whether it could reasonably be expected to influence the decisions of users,

the Task Force considered it useful to provide guidance on the context in which users make decisions. Such guidance, however, may be better placed in a generic context in the definition of materiality.

Mr Kellas suggested that, to the extent that the guidance was derived from the IASB's Framework, an appropriate reference could be included. He also noted that some of the points made by respondents would be helpful in refining the characteristics of users.

With regard to the proposed definition of misstatement, the IAASB requested the Task Force to:

- Ensure that both non-compliance with the applicable financial reporting framework and fair presentation of the financial statements are addressed in the definition of misstatement (which includes omission).
- Ensure that the definition of misstatement applies whether or not the applicable financial reporting framework is designed to achieve fair presentation.
- Consider the use of the term "misstatement" in other ISAs to ensure that it is used in the same context, or defined in the same way, as in the proposed ISA on identifying and evaluating misstatements.

The Qualitative Aspects of Materiality

Many respondents identified the need for more prominent guidance on the qualitative aspects of materiality. Respondents were of the view that the qualitative aspects of materiality should be considered at an earlier stage of the audit process – not only at the stage of evaluating uncorrected misstatements.

The IAASB agreed that the qualitative aspects of materiality are primarily considerations in evaluating misstatements. The IAASB, however, requested the Task Force to reconsider the proposed revised text, and how the requirement that the auditor should also consider the necessity to determine materiality for particular classes of transactions, account balances and disclosures ties into this guidance.

The Percentages of Benchmarks

On balance, respondents supported the guidance on benchmarks in the Exposure Draft. Many respondents, however, questioned whether it is advisable to include examples of percentages that might be applied to benchmarks in the proposed ISA on materiality in planning and performing the audit.

Ms. Esdon noted that the Task Force considered the following alternatives, some of which were suggested by respondents: (a) moving the examples of percentages to an appendix; (b) presenting the examples of percentages in a guidance note (or rather an IAPS); (c) deleting the examples; and (d) limiting the examples to just one. The latter was the Task Force's preferred approach.

The IAASB discussed at length whether the examples of percentages of benchmarks should be retained and, if retained, how they should be revised. A small majority of IAASB members were in favor of deleting the examples. Some IAASB members suggested that the guidance be expanded to provide examples of factors that would affect the auditor's determination of the percentage.

Next Steps

The allocated agenda time did not allow for discussion of the remaining significant comments. The IAASB agreed that they should be discussed at the December 2005 IAASB meeting, along with the text of the revised proposed ISAs.

4. Estimates

Mr Ashton welcomed Mr Noonan, a former IAASB member and member of the Estimates Task Force who attended the session. Mr Ashton indicated that the objective of the session was to consider the issues raised by the respondents, and to seek IAASB's views on how the Task Force has responded to those issues.

Mr Ashton reported that 40 comment letters were received on the Exposure Draft. He noted that respondents expressed broad support for the proposed ISA, but had raised various issues in relation to scope and structure, the development of ranges, indicators of possible management bias and the applicability of the proposed requirements to the audit of smaller entities. Mr Ashton reported also that the IFAC Small and Medium Practices Permanent Task Force had submitted comments on the proposed revised ISA included in the agenda papers. Copies of these comments were circulated to the Board.

Mr Ashton led the IAASB through the main issues and a review of the proposed draft ISA 540 (Revised).

STRUCTURE

The IAASB agreed with the recommendations of the Task Force, and, with the exception of certain matters, to the proposed wording in the draft revised ISA, in relation to the following:

- Combining the sections on risks of material misstatements and significant risks, to indicate more clearly that the responses to significant risks are an extension of the responses to risks of material misstatement.
- Expanding the guidance in the proposed ISA to clearly demarcate the responsibilities of management and the auditor.
- Repositioning of the requirements and related guidance dealing with the auditor's consideration of events up to the date of the auditor's report.
- Retaining the need for further substantive procedures in the event that estimation uncertainty gives rise to a significant risk, even in the circumstances where the auditor has developed a point estimate independently.

The IAASB asked, however, that the Task Force consider further the following:

- Whether the proposed risk assessment procedures are sufficiently clear in terms of their relationship with the requirements and guidance of ISAs 315 and 240.
- Whether the guidance explaining the risk assessment procedure pertaining to the auditor's review of the outcome of prior period accounting estimates unduly emphasizes the notion that difference from the prior period may indicate a misstatement.

- Whether it is necessary to repeat the overarching bold type requirement in the introduction of the ISA in the section dealing with evaluating audit evidence and concluding on the reasonableness of the accounting estimates. If it is to be repeated, the wording of the paragraphs should be made consistent.
- Whether it is appropriate to limit the requirements dealing with: (i) the auditor's consideration of the sufficiency of audit evidence in relation to estimate recognition by management; and, (ii) the adequacy of disclosure of estimation uncertainty, to significant risks, or whether they should be made applicable to all estimates.
- Additional guidance that explains that making a point estimate may be appropriate even when controls and process are well-designed and properly implemented, simply because it may be an effective and efficient procedure in the circumstances.

CONSIDERATION IN AUDITS OF SMALLER ENTITIES

The IAASB discussed the issues raised by respondents concerning the applicability of the Exposure Draft to smaller entities and the Task Force's recommendations in response thereto, and the matters raised by the IFAC Small and Medium Practices Permanent Task Force identified in its review of the agenda material.

After debate of the issues, including the extent to which ISAs should address issues pertaining to small and medium practices as opposed to considerations in the audit of small entities, the IAASB concluded that the proposed requirements appear to be appropriate for audits of entities of all sizes. However, the IAASB asked the Task Force to consider areas where additional guidance can be given to amplify the existing guidance and further explain the application of the ISA to audits of smaller entities, in particular, in relation to the following:

- The relationship between: (a) requirement in paragraph 64 for the auditor to evaluate how management has considered alternative assumptions or outcomes, and, (b) the requirement in paragraph 69 for the auditor to request management to support whether and how it has assessed the effects of estimation uncertainty.
- The fact that management process of considering alternative assumptions or outcomes, or assessing the effects of estimation uncertainty, does not need to be part of a formal process or be supported by extensive documentation.
- Emphasizing further that the most effective audit procedure in the context of an audit of smaller entity may be auditing of events up to the date of the auditor's report.
- Management's process used to make the accounting estimate, and how it may differ in a smaller entity from that in a larger entity.

RANGES AND BIAS

The IAASB raised a number of concerns with respect to the issue of the development of ranges by the auditor. The IAASB asked the Task Force to consider further the following:

- Use of the term "range of reasonable outcomes," and whether it conveys adequately the need for the auditor to be satisfied that both the range and the outcomes within the range are reasonable.

- Use of the term “as likely to occur as not,” and whether this term and the related guidance are clear and accurate in describing the process of narrowing a range.
- The guidance pertaining to narrowing a range and the relationship between the range and tolerable error and materiality, including whether it is appropriate to circumscribe the range of reasonable outcomes as being equal to, or less than, tolerable error, recognizing that this may create an unrealistic expectation particularly in relation to certain industries.
- Additional guidance explaining that the auditor may make a preliminary estimate as a starting point for discussions with management and then, as appropriate, may seek further audit evidence through the development of a range.

With respect to the Task Force’s recommendations regarding the auditor’s consideration of indicators of possible management bias, the IAASB agreed that the auditor’s responsibility should be to obtain sufficient appropriate audit evidence to conclude on the reasonableness of each accounting estimate, but that the auditor should be alert to circumstances that may indicate a pattern when all estimates are considered in the aggregate. The IAASB noted, however, that bias may manifest itself over several years. Accordingly, the IAASB asked the Task Force to consider including additional guidance on the auditor’s consideration of indicators of possible management bias in relation to the cumulative and iterative nature of the audit, and the effect that such indicators may have on the subsequent year audit.

RELATIONSHIP OF ISA 540 AND ISA 545

The IAASB agreed that, in light of the effect on the timetable to finalize the ISA and the potential effect on the overall understandability of the ISA, ISA 540 and ISA 545 should not be combined, or amalgamated, as recommended by some respondents to the Exposure Draft. Rather, the IAASB asked that the Task Force identify a solution to address the overlap between the two ISAs, possibly by presenting additional requirements and guidance that are unique to the audit of estimates involving fair value measurements within a separate ISA that supplements ISA 540 (Revised). The combination of the two ISAs could be completed in the future, if considered necessary and appropriate.

OTHER MATTERS

The IAASB agreed the following matters:

- The guidance pertaining to the auditor’s consideration of whether an accounting estimate has high estimation uncertainty such that there may be a significant risk should be clarified to explain that an immaterial estimate may also have high estimation uncertainty, but that such estimates are relevant only when there is the capacity for a material misstatement to occur as a result of the estimation uncertainty.
- The sequence of the requirements pertaining to the auditor’s evaluation of whether and how management has considered alternative assumptions or outcomes, and whether the significant assumptions provide a reasonable basis for the accounting estimate, should be reversed.
- The proposed requirement pertaining to documentation should not refer to ISAs 230, 315 and 330; reference thereto in the proposed application guidance is sufficient.

- A requirement to document misstatements identified by the auditor is unnecessary, if such a requirement is included in the proposed ISA dealing with materiality and the evaluation and aggregation of misstatements.

The IAASB asked that the Task Force consider its comments and present the following at its March 2006 meeting:

- Revised wording of draft ISA 540 (Revised), drafted in accordance with the existing drafting conventions, for approval of content.
- Draft revised ISA 540 (Revised and Redrafted), redrafted in accordance with the new drafting conventions under the Clarity project, for discussion.
- An outline of the proposed revision and redrafting of ISA 545, “Auditing Fair Value Measurements and Disclosures,” for discussion.

5. Practice Problem Arising – ISA 200/210/701

Mr Kellas reported that the IAASB has been informed by the Transnational Auditors Committee of an implementation problem arising from possible inconsistencies or uncertainties between certain requirements of ISAs 200 and 210, and those of proposed ISA 701, which may lead to some uncertainty in practice until ISA 701 has been finalized. Mr Kellas noted that the points at issue are technical, requiring a close reading and analysis of the relevant standards.

The IAASB discussed the issue in light of the implementation of the ISAs in various jurisdictions and considered the available options. After further deliberation, the IAASB agreed to defer the effective date of the following requirements and guidance until ISA 701 becomes effective:

- Amended ISA 200: the final sentence of paragraph 3 and paragraphs 37-48.
- Amended ISA 210.

Mr Kellas indicated that a press release will be issued within the next two weeks.

6. Project Proposal - Material Weaknesses in Internal Control

Mr Ashton explained the background to the project proposal to develop additional standards and guidance regarding the meaning of material weaknesses in internal control. There is increased interest around the world in management or those charged with governance reporting on internal controls or risk management. However, there is currently little consensus at the international level on an appropriate scope for a standard under which auditors may report on internal control. Nevertheless, it is recognized that the definition of “material weakness” within the ISAs is rather general, and the proposal to provide more guidance on the meaning of the term would be intended to improve the consistency with which auditors treat identified weaknesses as material (with consequent reporting implications). Mr Ashton emphasized that the project will not seek to extend the auditor’s responsibilities beyond those set out in ISAs, and will avoid unnecessary complexity that may not be justified given that ISAs address audits of both non-listed and listed entities. The IAASB agreed that the output of the project should be amplification and further clarification of the relevant standards and guidance in the extant ISAs.

The IAASB approved the project proposal. Mr Kellas invited IAASB members who are interested in serving on the task force to contact him or Mr Sylph.

7. Next Meeting

The next meeting of the IAASB is scheduled for December 5 - 9, 2005 in Cape Town, South Africa.

8. Closing Remarks

Mr Kellas thanked the American Institute of Certified Public Accountants for making their meeting facilities available to the IAASB and for the assistance of its staff.

Mr. Kellas closed the meeting.

