

Minutes of the 20th Meeting of the INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD

Held on May 22-26, 2006 in New York

Voting Members

Present: John Kellas (Chairman)
Denise Esdon (Deputy Chair)
Craig Crawford
Phil Cowperthwaite
Sukanta Dutt (May 22-23)
Josef Ferlings
John Fogarty
Jan Bo Hansen
Diana Hillier
Kjell Larsson
Marcel Pheijffer
Ian McPhee
Will Rainey
Bodo Richardt
Makoto Shinohara
David Swanney
Roberto Tizzano
Gérard Trémolière

Technical Advisors

Kelly Ånerud (Mr Larsson)
Wolfgang Böhm (Mr Ferlings)
Philip Ashton (Ms Hillier)
Cédric Gélard (Mr Trémolière)
Jon Grant (Mr Rainey)
Jennifer Haskell (Mr Hansen)
Richard Mifsud (Mr McPhee) May 24-26
Greg Shields (Mr Cowperthwaite)
Sylvia Smith (Mr Crawford)
George Tucker (Ms Esdon)
Hans Verkruijsse (Mr Pheijffer)
Sharon Walker (Mr Fogarty)
Yuichi Yamamoto (Mr Shinohara)

Absent:

Non-Voting Observers

Present: Jennifer Rand
Hisashi Yamaura
David Damant
Jürgen Tiedje (May 22-25)

Public Interest Oversight Board (PIOB) Members Observer

Present: Stavros Thomadakis (in part)

IAASB Technical Staff

Present: Jim Sylph (Technical Director), James Gunn, Michael Nugent (May 25-26), Alta Prinsloo, Ken Siong, Jan Tyl (May 22-24)

1. Opening Remarks and Minutes

WELCOME AND INTRODUCTIONS

Mr Kellas introduced Mr Jürgen Tiedje, a non-voting observer appointed by the European Commission. Further, he noted that Mr Stavros Thomadakis, Chair of the PIOB, would be observing the meeting and that Mr Ian Ball, Chief Executive of IFAC, would observe the clarity project discussion.

Mr. Kellas further noted that Mr. Dutt would leave the meeting on Tuesday afternoon and had appointed Mr. Kellas as his proxy for later matters. In addition, Mr. Rainey would leave on Thursday evening and had appointed Mr. Grant as his proxy for the Friday session.

Mr. Kellas informed the members that the 2006 issue of IFAC Handbook had been finalized and copies sent out.

The first open meeting of the IAASB CAG took place in May. Mr. Kellas invited Mr. Damant to provide the members with a brief summary of the meeting. Mr. Damant noted that opening the meeting to the public made no difference to the breadth and quality of discussions. There were between 4 and 8 observers at times. Mr. Damant reported some CAG representatives raised corporate governance issues in relation to audit, specifically whether auditors should have any responsibility for reviewing corporate media releases and whether such requirement would overly extend the boundaries of auditors' responsibilities. Mr Damant also announced that the CAG had set up two working groups; one group to address the objectives of ISAs, and the other group to consider strategic issues in relation to the objectives of an audit. Comments were made at the meeting about the balance between strategic and technical matters raised with the CAG; it was important to try to benefit from the CAG's strategic perspectives.

Mr Kellas also noted that he and Messrs Damant and Sylph had attended a PIOB meeting in March to inform the PIOB on current IAASB and IAASB CAG activities. At that meeting, the PIOB approved Terms of Reference of the IAASB and the IAASB CAG.

MINUTES OF PREVIOUS MEETING

Following an amendment submitted by Ms Hillier, the minutes of the public session of the previous IAASB meeting were approved.

2. Materiality

Ms. Esdon led the discussion of the proposed close off documents of ISA 320 (Revised), "Materiality in the Identification and Evaluation of Misstatements" and ISA 450, "Evaluation of Misstatements Identified during the Audit."

ISA 320 (Revised)

Members' comments included the following:

- Some members argued that the overall requirement (objective) of the ISA (paragraph 2) was circular. It was agreed that the phrase "to reduce audit risk to an acceptably low level" should be deleted.

- A member was concerned about the use of “could” in the sentence “misstatements ... could reasonably be expected to influence the economic decisions of users ...” (paragraph 4) as this may establish a very low materiality threshold. He preferred the US GAAP definition that uses “probable.” Mr Kellas explained that the guidance should be understood as a default for circumstances where the financial reporting framework does not define materiality. It was agreed that the proposed wording should not be amended.
- A member was of the view that the decisions of users are not always economic decisions. He referred to the Public Sector Perspective, which acknowledged this fact. He was of the view that it also applies in the private sector. After debate, it was agreed that the proposed wording should not be amended, but that the Public Sector Perspective should be reconsidered when it is incorporated in the clarity drafts.
- A member was concerned about the paragraph indicating that the definition of materiality in the applicable financial reporting framework provides a frame of reference to the auditor in determining materiality (paragraph 5). He noted that the financial reporting framework may be deficient. Ms Esdon responded that the auditor is required to determine the acceptability of the financial reporting framework when accepting the engagement. It was agreed that the proposed wording should not be amended.
- Some members were concerned that the reference to “the needs of specific users” in the guidance for audits of financial statements prepared for a special purpose (end of paragraph 6) was not clear. It was agreed that the guidance should be aligned with the definition of “special purpose financial statements.” (During the discussion of the Special Reports Project it was agreed that special considerations in the audit of special purpose financial statements should not be presented in each individual ISA, but in a separate ISA. The guidance in ISA 320 (Revised) was therefore deleted.)
- Some members were concerned about the position of the guidance that stated that “although the auditor is alert for misstatements that could be material because of their nature, it is not practical to design audit procedures to detect such misstatements” (paragraph 8). It was agreed that the task force should reconsider the wording and flow of the paragraph, making it more positive.
- A member was of the view that the reference to “profit before tax from continuing operations” as an example of a benchmark should be changed to “profit before tax.” Another member was concerned about the example of a percentage to be applied in the case of a not-for-profit entity, while another member proposed that an example be inserted for a public sector entity. After debate, it was agreed that the reference and proposed examples should not be amended.
- Some members were of the view that the wording of the requirement for the auditor to determine amounts lower than the materiality level or levels for purposes of assessing risks and designing further audit procedures (“tolerable error”) (paragraph 19) was not correct. They argued that the guidance should address uncorrected and undetected misstatements. It was also noted that the requirement was complicated and difficult to understand. It was agreed that the task force should reconsider the wording of the requirement.
- Some members were of the view that the documentation requirement (paragraph 25(e)) might lead to inconsistent application due to its general nature. It was agreed that the task force should

reconsider the wording of the requirement to provide more specificity on the level of documentation.

- The IAASB also agreed to delete the paragraph referring to ISA 260 (Revised), “Communications with Those Charged with Governance” (paragraph 24).

ISA 450

The members’ comments included the following:

- A member questioned the wording of the overall requirement (objective) of the ISA (paragraph 2), suggesting that the phrase “...the financial statements as a whole” was inconsistent with other requirements in the ISA. The IAASB considered the use of the phrase in this paragraph and elsewhere in the ISA and proposed that the matter be further considered during the discussion of the Modifications Project. (After that discussion, it was confirmed that it was not necessary to amend the references in ISA 450.)
- Referring to the categories of misstatement and, in particular, projected misstatements (paragraph 7), a member noted that ISA 530, “Audit Sampling and Other Means of Testing” does not explain how projected misstatements should be determined or how the results should be evaluated. He was of the view that it is important to indicate that audit samples should be statistically sound and render a high level of confidence. It was agreed that the reference to ISA 530 should be amended but that the perceived shortcomings in ISA 530 could not be addressed in ISA 450.
- A member noted that the introduction to the categories of misstatement (paragraph 7) was not aligned with guidance that followed later in the ISA (paragraph 35). It was agreed that the task force should align the guidance.
- A member was concerned that the guidance following the requirement for the auditor to request management to correct all misstatements accumulated during the audit (paragraph 14) might be read as implying that the auditor corrects the misstatements. It was agreed that the text should be amended to address this concern.
- Some members were concerned that the guidance on management representations might be read as implying that fraud may be immaterial. It was agreed that the words “resulting from either fraud or error” (paragraph 17) should be deleted.
- Referring to the requirement and guidance on communication with those charged with governance (paragraph 18), a member noted that, in the case of an SME, management and those charged with governance may be the same individuals. He suggested that guidance similar to that in ISA 260 (Revised) be included. Another member was concerned that the wording of the requirement might be read as implying that uncorrected material misstatements, as opposed to uncorrected material and immaterial misstatements, are communicated to those charged with governance. Ms. Esdon agreed to consider these comments.
- Referring to prior period uncorrected misstatements, a member noted that the guidance did not address the group auditor’s role in ensuring a consistent approach to such misstatements. Another member responded that such guidance would be better placed in proposed ISA 600 (Revised), “The Audit of Group Financial Statements.”

- Some members argued that the guidance on the different approaches to the consideration of prior period uncorrected misstatements was not sufficient and should be either expanded or deleted. A member also argued that the guidance should also address the circumstances where there was a change in auditor and the new auditor uses a different approach. Following a lengthy debate, the IAASB agreed that the description of the different approaches (in paragraph 26) should be deleted. The guidance should only acknowledge that there are different acceptable approaches and that the approach selected by the auditor should be followed consistently from period to period.
- Ms Esdon explained that, based on a comment received from a CAG Representative, the examples of qualitative aspects that may affect the evaluation of misstatements (paragraph 27) would be expanded to include the incorrect selection or application of an accounting policy that has an immaterial effect on the current period's financial statements but is likely to have a material effect on future periods' financial statements.

Ms Esdon noted that the IAASB had agreed to log a project to develop an ISA on forming an opinion, which has an effect on the requirements and guidance in this ISA. In particular, the section on Evaluating Whether the Financial Statements as a Whole are Free of Material Misstatement would be moved to the new ISA. Mr Kellas was not convinced that the relevant requirements and guidance in ISAs 330, 450 and 500 were enough to warrant a new ISA. A member noted that future extraction of the section from ISA 450 may harm the flow of the ISA.

Approval of Close Off Documents

The IAASB considered ISAs 320 (Revised) and 450, revised based on the above comments, and unanimously approved the close off documents.

Ms Esdon highlighted changes to the requirements in the Exposure Draft and the IAASB concluded that re-exposure of the requirements and guidance was not necessary. Mr Sylph confirmed that the IAASB has followed due process with regard to the project.

It was agreed that the clarity drafts of the ISAs should be reviewed at the July 2006 meeting.

3. Close Off and Clarity Exposure Process

Mr McPhee opened a discussion of the close off of the draft of revised ISA 260, "Communication with Those Charged with Governance," by explaining that the objective was to obtain the IAASB's approval of (a) the close off draft and (b) pending only those amendments, if any, that arise from subsequent changes to the clarity drafting conventions, the clarified version for exposure. As this was the first ISA to be considered for "close off", the IAASB discussed in some detail the process for close off and exposure that would apply to this and other ISAs that had been exposed in "old" (i.e., "pre-clarity") format but not yet approved for inclusion in the Handbook. It was agreed that for each proposed revised ISAs in this situation, the IAASB will:

- (a) Consider the comments received on the exposure draft and amend the proposed revised ISA accordingly;

- (b) Conclude whether there have been substantial amendments to the proposed revised ISA that warrant re-exposure;
- (c) Confirm that it has followed due process with regard to the proposed revised ISA; and
- (d) Approve the final wording in the “old” format (referred to as the “close off document”).

The IAASB will not include an effective date in the close off documents, and does not intend to release them for application by practitioners. Rather, the IAASB will include a copy of the close off documents as attachments to the minutes of the IAASB meeting at which they are approved. This will make them available to the public.

The next step will be to consider the application of the clarity drafting conventions to the close off documents. The IAASB will seek comments only on the application of the clarity drafting conventions to the close off documents. To assist respondents, the exposure drafts of the clarified ISAs will include the following:

- (a) The proposed ISA written in the clarity style;
- (b) The approved close off document;
- (c) A basis for conclusions that will explain major decisions made through the due process that led to approval of the close off document; and
- (d) A mapping document that assists respondents to identify how the clarity drafting conventions have been applied to the close off document.

The issue date of the exposure drafts will depend on the outcome of discussions of the four ISAs being redrafted as part of the Clarity Project (i.e., ISAs 240, 300, 315 and 330).

4. Communications

ISA 260 CLOSE OFF DOCUMENT

Mr McPhee led the discussion noting that the main issue outstanding from the March meeting had been the final wording for the documentation requirement. He also noted that the draft had been discussed at the May IAASB CAG meeting, and that comments had been received from the IFAC SMP Committee. Although significant SME issues have already been addressed, it was noted that there were some residual concerns in relation to smaller entities.

Mr Tiedje noted that the EC Directive contains particular requirements to communicate with audit committees, and queried whether the draft may be in conflict with this. In response, it was noted that the draft specifically addresses communication with audit committees, and that in any case ISAs do not seek to override local legal requirements.

In addition to editorial matters, the IAASB agreed to:

- Simplify the paragraphs dealing with situations when all those charged with governance are involved in managing the entity.

- Add text regarding communicating concurrently with components of a group that conduct the same businesses within the same system of internal control and using the same accounting practices.
- Reinsert some of the proposed deletions into the ISA 300 conforming amendment.

The IAASB assessed whether there had been substantial change to the exposed document that might warrant re-exposure. In particular, the IAASB considered whether changes regarding “supplementary matters” warranted re-exposure and concluded the changes responded appropriately to comments received on exposure and that re-exposure was not warranted.

Following a further review after processing agreed changes, and confirmation from the Technical Director that due process has been followed, the IAASB approved the close-off version of ISA 260.

CLARIFIED ISA 260

Introduction, objective and definitions

Mr McPhee noted that the proposed objective is based on a paragraph in the close-off version addressing the “purpose of communication.” It was noted that the part of this objective that refers to “establishing a mutual understanding” might suggest the auditor can control whether a mutual understanding with those charged with governance could be accomplished. The IAASB agreed to amend this wording in the objective and in other parts of the ISA.

Requirements

The IAASB agreed to move the requirement regarding the clarity of communications into the application material because of the difficulty in objectively determining whether communication is “clear.” It also agreed to move the requirement to consider whether the auditor should communicate regarding independence with entities other than listed entities into the application material pending further consideration of this issue by the International Ethics Standards Board for Accountants.

Some members questioned the positioning of the material dealing with communication when all of those charged with governance are involved in managing the entity. Because the paragraph does not include a “shall” statement, it was suggested that it may be better placed in the scope section or the application material, as a consideration in the audit of smaller entities. It was also argued, however, that due to the importance of the paragraph and its implications for the applicability of other requirements, it should be left in the requirements section. Following discussion, the IAASB agreed to retain this material in the requirements section.

Application material

The IAASB debated whether the guidance related to considerations in audits of smaller entities should be separated by sub-headings. The Technical Director noted that a debate had been held on the structure of clarified documents and one of the conclusions was that paragraphs related to considerations in audits of smaller entities should be separated by sub-headings, and should be placed where they logically fit rather than being grouped together, perhaps at the end of the application material. It was noted that in the context of communications, some guidance intended for

smaller entities may also be applicable to large privately-held entities. The IAASB agreed to retain references to smaller entities where they logically fit, separated by sub-headings.

Approval

Following processing of these changes and further editorial and minor restructuring suggested during the meeting, the IAASB discussed a revised draft. Minor editorial changes were made to the revised draft, which was then agreed as the basis for exposure pending only those amendments, if any, which arise from subsequent changes to the clarity drafting conventions. Formal approval of the exposure draft was deferred until the clarity drafting conventions are finalized.

5. Modifications

Mr Hansen led a paragraph review of the close-off drafts of the proposed ISA 705, “Modifications to the Opinion in the Independent Auditor’s Report,” and the proposed ISA 706, “Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor’s Report.” He noted that in discussing the main issues, he would highlight comments received at the IAASB CAG meeting held earlier in May.

PROPOSED ISA 705

Description of Pervasiveness

In relation to misstatements, Mr. Hansen explained that the task force proposed to revise the description of “pervasiveness” in terms of whether the effects of the misstatement (or the combination of misstatements) affect the financial statements to such an extent that the financial statements, taken as a whole, are not prepared in accordance with the applicable financial reporting framework. The task force also proposed criteria to assist the auditor in judging whether the effects of the material misstatements would be considered pervasive. Mr. Hansen noted that CAG representatives generally supported this approach.

Some members noted that even if the misstatement were merely material but not pervasive, the financial statements would still not be considered prepared in accordance with the financial reporting framework. The proposed description of “pervasiveness” also seemed difficult to understand in the context of the related guidance on criteria. In addition, it was unclear whether the terms “exceptionally large proportion” and “substantial proportion” used in the proposed guidance had the same meaning. The IAASB concluded that it would be sufficient to describe “pervasiveness” simply in terms of the relevant matters the auditor would consider, based on those matters the task force had proposed as criteria. Accordingly, the proposed guidance should be streamlined to that effect. The IAASB also agreed that the wording used in the proposed ISA should reflect the fact that a pervasive misstatement or misstatements can only arise if the misstatements were already material, individually or in the aggregate.

In relation to an inability to obtain sufficient appropriate audit evidence, the IAASB further agreed to align the description of the term “pervasiveness” with the revised description relating to misstatements. Thus, such an inability would be considered pervasive if its effects could not be confined to specific elements, accounts or items in the financial statements or, if confined, the effects could represent a substantial proportion of the financial statements.

Management-Imposed Scope Limitation after Engagement Acceptance

Mr Hansen reported that a CAG representative had suggested that the proposed requirements dealing with a management-imposed scope limitation after engagement acceptance should be re-ordered so that, in the first instance, the auditor should disclaim an opinion, and, in second instance, the auditor should consider resigning from the engagement. Mr. Hansen noted that the timing of the auditor's resignation would depend on the stage of completion of the audit. For example, if the scope limitation took place at the acceptance stage, it would be appropriate for the auditor not to accept the engagement. However, if it were to occur towards the completion of the audit, it would be appropriate for the auditor to complete the audit to the extent practicable, describe the scope limitation in the Basis for Disclaimer of Opinion paragraph in the auditor's report, and then resign. The IAASB agreed that it would be appropriate to add guidance to that effect. The IAASB also agreed that the proposed ISA should include a requirement that if the auditor were to become aware of matters that would have given rise to a modification of the opinion regarding misstatements identified during the audit, the auditor should communicate such matters to those charged with governance.

Disclosure of Omitted Information in the Auditor's Report

Mr Hansen explained that the task force had reflected the IAASB's decision that the ISA should require the auditor to disclose omitted information in the auditor's report, unless impracticable or prohibited by law or regulation. He reported a CAG representative's concern that the auditor would be unable to do so without assuming management's responsibility and, further, the auditor would have no means of knowing whether the information was accurate because management had not made any representations about it. Some members agreed with the CAG representative's view and expressed concern that the IAASB was overstepping its mandate by requiring the disclosure. Others reiterated their support for the proposed guidance on the basis that the omitted information would be disclosed only if it were practicable to do so and not prohibited by law or regulation, and the auditor had obtained sufficient appropriate audit evidence about the omitted information. A vote was taken on the issue and the majority of the IAASB agreed to retain the proposed requirement. The IAASB, however, agreed to further clarify the guidance on practicability, including guidance on circumstances where the auditor would be considered to be assuming management's responsibility for preparing the omitted disclosures.

Other Comments or Changes

In addition to editorial changes, the IAASB also agreed the following:

- The table illustrating the different types of modifications to the opinion should emphasize the importance of the auditor's judgment in selecting the appropriate modification based on the circumstances. This would also respond to comments from a CAG representative.
- The wording of the guidance on multiple uncertainties should be clarified to indicate that the reference to extremely rare circumstances relates to the inability to form an opinion due to the interaction and cumulative possible effects of multiple uncertainties, and not to the existence of the multiple uncertainties themselves.
- The guidance explaining the nature of a disagreement with management should in fact be related more generically to the existence of material misstatements rather than disagreements with management.

- The guidance on misstatements regarding the appropriateness or adequacy of disclosures should be streamlined in terms of the financial statements not including all required disclosures, the disclosures not being presented in accordance with the applicable financial reporting framework, and the financial statements not providing the disclosures necessary to achieve fair presentation.
- A conforming amendment to ISA 210 should be made to include guidance currently found in extant ISA 701 to deal with circumstances where management imposed a scope limitation before engagement acceptance that the auditor believed would result in a disclaimer of opinion.
- The guidance on circumstances that would not be treated as giving rise to piecemeal opinions should be streamlined to focus simply on illustrating two situations that would not give rise to piecemeal opinions.
- The “Basis for Disclaimer of Opinion” paragraph of the fourth illustrative example report should be aligned with wording similar to that used in the proposed revised ISA on Group Audits, i.e. simply to state that the auditor was not allowed access to management and the auditor of the joint venture company.

PROPOSED ISA 706

Criteria for Emphasis of Matter Paragraphs

Mr Hansen explained that the task force proposed that the auditor be permitted to exercise professional judgment in determining when to emphasize a matter, provided the matter was already presented and disclosed in the financial statements and it met the specified criteria. Further, to make it clear that the emphasis of matter would be limited only to situations when those criteria had been met, the task force proposed a requirement that a matter could not be emphasized unless all the specified criteria had been met. It was noted that the interaction between the proposed guidance allowing use of judgment to determine when to emphasize a matter and the proposed prohibition immediately following it was unclear. Some members argued that the only relevant criterion should be that the matter was fundamental to the users’ understanding of the financial statements, and that the auditor should be allowed full use of professional judgment. Other members were of the opinion that the guidance would be clearer if it were restructured, particularly to highlight earlier that an emphasis of matter should not be a substitute for a qualification. The IAASB concluded that the guidance on criteria should be streamlined by focusing on matters that, in the auditor’s judgment, are fundamental to users’ understanding of the financial statements, provided the auditor has obtained sufficient appropriate audit evidence about them and these matters are not misstated. Further, the wording of the proposed requirement that a matter should not be emphasized unless all the specified criteria had been met should be merged with the guidance introducing emphasis of matter to highlight that widespread use of Emphasis of Matter paragraphs diminishes the effectiveness of the auditor’s communication of such matters.

Other Comments or Changes

In addition to editorial changes, the IAASB also agreed the following:

- The going concern example in the explanatory paragraph dealing with circumstances when the auditor would use an Emphasis of Matter paragraph should be deleted.

- The example of an emphasis of matter regarding significant related party transactions that occur rarely, disclosure of which would be fundamental to users' understanding of the financial statements, should be deleted.
- The guidance in paragraph 45 of ISA 700 (Revised) dealing with matters that provide further explanation of the auditor's responsibilities in an audit should be moved to the proposed ISA 706, with a cross-reference added in ISA 700.
- Guidance should be added to clarify the requirement to communicate with those charged with governance regarding other matter(s) paragraphs, in that such communication need not be repeated if it recurs on each successive engagement.

WAY FORWARD

The IAASB asked the task force to present revised drafts of the proposed ISAs 705 and 706 for approval for close off at the July 2006 IAASB meeting.

6. Special Reports

The discussion was led by Mr Dutt. The task force submitted a paper indicating how it had addressed the comments received at the March 2006 IAASB meeting, and revised drafts of ISA 200, "Objective and General Principles Governing an Audit of Financial Statements," ISA 210, "Terms of Audit Engagements," ISA 700 (Revised), "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements," and ISA 701, "The Independent Auditor's Report on Other Historical Financial Information."

The IAASB debated whether the definitions of general purpose financial statements and special purpose financial statements should be linked to the purpose for which the financial reporting framework was designed or to the purpose for which the financial statements were prepared. At present, they were linked to the applicable financial reporting framework. After lengthy debate, the IAASB concluded that the definitions should be linked to the applicable financial reporting framework.

Mr Tiedje noted that the European Commission's 8th Directive concerned statutory audits of general purpose financial statements only and that the European Commission would not endorse ISAs dealing with matters beyond such audits. He also stated that the distinction between statutory audits and contractual audits needs to be clear. Some members thought that, from an international perspective, a clear distinction between statutory and other audits might not be practicable. Mr Ferlings confirmed that the general purpose compliance audits in Germany would not be statutory audits falling under the 8th Directive. Mr Dutt noted that regulatory agencies themselves frequently request special audits in various circumstances. Ms Hillier noted that the proposed inclusion of compliance audits in the scope of ISA 700 (Revised) would complicate matters for the European Commission.

A member was concerned about the guidance that general purpose financial statements prepared for a special purpose were regarded as special purpose financial statements and did not see the need for this guidance. Mr Kellas explained that in this case, irrespective of the fact that the framework was designed to meet the common financial information needs of a wide range of users, the auditor will have to consider whether the framework is appropriate in the circumstances, and whether it is

necessary in the auditor's report to restrict the use of the financial statements and to draw the users' attention to the framework. It was also noted that, in this case, the auditor might apply levels of materiality that are different from those that would have been applied in the case of general purpose financial statements.

Referring to the description of the financial reporting framework, some members thought that management is responsible for identifying the "other sources" that comprise the framework, because management is responsible for selecting appropriate accounting policies. A member asked whether the description of the framework could be addressed in ISA 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement." Other members thought that the framework might provide a hierarchy of sources and that the auditor could not be expected to identify all the "other sources" from which management has obtained direction on the application of the financial reporting standards, law or regulation.

Referring to the description of a fair presentation financial reporting framework, Ms Hillier noted that ISA 700 (Revised) and related amendments to ISAs 200 and 210 were based on the presumption that a framework designed for a general purpose achieves fair presentation. It seemed to her that the proposed requirements and guidance, however, expect the auditor to argue his or her way into such a framework. That is, the auditor now has to determine whether the framework is a fair presentation framework. She argued that this change in approach may create confusion due to its complicated nature and implications for the requirements and guidance. Mr Kellas noted that the IAASB had received conflicting advice from the CAG in that, on the one hand, CAG Representatives indicated that fair presentation could not be achieved where the financial reporting framework is deficient and, on the other hand, that the determination of the acceptability of the framework would place an undue burden on the auditor.

Some members thought that the proposed requirements and guidance relating to the financial reporting framework were not applicable in a majority of cases, in that the relevant framework will be specified or in common general use. They were of the view that the revised drafts of the ISAs could be restructured to address this issue.

Members also raised comments of detail for further consideration by the task force.

The IAASB agreed that:

- ISA 700 (Revised) should deal with the auditor's report on general purpose financial statements, while ISA 701 should deal with the auditor's report on special purpose financial statements;
- Special considerations in the audit of special purpose financial statements (relating to both performance and reporting) should be dealt with in ISA 701;
- Standards and guidance relating to determining the acceptability of the financial reporting framework should be moved to ISA 210;
- Standards and guidance on forming an opinion should be retained in ISA 200 until the proposed ISA on forming an opinion is developed; and

- The task force should reconsider whether the approach to frameworks did have the effect suggested by Ms Hillier and whether it is appropriate.

The IAASB debated whether the requirements and guidance for audits of specific elements, accounts or items of a financial statement should be withdrawn. Some members thought that an increasing demand exists for such audits. Others argued that the proposed requirements and guidance were inadequate. Mr Sylph noted that withdrawal might be the optimal solution because inadequate requirements and guidance might result in problems in practice. Some members were concerned that withdrawal might lead to inconsistency in practice. A member noted that the International Standard for Assurance Engagements (ISAE 3000) might be appropriate for these audits. Mr Kellas suggested that staff prepare a paper that addresses this issue for further consideration by the IAASB.

7. Clarity Update

Mr Kellas introduced the agenda item, noting that the objective of the discussion is to consider certain of the significant issues raised by respondents to the October 2005 Clarity Exposure Drafts, and the Clarity task force's proposed responses thereto. He welcomed Mr Ball, IFAC Chief Executive, as an observer to this part of the meeting.

OBJECTIVES

Draft Objectives for ISAs

Mr Kellas reported that staff has developed, on a preliminary basis, draft objectives for all of the ISAs, in response to recommendations by respondents. They have been presented for discussion purposes only to help facilitate the IAASB's consideration of the way forward and of whether the objectives appear complete and coherent. He noted that the draft objectives have been presented to the IAASB CAG at its May meeting and at the March IAASB-National Auditing Standard Setters meeting for the same purpose. He reported that the IAASB CAG questioned whether the objectives are complete in relation to reference to independence, and has asked that the IAASB consider the need to consult further on the objectives.

Having regard to the areas of importance to an audit and to that fact that the set of objectives is not intended to cover all detailed topic areas that may exist in an audit, the IAASB did not identify any obvious gaps in the list of draft objectives. It was noted, however, that the scope of public sector audits may require additional objectives. Mr Kellas indicated that some members of the CAG also raised questions about the scope of an audit (and therefore of the objectives), but that it was concluded that IAASB's considerations need not extend beyond the audit of historical financial information. Mr Damant reported that a CAG working group was being organized to look at the objectives; however, consistent with this conclusion, it would not address issues pertaining to the scope of an audit.

The IAASB discussed whether further consultation (e.g., exposure) on the objectives would be appropriate and if so, the nature thereof. It was noted that any formal consultation at this time would be of little benefit, particularly in light of the fact that the final wording of the objectives may change. Further, a consultation on objectives in isolation from the requirements of the ISAs would probably be ineffective.

The IAASB agreed that a document communicating the status of the Clarity project, including the draft objectives developed to date, would be of greater interest to stakeholders. Comments on the

completeness of the objectives could be invited as appropriate. Such a communication would be relevant at the time the IAASB approves the revised versions of the four exposed redrafted ISAs.

Extent of Objectives

Mr Kellas reported that although the majority of respondents supported having objectives specified within individual ISAs, some respondents felt strongly that doing so would be inappropriate. He explained the options considered by the task force in responding to these concerns, and the recommendation of the task force. He noted that from a regulatory perspective, there is an interest in a set of objectives that are sufficiently specific and set at an appropriate level to support the application of professional judgment. He also noted that the CAG has suggested that it would appear appropriate to specify an objective in each ISA to buttress the conclusion of the IAASB that the ISA is needed; the specific wording of the objectives in certain of the ISAs, however, could possibly take a different form.

The IAASB expressed mixed views on the issue:

- Several members were of the view that an objective should be specified in each ISA. It was noted that doing so provides the necessary context for the ISA and for the judgment to be made as to whether further procedures are necessary in the circumstances. It was also noted that it may be problematic to determine which ISAs need an objective, and which do not. It would also be the more understandable approach, and would be consistent with the general expectation that an objective for each ISA will be specified.
- Several members were of the view that objectives should be specified only for those ISAs that serve directly to assist in achieving the overall objective of the auditor. It was noted that specifying an objective in each ISA does not acknowledge the fact that the nature of some ISAs may be fundamentally different from others nor the interrelationship of the ISAs. Further, doing so may distract the auditor's focus away from achievement of the overall objective. It would also appear impossible to formulate objectives for some of the topic-specific ISAs in a manner that does not largely reflect their requirements.
- Several members supported the inclusion of objectives in each ISA, provided that the objectives for the topic-specific ISAs that amplify or apply the objectives and requirements of other ISAs could be constructed in such a manner as to highlight the specific nature of those ISAs and their interrelationship with the other ISAs, while minimizing repetition.

The IAASB noted that the acceptability of any decision is dependent on the obligations that would attach to the objectives.

Mr Kellas noted that the balance of views appear to support the inclusion of objectives in each ISA, provided that an appropriate construct for the objectives of certain of the ISAs can be formulated.

Obligation

The IAASB deliberated the task force's proposed revised obligation with respect to objectives.

The following significant concerns were noted:

- The proposed obligation appears to imply the need to document how the auditor has achieved the objective of the individual ISA. Such an additional 'layer' of documentation appears unduly

burdensome without adding value to the audit process, particularly if some objectives are not dissimilar to the requirements of the ISA.

- The obligation, if interpreted as requiring a conclusion on each objective, would appear to superimpose the structure of the ISAs into the audit process, which may not be consistent with the way in which audits are conducted and evidence is obtained and evaluated. This may inadvertently emphasize considerations in relation to the form of the ISAs, rather than their substance. ISA 530 dealing with audit sampling and ISA 700 dealing with the auditor's report were used to illustrate the difficulties. This concern would be reinforced by an obligation to document the achievement of individual objectives.
- It is unclear how the auditor's consideration of the objectives and the related documentation, if any, would be put into operation, particularly if the achievement of the objective in one ISA serves to fulfill, or is dependent on fulfillment of, the objective in another ISA.
- The focus of the obligation on whether further procedures are necessary to achieve the objective may detract from the question whether sufficient appropriate audit evidence has been obtained.

The IAASB was generally comfortable, however, with an obligation that focuses on the achievement of the overall objective of an audit.

Mr Kellas noted that a general increase in the extent of documentation arose in part from the regulatory and inspection processes. Mr Tiedje supported this view, indicating that European regulators would find it important for there to be a link between objectives and documentation, as they see objectives serving to focus on where professional judgment should be applied and in setting a framework for complying, and demonstrating compliance, with the requirements of the ISAs. It was also noted that there may be benefit in focusing on the documentation of the judgments made in relation to the achievement of the objectives, rather than on the performance of individual requirements.

One member noted that some legislation uses objectives as a basis for interpreting the specific provisions within the legislation; this may be a useful construct for consideration by the task force.

Form of the Objectives

The IAASB reviewed the proposed wording of the objectives in the four ISA Exposure Drafts, revised taking account of respondents' recommendations to formulate the objectives in a more outcome-oriented, and less procedural, manner, while retaining an appropriate level of detail. The IAASB asked that the task force reconsider:

- The use within the objectives of the phrase "to reduce audit risk to an acceptably low level." It was noted that it may be preferable to explain more fully this concept within ISA 200 as a link between the overall objective of an audit and the objective of the auditor to obtain sufficient appropriate audit evidence, rather than as an element in the objectives in individual ISAs.
- How the clarity of the individual objectives could be improved, even if it reduces to some extent the consistency in wording across the objectives.
- The proposed objective in ISA 240, having regard to respondents' concerns over use of the imperative 'to consider', and the interrelationship of the ISA with ISAs 315 and 330.

Mr Kellas noted that the form of the objectives, particularly for the other ISAs, may change depending on the final obligation that will attach to the objectives.

REQUIREMENTS, AND STRUCTURAL AND DRAFTING MATTERS

Mr Kellas reported on the main comments received on the ISA Exposure Drafts with respect to requirements and structural and other drafting matters, and the considerations of the task force to date. He noted that the task force will consider whether further guidance on audit documentation relating to requirements constructed using “shall consider” is appropriate and if so, the nature of such guidance.

With respect to aspects of the structure for redrafted ISAs, the IAASB agreed that:

- Each ISA should contain a section that defines the terms used in the ISA, as proposed in the four ISA Exposure Drafts; and
- The inclusion of ‘essential’ explanatory material within the requirements section of the ISAs should be eliminated or reduced where possible, as recommended by respondents. However, such material should be retained if necessary to appropriately define a requirement as to its scope.

IMPLEMENTATION TIMETABLE

Mr Kellas noted that respondents urged the IAASB to accelerate the timetable of the clarity implementation program, particularly in light of the approval of the 8th Directive by European Parliament.

Mr Tiedje reported that the 8th Directive has been approved, and will be officially published on or about mid-June 2006, with an effective date of mid-2008. He noted that completion of implementing the clarity project to all of the ISAs is vital to adoption of the ISAs by EU Member States, and that alignment of the implementation timetable with that of the effective date of the 8th Directive would be an important signal from the IAASB. He also noted that because the adoption of ISAs would be effected by legislative instruments, ISAs would become a part of the European legislation and therefore require review by relevant European institutions prior to approval. An important question will be not only whether the ISAs support high quality financial reporting, but whether they are “fit” for regulatory use.

Mr Kellas reported that several national auditing standard setters have agreed to assist the IAASB in the acceleration of its program by way of redrafting certain of the ISAs. A review of consistency in drafting would be provided by the task force or sub-group thereof. He also noted that some respondents suggested the need to revise certain of the existing ISAs. These respondents may be contacted to obtain more information on the nature of their concerns.

Mr Kellas noted that it would seem appropriate for the IAASB to establish a single effective date for the entire set of redrafted ISAs. The IAASB should be in position to communicate what that date might be in early 2007 once further progress has been made in implementing the drafting conventions. The IAASB agreed in principle that approved individual redrafted ISAs should be released as early as possible to assist in their translation, adoption and implementation.

8. INTOSAI Memorandum of Understanding

Ms Prinsloo introduced the agenda item, noting that INTOSAI signed the first Memorandum of Understanding (MoU) with the IAASB in January 2004 to formalize a project structure and cooperation process to enable INTOSAI to use ISAs as a basis for INTOSAI's Guidelines for Financial Audit and the IAASB to involve individuals with public sector audit experience in the development of ISAs. The MoU called for it to be reviewed after a two-year period. Due to recent changes in the structure of INTOSAI, amendments were necessary to the MoU. Further, INTOSAI concluded that it would be preferable to relocate the text concerning the project structure and cooperation process to a separate document to facilitate changes in future without having to re-open the MoU for revision. INTOSAI had earlier in the month approved the revised MoU and Project Structure and Cooperation Process document.

Mr Thomadakis noted that the PIOB viewed the interaction between INTOSAI and the IAASB favorably. He asked whether the MoU imposed any additional work on the IAASB, and whether INTOSAI's experts were involved in IAASB task forces. Ms Prinsloo noted, in reply, that INTOSAI was responsible for addressing the needs of the public sector (including, but not limited to, financial statement audits), and that there were currently approximately 7 INTOSAI experts participating in a technical capacity on IAASB task forces. Mr Grant questioned whether concern still existed that INTOSAI could carve out parts of ISAs for its purposes. Ms Prinsloo noted that this could not be ruled out but that, currently, there were no instances of carve-outs. Also, INTOSAI was in the process of developing a scope document within the Guidelines that would clarify that compliance with ISAs meant compliance with all applicable ISAs. Mr Sylph further noted that Mr David Walker, Comptroller General of the United States, had expressed strong support for a single set of auditing standards for both public and private sectors at the latest INTOSAI Professional Standards Committee meeting.

The IAASB unanimously approved the revised MoU and the new Project Structure and Cooperation Process document.

9. Practice Statements and Emerging Issues

Mr Gunn introduced, and provided background to, the agenda item. He indicated that material presented contains preliminary recommendations developed by staff as to the way forward in dealing with the issues of the status and authority of International Auditing Practice Statements (IAPSs), and responding to urgent or emerging issues, including interpretations. He noted that the recommendations were discussed at the March 2006 IAASB-National Auditing Standard Setters' (NSSs') meeting and, subsequently, subject to specific comment from NSSs from Canada, Germany, India and the Netherlands.

In relation to the recommendations set out in the agenda papers, the IAASB noted the following:

- It is not appropriate to elevate or change the authority of the extant IAPSs as they were developed with reference to a specific level of authority and obligation. There is, accordingly, a need to establish the future purpose of IAPSs, and to reconsider the nature of their existing content, prior to deciding how best to structure them.
- The desirability of continuing to issue IAPSs is questionable, particularly given that there is some concern over the appropriateness of the issue of authoritative industry-specific guidance in the international environment, and the amount of IAASB resources required to develop them.

- The clarity of the standards and their structure may be diminished, rather than enhanced, by having material of the same authority and obligation in different form and placement within the IAASB Handbook.

After further deliberation, the IAASB agreed the following:

- There should be no change in the status of authority of the existing IAPs, and as few new IAPs should be issued as possible.
- Where a need arises for specific new guidance in a given area, such material should as far as possible be developed at the level of authority of the application material in ISAs. Alternatively, a new ISA could be produced to address the topic.
- With regard to the extant IAPs, they should be reviewed over time as necessary, with consideration given to withdrawing them, or assigning them a higher status by incorporating their content into the application material in ISAs or converting such content into new ISAs. Specific consideration should be given to the status of IAP 1014 addressing reporting on compliance with IFRSs, as this material was more in the nature of interpretive guidance than application material, and to those IAPs addressing the audits of banks and derivative financial instruments.
- The IAASB Chair should contact the IFAC's Compliance Advisory Panel (CAP) to convey the IAASB's conclusions on this matter and to request that the CAP consider the findings from surveys of compliance with IFAC's Statement of Membership Obligations (SMO) No. 3, which requires IFAC member bodies to use their best endeavors to incorporate IAPs in their guidance at the national level, in light of these conclusions.

In relation to the recommendations pertaining to interpretations, the IAASB supported the view that any interpretation arising as a result of ambiguity in an ISA should be dealt with as an amendment to the related ISA(s). The IAASB agreed that the form of any such amendment, and manner in which it is to be effected, should be determined in the context of the specific issue at hand.

In relation to the recommendations pertaining to commissioning others to develop discussion papers to address issues or topics as and when considered appropriate, the IAASB agreed that it should not commit resources to reviewing or approving such documents, even though these documents might be published on IFAC's website.

10. Convergence

Mr. Kellas introduced the topic by explaining that the purpose of the paper "Modifications to IAASB's International Standards – A Guide for National Standard Setters Who Adopt Those Standards" is not an attempt to mandate a single approach to convergence. Rather, it had the more limited purpose of assisting those National Standard Setters (NSSs) who have essentially adopted International Standards by stating the extent to which they can modify the International Standards while still asserting conformity with those standards. NSSs reviewed the draft paper at their meeting in March 2006, and found it offered an appropriate balance of rigor and flexibility.

Concern was expressed that the paper would allow auditors to assert compliance with ISAs when they comply with national standards that include a modification to an ISA because application of a requirement of that ISA is not permitted by national law or regulation. It might even be possible that law or regulation is introduced for the express purpose of exempting auditors from a specific provision of an ISA. Was there not a risk that the resulting audit would not in fact be ISA-compliant?

It was noted that the most likely modification because of a conflict with national law or regulation would arise in the case of reporting requirements. For example, Mr. McPhee noted that in Australia the auditor is at times required by law to use the term “true and fair” in circumstances when it would not be permitted by the ISAs. He noted, however, that in such a case, the NSS could not assert compliance with ISAs because the paper allows this only if the objective of any deleted requirement is still met, which is not the case. The NSS in Australia is attempting to have the law changed so that the national standards can be fully compliant with ISAs.

The IAASB discussed mechanisms to monitor assertions made by NSSs, and it was agreed that the paper should be amended to request NSSs to notify IAASB of any modifications made because of conflicts with national law or regulation

Other matters discussed included:

- Whether the requirement to mark the text of a national standard “in a way that distinguishes modifications to the text of the International Standards,” implies that a literal translation of International Standards is necessary. It was agreed that this implication was not intended and that the paper should be clarified in this respect. It was also agreed that the paper should make reference to the IFAC translation policy.
- Whether the requirement to disclose International Standards that have and have not been included in national standards was intended to be a reference to disclosure by the NSS, or disclosure in individual auditor’s reports. Mr. Sylph responded that this disclosure is intended for NSSs, largely to assist auditors to know which standards over and above their national standards they need to comply with if they are to perform an engagement in accordance with ISAs. It was agreed that this should be clarified in the paper.
- Whether the paper would require NSSs to issue each International Standard as a complete document, or whether situations such as that in Japan, where the requirements and guidance are issued by different bodies, would be permitted within the scope of the statement. It was agreed that the paper does not require each International Standard to be issued as a complete document.
- Whether reference to Practice Statements continues to be appropriate following previous discussion at the meeting about the status of Practice Statements. It was agreed that the reference to Practice Statements should be deleted from the paper and that this should be communicated to the staff of the IFAC Compliance Function.

11. Early Application of Standards

Mr. Kellas introduced the topic noting that the effective date clause of some ISAs includes specific reference to early application whereas it does not for other ISAs. The IAASB was asked whether a consistent policy should be adopted to provide clarity and transparency.

It was noted that different types of ISAs may require different treatments; in particular, early application of ISAs that include reporting requirements could confuse readers if they find different auditor’s reports issued for the same period. This problem does not arise for ISAs containing performance requirements only. If, however, the IAASB had a policy of encouraging the early application of performance requirements, it may create an expectation that auditors should adopt a revised ISA immediately if the requirements of that ISA are more stringent than those they replace. However, this may not always be practical. Mr Tiedje, for example, noted that it would take at least

nine months to process new ISAs as legal instruments in Europe. On the other hand, if nothing is said, there may be confusion about whether those auditors who are capable of early application are permitted to do so.

The IAASB agreed that the “Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services” should be amended to include a statement to the effect that auditors are not precluded from applying an ISA before its effective date unless the effective date clause of an individual ISA contains a statement to the contrary. The IAASB also noted that, in general, the effective date for reporting requirements should be linked to the date of the auditor’s report, and for performance requirements, it should be linked to the starting date of the engagement.

12. Next Meeting

The next meeting of the IAASB has been scheduled for July 10-13, 2006 in Brussels.

13. Closing Remarks

Mr Kellas thanked the American Institute of Certified Public Accountants for hosting the meeting, and its staff for the assistance offered with the meeting arrangements.

Mr. Kellas closed the meeting.