

**Draft Minutes of the 24th Meeting of the  
INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD  
Held on December 4 - 8, 2006 in London**

**Voting Members****Technical Advisors**

Present:	John Kellas (Chairman)	Kelly Ånerud (Mr. Larsson)
	Denise Esdon (Deputy Chair)	Wolfgang Böhm (Mr. Ferlings)
	Phil Cowperthwaite	Philip Ashton (Ms. Hillier)
	Craig Crawford	Cédric Gélard (Mr. Trémolière)
	Sukanta Dutt	Jon Grant (Mr. Rainey)
	Josef Ferlings	Jennifer Haskell (Mr. Hansen)
	John Fogarty	Richard Mifsud (Mr. McPhee)
	Jan Bo Hansen	Greg Shields (Mr. Cowperthwaite)
	Diana Hillier	Sylvia Smith (Mr. Crawford)
	Kjell Larsson	George Tucker (Ms. Esdon)
	Ian McPhee	Hans Verkruijsse (Mr. Pheijffer)
	Marcel Pheijffer	Sharon Walker (Mr. Fogarty)
	Will Rainey	Yuichi Yamamoto (Mr. Shinohara)
	Bodo Richardt	
	Makoto Shinohara	
	David Swanney	
	Roberto Tizzano	
	Gérard Trémolière	

## Apologies:

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**Non-Voting Observers**

Present:	David Damant
	Jennifer Rand
	Jean-Philippe Rabine
	Hisashi Yamaura

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Public Interest Oversight Board (PIOB) Observer

Present: Stavros Thomadakis (12/4 and 12/5) and Sir Bryan Nicholson (12/6-12/8)

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**By Invitation**

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Present: Steve Leonard, Jacqui Bridel

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**IAASB Technical Staff**

Present: Jim Sylph (Executive Director), James Gunn, Kathleen Kerrigan, Michael Nugent, Alta Prinsloo, Ken Siong

## 1. Opening Remarks and Minutes

### WELCOME AND INTRODUCTIONS

Mr. Kellas welcomed Mr. Thomadakis, who observed the meeting on behalf of the PIOB on Monday and Tuesday. Sir Bryan Nicholson observed the meeting on behalf of the PIOB on Wednesday to Friday. Proxies were noted for the following members as they may variously have to be absent at certain points during the week:

- Mr. Swanney (Mr. Kellas);
- Mr. Richardt (Mr. Kellas);
- Mr. Rainey (Mr. Grant);
- Mr. Trémolière (Mr. Gélard); and
- Mr. Dutt (Mr. Kellas).

### MINUTES OF PREVIOUS MEETING

The minutes of the public session of the previous IAASB meeting were approved as presented. The close off version of ISA 800, “Special Considerations—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement,” which was approved at the October meeting, was distributed with the minutes of the public session for that meeting.

### BOARD APPOINTMENTS

Mr. Kellas noted the following new Board members have been confirmed by the IFAC Board and the PIOB, with their terms beginning January 1, 2007:

- Professor William Kinney, The University of Texas at Austin;
- Mr. Muhammed Yusef, Chairman of Central Board of Revenue from Pakistan;
- Ms. Susan Jones, a practitioner from the US firm of Grant Thornton LLP.

He also noted that Messrs. Fogarty, Trémolière and Larsson and himself have been reappointed.

### OTHER MATTERS

Mr. Kellas noted that the World Congress of Accountants, held in Istanbul, Turkey in November, was well-attended, and congratulated Mr. Sylph for his part in the organization of such a successful event. He noted that the IAASB was well represented, with presentations by Messrs. Trémolière, Sylph, Verkruijsse and Kellas; Mr. Thomadakis spoke on the oversight of the accounting profession; and Sir David Tweedie reiterated the importance of IAASB support for the IASB in regard to their activities surrounding the use of “IFRS as modified by Country X” in auditor’s reports.

## 2. Estimates

Mr. Ashton summarized the main issues arising from the September meetings of the IAASB and IAASB CAG, and the task force’s recommended changes to the proposed revised and redrafted ISA 540, “Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures.”

The IAASB discussed the proposed ISA and, except for certain editorial changes and the matter noted below, agreed the changes proposed by the task force.

The IAASB did not support the task force's proposal to delete the requirement for the auditor to document the basis for the auditor's conclusions about the reasonableness of accounting estimates that give rise to significant risks. The IAASB deliberated the appropriateness of continuing to include specific requirements for documentation in individual ISAs in addition to the general requirements of ISA 230, "Audit Documentation." Some members were of the view that in this case the proposed requirement is effectively covered by ISA 230's requirements for documentation in respect of significant matters. In accordance with that view, including specific additional audit documentation requirements in this (and possibly other) individual ISAs appears unnecessary and may undermine the general effect of ISA 230.

While accepting that the foregoing argument has some merit, and without necessarily establishing a precedent for future ISAs, the majority of the IAASB concluded that including such a specific audit documentation requirement in the proposed ISA 540 would promote consistency in the application of the general requirements of ISA 230. The IAASB agreed that the explanatory memorandum accompanying the exposure draft should seek the view of respondents on the inclusion of the specific proposed documentation requirement in the proposed ISA 540, having regard to the proposed redrafted ISA 230.

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

- Essential explanatory material should be added to the requirement for the auditor to review the outcome, or re-estimation, of accounting estimates made in the prior period financial statements. That material should explain that the nature and extent of the auditor's review is determined taking account of the nature of the accounting estimate, and whether the information from the review would be relevant to identifying and assessing risks of material misstatement made in the current period financial statements. In addition, application material should be provided explaining further the purpose of the requirement and how it may be applied
- In some cases, events occurring up to the date of the auditor's report may provide audit evidence that confirms or contradicts an accounting estimate, and may provide sufficient appropriate audit evidence such as to remove the need to perform additional procedures on the accounting estimate. Discussion of this possibility should be included in the application material relating to the auditor's procedure of determining whether such events provide audit evidence regarding the accounting estimate.
- A footnote referring to the work of the IAASB to revise ISA 620, "Using the Work of an Expert" should be added to the proposed requirement for the auditor to determine the need to use the work of an expert. The footnote should explain that the IAASB will reconsider the requirement in finalizing the revised ISA 620.

The IAASB also discussed whether there is a need to include a specific reference in the proposed ISA to the inherent limitations of the audit in the context of accounting estimates. The IAASB noted that there does not appear to be any significant and unique inherent limitations in relation to the audit of accounting estimates in relation to evidence gathering. However, it agreed that there is an inherent limitation arising as a result of the financial reporting framework in terms of dealing with uncertainty

and reliability of the measurement of certain financial statement items, and how this may introduce possible management bias. It was agreed that the Clarity task force should consider whether this point should be emphasized in ISA 200, “Objective and General Principles Governing an Audit of Financial Statements” when it is revised.

#### APPROVAL OF EXPOSURE DRAFT

The IAASB approved the proposed revised and redrafted ISA 540 for issue as an exposure draft with a 120 day comment period.

Mr. Ferlings abstained from the vote to approve the proposed ISA for exposure. Although he agrees with the content of the proposed ISA and would not vote against it, he is of the view that the inclusion of specific documentation requirements in this ISA results in a proliferation of unnecessary requirements which is inconsistent with the principles of the Clarity project. Further, he believes that the proposed documentation requirements hinder the auditor from using judgment as to the appropriate matters to document in accordance with proposed redrafted ISA 230.

### 3. Other Information

Mr. Rainey introduced the topic, and noted the goal of the session was to approve the proposed redrafted ISA 720, “Reading Other Information in Documents Containing Audited Financial Statements.” He then led a discussion of the matters outlined in the agenda materials, which were primarily matters noted by the IAASB when reviewing an earlier proposed redraft of the ISA at the October 2006 meeting.

#### CHANGES TO THE PROPOSED ISA

In addition to editorial changes the IAASB considered the following matters and, where indicated below, made changes to the redrafted ISA:

- The IAASB agreed that the ISA would be more appropriately titled “The Auditor’s Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements.”
- Discussion clarified that the statement in paragraph 2 “... documents containing audited financial statements that are provided to owners on the same terms, and at the same time as the financial statements...” was intended to conform to paragraph B6 of IFRS 7 which addresses information that forms part of the financial statements but which is included in a statement such as a management commentary.
- The first sentence of the objective was revised to state that the “objective of the auditor is to avoid being associated with other information that may undermine the credibility of the audited financial statements, through...” This change balances the need for the objective to be outcome based and for it to form the necessary linkage between the objective and the requirements.
- Clarification was made in the application material to address the fact that there may be certain situations in the circumstances of an engagement, particularly in Germany and also in the case of public sector entities, where the auditor would be required to issue an opinion on certain other information.

## OTHER DISCUSSIONS

The IAASB also discussed including a reference that the auditor shall take further appropriate action specifically in order to avoid being associated with misleading information, but determined that for purposes of the clarity redrafting it would be inappropriate to expand the scope of the ISA to encompass “misleading information.” A member questioned whether it would be appropriate for the auditor to withhold the audit report when a material inconsistency was identified; it was concluded that if there was a duty to report, then the most appropriate action is to include an Other Matters paragraph. If the auditor had already issued a report, the auditor follows the guidance in proposed redrafted ISA 560, “Subsequent Events.”

## REFERENCE TO OTHER INFORMATION CONTAINED IN SECURITIES OFFERINGS

Mr. Kellas noted that since the extant ISA refers to other information contained in securities offerings, for purposes of the clarity drafting exercise, such extant material would not normally be deleted. In general, the IAASB was of the view that this reference should be dropped; as such, the redrafted ISA notes that it may be applied, adapted as necessary, to other documents such as securities offerings. This matter will be explicitly requested for specific comment in the exposure draft.

## APPROVAL OF EXPOSURE DRAFT

The IAASB approved ISA 720 (Redrafted), “The Auditor’s Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements” for issue as an exposure draft with a 90 day comment period.

## **4. Written Representations**

Mr. Fogarty introduced the topic, noting that the proposed ISA had been reviewed by the IFAC Small and Medium Practices (SMP) Committee.

## SIGNIFICANT MATTERS DISCUSSED

Some IAASB members were concerned about the specificity of the general written representations regarding the financial statements. In particular, they were concerned about the detailed elements of the third bullet of paragraph 8, which requires relevant parties to state whether specific matters, where relevant under the applicable financial reporting framework, have been recognized, measured or disclosed in accordance with that framework. The majority of the IAASB was of the view that the detailed elements are necessary to reinforce the implications of the overall written representation about the preparation of the financial statements in accordance with the applicable financial reporting framework. The detailed elements help to avoid misunderstanding and thereby improve the quality of the written representation.

The IAASB extensively deliberated the requirement for the auditor to request relevant parties to provide a written representation that they believe that the internal control they have maintained is adequate for the purpose of preparing and presenting financial statements that are free from material misstatement. Mr. Fogarty explained that the intent of this requirement was not to establish a requirement for management to perform an assessment of the effectiveness of internal control, but rather to confirm that management believes that the internal control is adequate to support the preparation and presentation of the financial statements. It would also avoid the risk that relevant

parties might acknowledge their responsibilities but be aware of shortcomings in the internal control that may affect the financial statements without informing the auditor.

Some IAASB members were concerned about the requirement in paragraph 19 for the auditor to disclaim an opinion on the financial statements when relevant parties do not provide the general written representations about the premise, relating to management's responsibilities, on which an audit is conducted. They noted that this does not allow the auditor to judge the seriousness of the matter, particularly as the requirement would be triggered by a failure to provide one of the detailed elements of the general written representations discussed above. The majority of the IAASB, however, was of the view that a failure to provide a specific element of the general written representations would undermine the validity of the whole general written representations. If relevant parties have a concern about one or more aspects of the requested general written representations, they could choose to modify such representations to reflect their concern. In those circumstances, the auditor would evaluate the effect of the modified general written representations on the audit and the auditor's report.

The proposed ISA requires that general written representations be as of the same date as the auditor's report on the financial statements. A member was of the view that the requirement may not be practical and that the date of the general written representations should be the same date as the approval of the financial statements by management.

Due to the significance of the matters detailed above, the IAASB agreed that they should be raised in the explanatory memorandum that accompanies the exposure draft, requesting specific comments from respondents.

#### CHANGES TO THE PROPOSED ISA

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

- The objective was modified to specifically note that the purpose of written representations was to corroborate the validity of the premises and other audit evidence obtained.
- The term "management" was noted to describe those responsible for preparing and presenting the financial statements, while acknowledging that other terms may be appropriate depending on the legal framework in a particular jurisdiction.
- The term "relevant persons" was changed to "relevant parties" to address concerns that the definition did not address the situation in Europe, whereby certain bodies would be signing the representation letter and the legal definitions of "persons" did not include such bodies.
- A new requirement was added to indicate that relevant parties are requested to provide written representations based on their knowledge and belief, having made appropriate inquiries for them to be able to provide such representations.
- Changes were made to clarify the actions the auditor is required to take when general written representations are not obtained and the actions the auditor is required to take when specific written representations are not obtained.

- Application material was added to provide examples of actions an auditor could take if the auditor has doubts about inconsistencies between written representations and other audit evidence.
- Application material was added to provide examples of cases giving rise to modified written representations and the auditor's evaluation of the effect thereof on the audit and the auditor's report.

#### APPROVAL OF EXPOSURE DRAFT

The IAASB approved proposed ISA 580 (Revised and Redrafted), "Written Representations" for issue as an exposure draft with a 120 day comment period. Five members of the IAASB voted against the exposure draft for the following reasons:

- Mr. McPhee believes the more appropriate date for the representation letter is the date of the financial statements rather than the date of the auditor's report. The auditor should assess the risks to the audit, and any required action, if there is a difference between the date of the financial statements and the date of the auditor's report. The proposals in the exposure draft concerning the date of the representation letter will cause practice difficulties in some jurisdictions.
- Mr. Tizzano believes that the standard does not seem to have a sufficient international perspective in mandating the auditor to disclaim an opinion when the general written representations are not obtained (and when such representations are deemed not to be reliable). This may be particularly problematic in jurisdictions and situations where there is a statutory audit requirement (but written representations are not mandatory).
- Ms. Hillier believes that the standard as revised has done much to progress the logic supporting the need to obtain written representations and to clarify whether written representations constitute audit evidence. However, she does not agree that a disclaimer of opinion is necessarily the only recourse when the auditor is unable to obtain all required general written representations, particularly in light of the level of detailed specific representations in the bullet points in paragraph 8 and in other ISAs that are considered part of the general representations. She also believes that the standard is unclear about whether requirements for specific representations in other ISAs are general or specific representations, and therefore it is unclear whether or not the auditor is required to disclaim an opinion if one of those representations is not obtained.
- Mr. Rainey agreed with the points raised by Ms. Hillier. He also believes that the requirement to disclaim an opinion when the general written representations are not obtained is not appropriate in all situations. He also believes that the general written representation about the adequacy of internal control may be interpreted as a requirement for management to make an assertion about the effectiveness of internal control.
- Mr. Swanney agreed with the points raised by Mr. Rainey. He did not support the specificity of the general written representations and the automatic issue of a disclaimer of opinion when they are not obtained.



## 5. Audit Documentation

Mr. Kellas introduced the topic. He noted that the IFAC SMP Committee had reviewed the proposed redrafted ISA 230, “Audit Documentation” and he would raise their comments at relevant points in the discussion.

### EXPERIENCED AUDITOR VS EXPERIENCED REVIEWER

The task force proposed to change the term “experienced auditor” in the extant ISA to “experienced reviewer” in response to a respondent’s comment on the October 2005 Clarity exposure drafts that indicated that the test of adequacy of audit documentation by reference to an experienced auditor showed a bias in favor of peer review at the expense of regulatory monitoring. Some members disagreed with this proposed change as they believed it was outside the scope of the redrafting project. It was also noted that the majority of audits are performed for unlisted entities and these are generally not subject to regulatory monitoring. There was agreement that the ISA did not intend to favor peer reviews over regulatory inspections. After further deliberation, the IAASB agreed to reinstate the original term “experienced auditor” and to deal with the concern by appropriate drafting changes to the description of how audit documentation enables the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

### OTHER CHANGES TO THE PROPOSED REDRAFTED ISA

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

- In relation to the test of adequacy of audit documentation, the task force should clarify that the auditor shall also document conclusions reached in respect of the significant matters arising during the audit.
- In relation to documentation of compliance with ISAs, further examples focusing on behavioral aspects (such as professional skepticism and the engagement partner’s leadership responsibility) should be provided to clarify the point that it is unnecessary for the auditor to document separately compliance with matters for which compliance is self-evident within the audit file. With the provision of these examples, the IAASB agreed to delete the reference to the use of a checklist to record compliance with every requirement.
- In relation to documentation relating to the use of professional judgment, the list of examples provided in the application material should be described as examples of *circumstances* as opposed to examples of *matters*. In addition, the task force should clarify that documentation in these circumstances would only be prepared where the matters and judgments are significant. Further, the task force should clarify the last example in this context relating to investigating the authenticity of a document to avoid giving the impression that the auditor has authentication expertise.
- In relation to the benefits of preparing a summary of significant matters identified during the audit, rather than indicating that this may assist the auditor’s consideration of the achievement of the objectives specified in relevant ISAs, the application material should explain that the preparation of such a summary is likely to help the auditor to consider whether, in light of the audit procedures performed and conclusions reached, there is any individual relevant ISA

objective that the auditor has not met or is unable to meet that would prevent the auditor from achieving the auditor's overall objective.

- Guidance focusing on considerations specific to smaller entities should explain that the documentation for the audit of a smaller entity will generally be less extensive than that for the audit of a larger entity.
- In relation to the assembly of the audit file, the reference to the time limit for completing file assembly should be made consistent with ISQC 1, i.e. *not more than* 60 days after the date of the auditor's report.
- In relation to documenting changes to audit documentation in exceptional circumstances after the date of the auditor's report, the terminology used regarding "discovery of facts" should be made consistent with wording used in the proposed redrafted ISA 560.

#### OTHER MATTERS

The IAASB briefly discussed whether ISA 230 could be refined to create a standard covering other assurance engagements. The IAASB was generally of the view that it would not be appropriate to consider developing a new documentation standard for such engagements until such time as ISAE 3000, "Assurance Engagements Other Than Auditors or Reviews of Historical Financial Information" is redrafted under the clarity conventions. Accordingly, the IAASB agreed to defer consideration of this matter to a later date.

#### APPROVAL OF EXPOSURE DRAFT

The IAASB approved ISA 230 (Redrafted) for issue as an exposure draft with a 90 day comment period.

### 6. Subsequent Events

Mr. Hansen introduced the topic, noting that the proposed redrafted ISA 560, "Subsequent Events" had been reviewed by the IFAC SMP Committee, who had no specific comments on the clarified ISA.

He noted the existence of a number of conditional requirements in the redrafted ISA; it was the view of the task force that such requirements meet the criteria for establishing requirements because if certain conditions are present, the procedure or action would always be required. It was also noted that certain text that clarifies the limit of the auditor's responsibilities has been included with the requirements as essential explanatory material. Such explanation is deemed to be important in particular jurisdictions.

#### CHANGES TO THE PROPOSED ISA

In addition to editorial changes, the IAASB considered the following matters and made changes to the redrafted ISA, as noted:

- The meaning of the term "date the financial statements are issued" was debated, with the conclusion that this was the date that the auditor had issued his report to the entity, as it was noted that the auditor's actions in the case of subsequent events might differ if the report had been issued to the entity or if the report had been issued to third parties. Additionally, in the case

of the public sector, this may be the date the audited financial statements and the auditor's report thereon are presented to the legislature.

- The conditional requirement that an auditor is not expected to conduct a continuing review of all matters to which previously applied procedures have provided satisfactory conclusions was modified to state that the auditor is not expected to perform additional procedures. This change was made because members felt the notion of a "continuing review" did not acknowledge that the auditor may not need to perform additional work on ordinary balances.
- A new paragraph was included to address the concept of "dual dating," whereby certain financial reporting frameworks may allow management to restrict the amendment of the financial statements to the effects of the subsequent events, and the auditor may be permitted to restrict the additional audit procedures to subsequent events. The IAASB debated whether this was permitted by the extant ISA; as it was deemed to be unclear, this additional language was included and posed as a question for respondents to specifically consider in the exposure draft.
- Consideration of the auditor's legal rights and obligations and the recommendations of the auditor's legal counsel was included as a potential action the auditor may take if management does not amend the financial statements in circumstances where the auditor believes they need to be amended and the auditor's report has already been issued to the entity.
- Specific application material was included to note that in some cases, law, regulation or the applicable financial reporting framework may recognize that there are circumstances where it may not be necessary for management to amend the financial statements; in particular when issuance of the financial statements for the following period is imminent.
- Application guidance for small entities was expanded to acknowledge that the subsequent events procedures may need to be adapted in the case where no interim financial statements, whether for external or internal purposes, have been prepared.
- Reference was made to ISA 210, "Terms of Engagement" to reiterate that management, as agreed in the terms of engagement, has a responsibility to inform the auditor of facts of which they become aware.

#### OTHER DISCUSSIONS

It was noted that although the goal of the ISAs is to remain framework-neutral, the reference to International Accounting Standard 10 should remain as it is included in the extant ISA.

A suggestion was made to include guidance on the consequences for audit documentation when management amends the financial statements and the auditor amends the audit report after the original audit report has been issued. The IAASB agreed that it would be possible to apply the requirements of ISA 230 without further guidance specific to these circumstances.

It was also noted that there are specific public sector considerations, in particular situations where the auditor is not permitted to issue an amended auditor's report on amended financial statements, and other situations where it is possible, but not practicable to issue an amended auditor's report on the financial statements. As there are a number of situations that may arise, the IAASB did not consider any additional guidance to be relevant to all audits and it was thought that INTOSAI may need to issue specific guidance to cover these various situations.

It was agreed that a point should be included in the exposure draft to ask respondents to consider whether continuing to include references to subsequent events procedures in the context of securities offerings, as done in the extant standard, was appropriate in the redrafted ISA.

#### APPROVAL OF EXPOSURE DRAFT

The IAASB approved ISA 560 (Redrafted) for issue as an exposure draft with a 90 day comment period. As the IAASB had not reached a final position on the issues of dual dating and the references to securities offerings within the ISAs, it determined that highlighting these issues in the guide for respondents in order to seek input was appropriate. The public sector perspective will be sought on the application of the requirements in paragraph 14.

### 7. Internal Audit

Mr. Crawford introduced the topic, noting the proposed change to the title of the ISA to ISA 610, “The Auditor’s Consideration of the Internal Audit Function,” and remarking on some of the drafting challenges the task force had encountered in the wording of extant ISA 610.

#### OBJECTIVE

The IAASB discussed the wording of two alternative objective paragraphs put forward by the task force. One alternative included a stepped approach whereby the external auditor determines the relevance of the internal audit function’s activities to the audit, and only if those activities are relevant, the external auditor determines their effect on the external auditor’s procedures. The IAASB favored this approach, but agreed that it should include an additional step of obtaining an understanding of the internal audit function in light of the relationship of this ISA with ISA 315, “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment”.

#### RELATIONSHIP WITH THE AUDIT RISK ISAS

The IAASB discussed the structure of the ISA, and the wording and placement of certain paragraphs in terms of their relationship with the audit risk ISAs (e.g., ISAs 300, 315 and 330). The IAASB decided that ISA 610 should be better aligned with those other ISAs, in particular:

- (a) The flow of headings and paragraphs in the requirements section should be revised to follow the structure of (a) obtaining an understanding of the internal audit function, (b) planning to use the work of the internal audit function, and (c) using the work of the internal audit function;
- (b) There should be a requirement to evaluate such things as the objectivity and technical competence of the internal audit function only when the external auditor intends to use the work of the internal audit function; and
- (c) The proposed requirement to “test a portion of the internal audit function’s work” as part of evaluating that work when intending to use it for the external auditor’s purposes should be deleted (it was noted that other procedures may be appropriate when following a risk based approach to the audit).

The IAASB noted that the task force should consider identifying in the explanatory memorandum accompanying the exposure draft of ISA 610, significant changes to the extant ISA that result from applying the audit risk ISAs.

## OTHER MATTERS

In addition to editorial and other minor changes, the following matters were noted:

- The scope of the ISA should continue to exclude instances when personnel from internal audit assist the external auditor in carrying out external audit procedures.
- As with the extant ISA, the redrafted ISA should note that the internal audit function is not independent of management.
- The reference in the application material to the need for the internal audit function to maintain objectivity should be deleted because it may imply that other characteristics, e.g., competence, are less important.

## APPROVAL

The IAASB approved ISA 560 (Redrafted) for issue as an exposure draft with a 90 day comment period.

## 8. Summary Financial Statements

Mr. Dutt introduced the topic and summarized the issues identified by the task force in developing ISA 805, “The Independent Auditor’s Report on Summary Financial Information Derived from Audited Financial Statements.” Mr. Damant noted the importance of this topic in light of the increasing complexity of financial statements and the consequent use of summary financial statements as a primary form of communication to many investors.

### AUDITOR OF THE FULL FINANCIAL STATEMENTS

The IAASB discussed whether the auditor of the summary financial statements needs to be the auditor of the full financial statements. It was noted that, in practice, the auditor of the summary financial statements may not be the auditor of the full financial statements, e.g., where the summary financial statements are included in a prospectus, or where there has been a change of auditor between the time the full financial statements are audited and when a report on the summary financial statements is required. A comparison was made with ISRE 2410, “Review of Interim Financial Information Performed by the Independent Auditor of the Entity,” which is to be applied only when the review is performed by the auditor of the entity because an audit based understanding of the entity is required for such engagements.

It was acknowledged that an audit based understanding of the entity may not be necessary for an engagement with respect to summary financial statements because the auditor needs only to conclude whether those statements are a fair summary. However, the IAASB agreed that, because the ISA was written from the perspective of the auditor of the summary financial statements also being the auditor of the full financial statements, which is the most common case, its use should be restricted to those circumstances. This is to be expressed as a requirement to accept an engagement to report in accordance with ISA 805 only when the auditor is the auditor of the full financial statements.

### DOCUMENTS CONTAINING SUMMARY FINANCIAL STATEMENTS

The IAASB discussed the proposed requirement for the auditor to request management to confirm that, where any document containing the summary financial statements refers to the auditor, such reference would not be misleading. The associated material regarding auditor association was also

discussed. The IAASB considered an alternative whereby the auditor would be required to make a judgment about whether any such reference was misleading on a case-by-case basis. It was noted, however, that such a requirement may not be practical as it imposed an ongoing obligation on the auditor who may not even be aware of all documents that contain a reference to the auditor's report on the summary financial statements. Also, use of the term "misleading" could be thought of as implying bad faith on the part of management. It was also noted that no equivalent requirement exists with respect to full financial statements.

It was agreed that the ISA should require the auditor to request management to confirm that, where any document containing the summary financial statements indicates that the auditor has reported on those statements, the auditor's report will also be included in the document. It was further agreed that, consistent with the expectation expressed in ISRE 2410 with respect to the auditor's report on interim financial information, this requirement should not include an alternative that the document merely indicate from whom or where the auditor's report is available. The task force was asked to revise the associated material regarding auditor association accordingly.

A member indicated that the above requirements may be problematic in jurisdictions where auditors are advised not to include the auditor's report on summary financial statements in documents offering securities to the public. Recognizing that the ISA has not been drafted specifically with such documents in mind, and that such documents are usually subject to regulatory mechanisms to protect the public interest, the IAASB agreed that auditors' reports on summary financial statements included in documents offering securities to the public should be excluded from the scope of the proposed ISA. The IAASB requested the task force responsible for redrafting the ISA to reconsider the appropriateness of the proposed description of such documents.

#### CRITERIA

The IAASB considered the section of the proposed ISA discussing the criteria to be applied in preparing and presenting summary financial statements, and agreed:

- (a) To simplify the section by restructuring and rewording the text;
- (b) To explicitly acknowledge that the criteria could be specifically developed for the engagement, and to refer to industry practice in this context;
- (c) To remove the tautological reference to the summary financial statements containing "the information necessary to be a fair summary" as part of the criteria for determining whether the summary financial statements are a fair summary; and
- (d) To retain the list of matters cited in the draft that identifies the characteristics of summary financial statements which have been derived using suitable criteria, and to add a further characteristic to that list regarding adequate disclosure of the applied criteria.

The IAASB also discussed whether criteria are usually sufficiently specific to determine, for example, which of the many disclosures in a full set of financial statements could be omitted with the result still being a "fair summary." It was acknowledged that determining the suitability of criteria in the circumstances of the engagement requires considerable judgment, which ought to be exercised in the context of the matters noted in the proposed ISA, such as the nature of the entity and the purpose of the summary financial statements.

It was also agreed that the example description of criteria developed by management, contained in a footnote in the appendices, should be deleted to prevent it from becoming “boilerplate” wording that may be adopted inappropriately.

#### OTHER MATTERS

In addition to editorial and other minor changes, the following matters were noted:

- The term summary financial statements is preferred to summary financial information because the latter term would imply that isolated elements of the financial statements may be covered by the ISA.
- The ISA should specifically require the auditor to accept an engagement only where the criteria applied in summarizing the financial statement are acceptable in the circumstances, unless this is contrary to law or regulations.
- The ISA should require the auditor to restrict distribution or use of the auditor’s report on the summary financial statements where the auditor’s report on the full financial statements is restricted in accordance with ISA 800.
- The title should be changed to “Engagements to Report on Summary Financial Statements”

#### APPROVAL

Based on the recommendation and analysis of the task force, the IAASB agreed that when the ISA is exposed in redrafted format in accordance with the clarity drafting conventions, the explanatory memorandum should seek respondents’ views on the following two issues:

- (a) Any unintended consequences that may exist if the ISA, as currently drafted, were to apply to auditors’ reports on summary financial statements in documents offering securities to the public; and
- (b) The appropriateness of the “fair summary” wording of the auditor’s opinion, which had been discussed extensively in previous meetings.

Mr. Sylph advised the IAASB that due process has been followed in developing and finalizing the close off version of ISA 805, Special Considerations When Reporting on Summary Financial Statements.”

The IAASB approved the close off version of ISA 805, a copy of which is attached to these minutes.

Mr. Rainey voted against the approval of the document. In his opinion:

- (a) This document dilutes the meaning of “audit” and therefore should not be an ISA; and
- (b) The “fair summary” wording of the auditor’s opinion is not appropriate because criteria will rarely be specific enough for the auditor to form this conclusion (as opposed to concluding that the summary financial statements are “not misleading”). Further, he was of the view that the ISA does not offer sufficient guidance on this matter, and is likely to create an expectation gap regarding the auditor’s role in relation to summary financial statements.

## 9. ISA 200

Mr. Kellas introduced the topic, noting that the proposed draft revised ISA 200, “Overall Objective of the Independent Auditor, and Fundamental Concepts Relevant to an Audit of Financial Statements” had been revised on the basis of discussion at the September 2006 IAASB meeting, and had been aligned with the approved amended Preface. In addition, it had been updated for consequential amendments arising from changes to proposed ISA 580 and the approved close off version of ISA 800.

### REASONABLE ASSURANCE

Mr. Kellas noted that a number of regulators had expressed concern over the removal of the term “high, but not absolute assurance” from the definition of reasonable assurance in the Assurance Framework as this change may have been viewed as accepting a lower level of assurance in an audit than hitherto, which of course is not the case. The task force therefore proposed including the phrase in the definition in ISA 200. He noted that the task force had explored various options for refining the definition of reasonable assurance, as suggested at the September 2006 meeting, but doing so raised a number of unintended consequences and issues. Further, he noted that while the suggestion of including a reference to the inherent limitations of an audit as part of the definition of reasonable assurance may have merit, it is not necessary because the remainder of ISA 200 puts the term reasonable assurance into the appropriate context in this regard.

It was suggested that some readers of the ISA may interpret the phrase “high, but not absolute assurance” as meaning that the level of assurance obtained is virtually 100% in all cases, even though under the Assurance Framework such a level would not be expected to be obtained on all audits or on all assertions within a set of financial statements. On the other hand, the Assurance Framework was not intended to change the meaning of “reasonable assurance” or become a point of difference between ISAs and national standards, several of which use “high, but not absolute assurance.” Accordingly, using the word “high” in relation to a financial statement audit is not, in fact, inconsistent with the Assurance Framework.

### ALIGNMENT WITH THE PREFACE

A number of suggestions were made to revise the wording in the draft that expresses the auditor’s obligation with respect to objectives. Mr. Kellas noted that the task force would consider the suggestions, but that the final wording must faithfully and clearly reflect the amended Preface approved by the IAASB in September.

Mr. Rabine asked about the extent to which revised ISA 200 would be exposed for comment after its scheduled approval in April, and in particular whether comments will be invited on the requirements derived from the amended Preface. Mr. Kellas explained that the amended Preface has been finalized in accordance with IAASB’s stated due process; accordingly, it would be unusual if the IAASB were to re-expose those provisions. Mr. Rabine noted that, in commenting on the proposals that accompanied the draft Preface, the European Commission had indicated that it would not be considering the Preface for adoption, but requested that its provisions be included in ISA 200 at which time it would comment on them.

### INHERENT LIMITATIONS



Mr. Kellas noted that the European Federation of Accountants (FEE) is undertaking a project to identify the inherent limitations of an audit. While the final results of that project may not be available until after ISA 200 has been approved, it is hoped that the approach taken in the current draft of ISA 200 will be consistent with those results.

A concern was expressed that ISA 200 may devote too much attention to the explanation of the inherent limitations of an audit. It was noted, however, that a concise but comprehensive explanation of the inherent limitations in ISA 200 is preferable to the approach of including discussion of inherent limitations at various places throughout the ISAs.

It was suggested that the discussion of inherent limitations could be improved if it addressed them under two principal categories: those limitations that make the achievement of absolute assurance impossible; and those that arise as a result of the need, in the public interest, for the auditor to form an opinion on the financial statements within a reasonable period of time and at a reasonable cost.

#### OTHER MATTERS

In addition to editorial changes, the IAASB asked that the task force consider further the following:

- Greater use of ‘essential’ explanatory material within the requirements section, to enhance the context and understanding of the intent of the requirements derived from the amended Preface.
- The use of another term instead of “fundamental” concepts relevant to an audit of financial statements.
- The order in which the fundamental concepts are presented.
- The logic of the flow of the application and other explanatory material related to the requirement dealing with the objectives in the ISAs, and whether anything more should be said in explaining that requirement.
- The presentation of the definitions of “compliance framework” and “fair presentation framework” as sub-definitions of “financial reporting framework”, to give them an appropriate context.
- The need for some linkage between the concepts and the requirements.
- The consistency of the definition of “detection risk” with extant ISA 200.
- The consistency of the section of the draft ISA relating to ethics with the IFAC Code of Ethics for Professional Accountants (IFAC Code).
- The discussion of profession skepticism and whether it should be split between the part explaining the concept and that expanding upon the requirement.
- The difference that may exist between the exercise of professional judgment and the judgment of a professional.
- Whether reference should be made to the fact that ISAs do not impose responsibilities on management and those charged with governance, nor override laws and regulations that govern those responsibilities.

The IAASB asked the task force to consider its comments and to present a revised draft for approval for exposure at the April 2007 IAASB meeting.

## **10. Related Parties**

Mr. Trémolière introduced the topic and summarized the main issues identified by the task force in the cover memorandum. He then led a paragraph-by-paragraph review of the draft ISA.

### **THE AUDITOR'S RESPONSIBILITIES**

Mr. Trémolière noted that, consistent with how the introduction to ISA 240 (Redrafted), "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" identifies the auditor's responsibilities with respect to fraud, the introduction to the draft ISA includes a section on the auditor's responsibilities with respect to related parties. It takes a three-part approach by identifying the auditor's responsibilities (a) when the applicable financial reporting framework establishes specific requirements for related parties; (b) vis-à-vis the "stand-back" responsibility identified in ISA 700 (Revised), "The Independent Auditor's Report on General Purpose Financial Statements" for both fair presentation and compliance frameworks; and (c) with respect to fraud. The IAASB agreed that this three-part approach provides a suitable framework for the ISA.

The IAASB asked the task force to reconsider the proposed wording regarding the "stand-back" responsibility because it appeared to imply that the ISA placed a new responsibility on the auditor to perform a stand-back test in the context of related parties, in addition to the stand-back requirement that is already set out in the revised ISA 700.

In relation to the description of inherent limitations with respect to related parties in the introductory section, the IAASB asked the task force to reconsider the wording proposed so as to more clearly differentiate the increased risk of material misstatement caused by related parties in particular circumstances (such as when information about related parties is lacking), from the limitations that are inherent to all audits.

### **NATURE AND EXTENT OF INQUIRIES OF MANAGEMENT**

The IAASB debated whether the auditor should be required to inquire of management regarding related party relationships and transactions when the applicable financial reporting framework does not establish related party requirements. Some members questioned whether it was appropriate to limit the proposed requirement for the auditor to make inquiries of management regarding the identity of the entity's related parties and the nature of the related party relationships and transactions to only those circumstances where the applicable financial reporting framework defines related parties. It was noted that it was unclear why, even if the framework establishes no related party definitions, the auditor would not also ask management about who the main parties are with whom the entity has "related party" relationships and the nature of any business undertakings between them and the entity, simply from the point of view of understanding the business.

The task force noted that the primary reason for this approach was to avoid the practical difficulties that would likely arise from trying to ask management to provide a list of related parties and related party transactions based on definitions and guidance that exist only in an auditing standard. Other members, however, argued that requiring the auditor to make these inquiries of management in all cases would be appropriate because management is in the best position to know who those parties

are and whether there have been transactions with them. The IAASB asked the task force to consider this matter further.

#### OTHER MATTERS

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

- In relation to the engagement team discussion, the task force should reconsider whether it is appropriate to distinguish between the risks of material misstatement due to error and those due to fraud.
- It should be made clear that the proposed definition of a related party applies for the purposes of the ISA regardless of any definition in the applicable financial reporting framework.
- In relation to the definition of arm's length assertion, the task force should consider whether the definition should refer to "prevailing market conditions" as opposed to "normal market conditions," given the difficulty in determining what is "normal."
- The description of the responsibilities of management and those charged with governance regarding related party relationships and transactions should be aligned with the amended description in the proposed revised ISA 200.
- In relation to new requirements established under the revised 4<sup>th</sup> and 7<sup>th</sup> Directives in Europe, the ISA should include some guidance to provide an indication of the possible implications of any implicit assertions within the financial statements that related party transactions are at arm's length. The IAASB noted that this guidance could be expanded and made more specific at a later stage if national standard setters reach a consensus on how to deal with the audit of such assertions.

The IAASB asked the task force to consider its comments and to present a revised draft at a subsequent IAASB meeting. The IAASB also asked the task force to consider, in preparing the revised ISA, the appropriateness of the proposed requirements in the context of both financial reporting frameworks that establish related party requirements and those that do not.

#### 11. Quality Control

Mr. Richardt introduced the topic noting that ISA 220, "Quality Control for Audits of Historical Financial Information" differs from other ISAs in that it has a companion standard, ISQC 1, which applies at the firm level, rather at the engagement level, and to broader assurance and related service engagements as well as audits of financial statements. He also noted that at this stage, the task force has not sought SME or public sector input.

#### RELATIONSHIP WITH ISQC 1

It was noted that extant ISA 220 includes paragraphs in the introduction section that were intended to assist the reader in understanding the relationship between ISA 220 and ISQC 1. These paragraphs have been moved to the application material in the draft clarified ISA, and as such may be overlooked when a reader first looks at the ISA. It was agreed that they should be moved back to the introduction to allow the reader to properly understand the scope of ISA 220. The task force was also asked to consider whether extant ISA 220.42 ("A deficiency in the firm's system of quality control does not indicate that a particular audit engagement was not performed in accordance with

professional standards and regulatory and legal requirements, or that the auditor's report was not appropriate”) should be included in the introduction for the same reason.

The Board discussed two paragraphs (10A and 11A) that the task force had suggested introducing in ISA 220. The paragraphs would impose obligations regarding engagement acceptance and continuance at the engagement level to mirror the firm’s obligation under ISQC 1. It was questioned, however, whether what the new requirements were trying to achieve was actually already covered by existing requirements under ISA 220 and, if retained, would impose specific obligations on the engagement partner that should exist only at the firm level. The task force was asked to reconsider this matter, particularly whether, if these paragraphs are not retained as requirements, some of the matters noted therein should be retained in the application material to draw the attention of the engagement team to matters considered as part of the firm’s quality control system.

#### ENGAGEMENT QUALITY CONTROL REVIEW

The IAASB considered whether the lists of matters included in a quality control review (extant ISA 220.39 – all audit engagements, and 220.40 – listed entities) should be elevated to requirements. On the one hand they are detailed lists, particularly the one applying to listed entity engagements, and therefore may be seen as creating rules rather principles. However, it was noted that experience in some jurisdictions had indicated that more detailed requirements may be needed in this area than in others. It was agreed that the list that applies to all audit engagements should be elevated to a requirement. Further, the task force should consider whether there are any additional considerations relevant to listed companies that should be requirements.

#### OTHER MATTERS

In addition to editorial and other minor changes, the following matters were noted:

- The reference to “the firm’s” quality control policies and procedures should be deleted from the objective.
- The task force should consider the implications for ISA 220 of likely change to the definition of engagement team in the exposure draft of the IFAC Code expected to be approved by the IESBA later in the month. It was noted that the definition is likely to exclude external experts for the purposes of the Code.
- The requirement related to the engagement partner’s review of the audit documentation and discussion with the engagement team should mention that the review and discussion should be “timely.”
- The task force should consider whether ISA 220 should include a definition of “consultation.”
- Extant ISA 220.29 (“Where more than one partner is involved in the conduct of an audit engagement, it is important that the responsibilities of the respective partners are clearly defined and understood by the engagement team”) should be elevated to a requirement.
- The task force should consider whether to elevate to a requirement the sentence in extant ISA 220.33 that states “The documentation of consultations with other professionals that involve difficult or contentious matters is agreed by both the individual seeking consultation and the individual consulted.”

- It was agreed that all documentation requirements should be grouped together towards the end of the requirements section.
- While it is unlikely the IAASB will be able to review and approve a clarified version of ISQC 1 given its current workload commitments, the task force should draw to the Board's attention any significant matters that arise from its review of ISQC 1.

The IAASB asked the task force to consider its comments and to present a revised draft for approval at the April 2007 IAASB meeting.

## **12. Presentations**

Mr. Kellas welcomed Mr. Paul George, Director of the Professional Oversight Board (POB) (UK), and Mr. Richard Fleck, Chairman of the Auditing Practices Board (APB) (UK), who had been invited to talk to the IAASB about UK developments that may assist it as background to its development of standard setting priorities and work program. Mr. Kellas noted that the Financial Reporting Council (FRC) in the UK has been working on topics that are relevant to the IAASB, including the FRC discussion paper on audit quality.

Mr. Fleck discussed the importance of audit quality, in particular due to the unprecedented level of change in the regulatory environment, a lack of consensus as to what constitutes a quality audit, and a strongly held belief that standards are an important but a relatively small part of audit quality. Acknowledging that auditing standards are not the complete answer to what drives audit quality, he noted that FRC therefore felt it was important to issue a discussion paper for purposes of better understanding audit quality in order to achieve its mission of promoting confidence in corporate reporting and governance.

Mr. Fleck noted that the FRC's goal is to start discussion about what might help achieve a higher quality audit, and to inspire firms and others to do more to add value beyond the issue of an audit opinion. The FRC believes the drivers of audit quality fall within four groups:

- The culture within an audit firm;
- The skills and personal qualities of the audit partners and staff;
- The quality of the audit process (including auditing and ethical standards); and
- The reliability and usefulness of audit reporting.

Mr. Fleck noted the potential conflict between the level of prescription within ISAs and other drivers of audit quality, in particular as it relates to professional judgment and the increased cost of the audit. In this context, he noted that interviews that firms held with staff who were leaving indicated that regulation was having a demotivating effect on good staff. Mr. Fleck also expressed the view that post clarity, successful implementation of the standards will require a period of stability. He also suggested that a focus on industry specific material, assurance service alternatives to an audit (in particular for the small- and medium-entities marketplace), and investment circular reporting standards would be valuable. He noted that the UK is exploring whether the auditor's report is as useful as it can be; in particular, consideration is being given to whether narrative reporting describing audit procedures and other matters of value would provide a better means of audit reporting.

Mr. Fleck concluded by noting that responses to the FRC's discussion paper are due by the end of March 2007. He invited the IAASB to comment on the matters addressed in the discussion paper, and indicated that he would hope to discuss the responses received by the FRC with the IAASB so that the final document can incorporate the IAASB's views.

Mr. George provided background information about the APB and the POB, in particular the POB's role in audit monitoring and its focus on review of the audits that had the largest risk to public confidence. He stressed that audit monitoring is an integral part of driving audit quality, with the hope that matters learned from monitoring and inspections are implemented by audit firms and incorporated in auditing standards where appropriate. The POB aims to have the process be non-adversarial and transparent.

He noted a number of themes emerging from audit inspection activity, including the following:

- The application of standards is more likely to give rise to concern than any significant deficiencies in the standards themselves;
- Some standards in particular, such as the use of experts, the risk standards, and going concern, are inconsistently applied;
- There are areas where further standards may be helpful, in particular group audits and taxation; and
- ISQCs could be better used by firms to improve audit quality, rather than merely to achieve an acceptable standard of practice.

Mr. Kellas thanked Messrs. Fleck and George for their presentations and sharing some of their thoughts with the IAASB.

### **13. Next Meeting**

The next meeting of the IAASB has been scheduled for February 13 - 16, 2007 in New York.

### **14. Closing Remarks**

Mr. Kellas thanked the Consultative Committee of Accountancy Bodies for hosting Monday evening's dinner.