

**Minutes of the 23rd Meeting of the  
INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD  
Held on October 25-27, 2006 in New York**

**Voting Members**

Present: John Kellas (Chairman)  
Denise Esdon (Deputy Chair)  
Phil Cowperthwaite  
Craig Crawford  
Sukanta Dutt  
Josef Ferlings  
John Fogarty  
Jan Bo Hansen  
Diana Hillier  
Marcel Pheijffer  
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)  
Greg Shields (Mr. Cowperthwaite)  
Sylvia Smith (Mr. Crawford)  
George Tucker (Ms. Esdon)  
Hans Verkruijsse (Mr. Pheijffer)  
Sharon Walker (Mr. Fogarty)  
Yuichi Yamamoto (Mr. Shinohara)

Apologies: Ian McPhee  
Kjell Larsson

**Non-Voting Observers**

Present: David Damant  
Jennifer Rand  
Jürgen Tiedje  
Hisashi Yamaura

**Public Interest Oversight Board (PIOB) Observer**

Present: Aulana Peters

**By Invitation**

Present: Steve Leonard

**IAASB Technical Staff**

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

## **1. Opening Remarks and Minutes**

### **WELCOME AND INTRODUCTIONS**

Mr. Kellas welcomed Ms. Peters, who observed the meeting on behalf of the PIOB. Proxies were noted as follows: Ms. Ånerud for Mr. Larsson, and Mr. Mifsud for Mr. McPhee.

Mr. Kellas welcomed Ms. Koukhar as new member of the IAASB technical staff.

### **MINUTES OF PREVIOUS MEETING**

Mr. Damant asked that a reference to “IAASB CAG” be changed to “CAG Representatives.” Subject to the editorial change suggested by Mr. Damant, the minutes of the public session of the previous IAASB meeting were approved.

The approved close-off version of ISA 540 was presented with the September minutes to the October Board meeting.

## **2. The Auditor’s Responsibilities Relating to Fraud**

Mrs. Esdon explained the proposed changes recommended by the Task Force in response to the following matters raised by the IAASB at its September meeting with respect to the proposed final draft of redrafted ISA 240, “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements”:

- Whether further description of the inherent limitations of an audit in the context of fraud should be included in the introductory section of the ISA; and
- Whether the ISA refers to “assessed risks” in all places where it is appropriate to do so.

Mrs Esdon also noted that one further editorial change is recommended, which was not indicated in the agenda papers presented to the Board. The change is to conform the wording in paragraph 8 of the proposed redrafted ISA with the proposed objective of the auditor.

The IAASB agreed the changes recommended by the Task Force.

Mr. Damant noted that some concern has been brought to his attention about the statements in ISA 240 that an audit performed in accordance with ISAs rarely involve the authentication of documents, and that unless the auditor has reason to believe the contrary, the auditor ordinarily accepts records and documents as genuine. He suggested that this concern might be alleviated in part by including reference in the introductory section of the ISA to the guidance included in the appendices of the ISA. After debate, the IAASB concluded that the ISA provides adequate discussion of the responsibilities of the auditor, and contains the appropriate cross-references to the appendices, and therefore no change is necessary.

The IAASB unanimously approved the redrafted ISA 240 as a final Standard. Mr Sylph advised the IAASB that due process has been followed in developing and finalizing the document.

## **3. Special Reports**

The IAASB discussed the amendments proposed to deal with the two open matters, as had been agreed at the September 2006 IAASB meeting. The open matters were:

- Proposed amendments to the requirement to include an Emphasis of Matter paragraph in the auditor's report when the financial reporting framework is deficient and management provide additional disclosures in the financial statements to avoid misleading users (paragraphs 22 and 23 of proposed amended ISA 210, "Terms of Audit Engagements" and proposed conforming amendment to ISA 706, "Emphasis of Matter Paragraphs or Other Matter(s) Paragraphs in the Independent Auditor's Report).
- The guidance on accepting an engagement to audit a specific element, account or item of a financial statement (paragraphs 22-26 of proposed ISA 800, "Special Considerations—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement").

#### PROPOSED AMENDED ISA 210

The IAASB debated whether to add "if necessary" in the requirement for the auditor to include a reference in the terms of engagement to the fact that an Emphasis of Matter paragraph will be included in the auditor's report in the circumstances described. The IAASB concluded that an Emphasis of Matter paragraph will always be necessary in those circumstances and that the requirement should not be amended.

#### PROPOSED CONFORMING AMENDMENT TO ISA 706

A member noted that the proposed amended ISA 210 contains an implicit requirement for the auditor to include an Emphasis of Matter paragraph in the auditor's report in the circumstances described, while the proposed conforming amendment to ISA 706 includes reference to such an Emphasis of Matter paragraph in a list of examples. It was agreed that ISA 706 should refer to this requirement for an Emphasis of Matter paragraph in a similar manner as for the requirement for an Emphasis of Matter paragraph in ISA 560, "Going Concern."

A member was concerned that the ISAs would not contain an explicit requirement for an Emphasis of Matter paragraph in the circumstances described. It was noted that the proposed amended ISA 700 (Revised), "The Independent Auditor's Report in General Purpose Financial Statements" and proposed ISA 800 do not deal with modified auditor's reports, and ISA 706 does not contain specific requirements for Emphasis of Matter paragraphs. The IAASB agreed that a requirement for such an Emphasis of Matter paragraph should be included in the ISAs as part of the project to "clarify" the proposed amended ISA 210.

#### PROPOSED ISA 800

A member expressed concern about the fact that a true and fair/fairly presents opinion could be expressed on a specific element, account or item of a financial statement; however, this matter was concluded at the previous meeting. Minor editorial amendments were agreed.

#### APPROVAL

Mr. Dutt confirmed that the Task Force did not consider it necessary to re-expose the documents. He explained that the majority of changes clarified or repositioned the requirements and guidance in the exposure draft. The IAASB agreed that re-exposure would not be necessary.

Mr. Sylph advised the IAASB that due process had been followed in developing and finalizing the “close off” documents.

Proposed amended ISAs 200, 210 and 700, proposed conforming amendment to ISA 706, and proposed ISA 800 were approved by the IAASB as follows:

- Proposed amended ISA 200 was approved unanimously.
- Proposed amended ISA 210 was approved unanimously.
- Proposed amended ISA 700 was approved by 17 members. Ms. Hillier dissented.
- Proposed ISA 800 was approved by 14 members. Ms. Esdon, Ms. Hillier and Mr. Swanney dissented. Mr. Rainey abstained.

Ms Hillier acknowledged that this has been a hard and difficult project on which the IAASB had debated a number of important matters of principle. She expressed appreciation to the Task Force and the IAASB for responding to a number of the comments she had raised, which in her view strengthened the guidance. However, she still felt it necessary to vote against the proposed amendments to ISA 700 and proposed ISA 800 for the following reasons: In her view, the requirements fall short of stakeholders’ expectations and, instead, entrench practices which perpetuate an unacceptable status quo in audit reporting practices. As far back as the Asian financial crisis in the 1990’s stakeholders, such as the World Bank, have been looking to the auditing profession to play a role in contributing to the quality of financial reporting world wide through restricting true and fair / fairly presents opinions to circumstances in which there is full, transparent and complete financial reporting. In her view, linking the wording of the audit opinion solely to whether or not the financial statements have been prepared in accordance with a fair presentation framework or a compliance framework (a determination that may prove quite difficult to make) does not achieve that aim. As a result, she is concerned that the new standards will tie the hands of those jurisdictions, firms and individuals who have been trying to respond to the challenge posed to the profession.

Furthermore, she is concerned about the number of jurisdictions who have indicated that they will not be adopting ISA 800, indicating that there is not consensus on this issue and that consistency in reporting is unlikely to be achieved.

Ms Esdon was of the view that ISA 800 undermines what the IAASB attempted to do with ISA 700 (Revised). Her concerns were of a practical nature, relating to audits of specific elements, accounts or items of a financial statement. She was of the view that the related requirements and guidance will not be helpful to auditors. Although she had no objection to an auditor reporting on an element, account or item when required to do so, she was concerned that the related requirements and guidance would give rise to diversity of practice.

Mr. Swanney did not support ISA 800 because he was of the view that an auditor could not express a true and fair opinion on a specific element, account or item of a financial statement if the auditor did not audit the entity’s financial statements.

Mr. Rainey abstained because, in addition to the reasons given by Ms Hillier, Ms. Esdon and Mr. Swanney, of his overarching concern about the continuing dilution of the meaning of “true and fair.” He was of the view that ISA 800 will contribute to this.

#### 4. Written Representations

Mr. Fogarty introduced the topic, indicating that the objective of the discussion was for the IAASB to review and approve for exposure the proposed revised ISA 580, "Written Representations." He noted that the proposed revised ISA was discussed by the IAASB CAG at its September meeting, with the majority of CAG representatives expressing support to the direction being taken. He also noted that the IFAC's Small and Medium Practice (SMP) Committee was broadly supportive of the draft proposed ISA. It expressed some concern, however, about the practicality of the concept of "threshold amounts" that is being introduced in the proposed ISA.

##### OBJECTIVE

The IAASB deliberated the proposed objective of the auditor, and possible alternatives for its form and content. It agreed that reference to obtaining sufficient appropriate audit evidence in the objective is not necessary, and therefore should be removed. Rather, the objective of the auditor in relation to the ISA should be to corroborate, by means of written representations, other audit evidence. One member noted, however, that the use of "corroborate" implies that there will always be some additional audit evidence which, in rare circumstances, may not be the case.

The IAASB also expressed concern with the use of the term "assumptions" in the stated objective, and in the proposed conforming amendment to ISA 200. In particular, it was noted that "assumptions" appeared to be matters the auditor negotiated with management. Further, Mr Tiedje noted that a legal requirement exists in Europe for management to publish a statement declaring that it has prepared the accounts in accordance with the applicable financial reporting framework, and that the implications of the introduction of this term are not clear. The IAASB asked that the Task Force consider further an appropriate alternative to this term.

##### REQUIRED REPRESENTATIONS

The IAASB deliberated the proposed general required representations. The IAASB questioned the meaning of the phrase "appropriate general written representations," and the degree of flexibility that would be permitted for the representations to remain appropriate. It was also noted that the suggested wording of the required representation may not be suitable in all jurisdictions, nor for audits of some small and medium sized entities. The IAASB asked that the Task Force consider further the degree to which the representations could be modified and still comply with the requirement to obtain general written representations, and to consider ways to introduce some flexibility in application without losing the substance of the requirement.

The IAASB also expressed concerns about how the phrase "fulfillment of responsibilities" as used in the proposed ISA might be interpreted, and whether its use in connection with responsibilities with respect to internal control would in effect require relevant persons to assess the effectiveness of internal control in order to make the representation.

##### OTHER MATTERS

The IAASB discussed and agreed a number of editorial changes to the draft revised ISA. In addition, the IAASB asked that the Task Force consider further the following:

- Presenting the discussion dealing with the auditor's response to unreliable written representation separate from that dealing with the auditor's response to circumstance where relevant persons refuse to provide the necessary written representations.
- Additional guidance addressing the application of the requirement for representations to cover all periods covered by the report in the circumstances where relevant persons have changed during these periods.
- Additional guidance for circumstances where the auditor is not allowed to withdraw from the audit engagement.
- Additional guidance providing examples of relevant persons in relation to specific written representations.
- The appropriate placement of the application and other explanatory material pertaining to threshold amounts, in light of the fact that such guidance may be applicable to both general and specific written representations.

The IAASB asked that the Task Force consider the input received and to present a revised proposed ISA 580 for approval as an exposure draft at the December IAASB meeting.

## **5. Materiality and Misstatements**

Ms. Esdon led a review of proposed ISA 320 (Revised and Redrafted), "Materiality in the Identification and Evaluation of Misstatements" and ISA 450 (Redrafted), "Evaluation of Misstatements Identified during the Audit." She summarized the main changes to the documents based on the comments received from the IAASB.

### **PROPOSED ISA 320 (REVISED AND REDRAFTED)**

In addition to amendments of an editorial nature, comments included the following:

- It was proposed that the footnotes in the Requirements section, which contained considerations specific to the public sector (i.e., footnotes 2 and 3), be moved to the Application Material section to be in line with the clarity drafting conventions.
- It was proposed that the word "normally" be added in the sentence "It is not practicable to design audit procedures to detect misstatements that could be material solely because of their nature ..." to reflect practice in the public sector (paragraph 6). It was agreed that the addition should not be made, as the comment was based on the wider mandate of a public sector audit, while the scope of ISAs is limited to the audit of financial statements.
- A member questioned the use of the present tense in the application material relating to determining the materiality level where the financial statements are prepared for a financial reporting period of more or less than twelve months (paragraph A6). He argued that the statement is always true and therefore should be relocated to the Requirements section. Mr. Kellas explained that the guidance relates to the requirement for determining materiality when planning the audit (paragraph 9); the fact that the statement is always true does not automatically make it a requirement. It was agreed that the application material should not be amended.
- It was agreed that a footnote to the effective date paragraph should indicate that the ISA will not become effective at a date earlier than December 15, 2008.

Ms. Esdon summarized the comments received from the IFAC Small and Medium Practices Committee (SMPC). The SMPC was of the view that the assumptions about users of the financial statements in the proposed ISA (paragraph 4) were unrealistic; particularly in the context of SMEs. The SMPC also argued that the example of a benchmark for SMEs was not unique to SMEs. The IAASB agreed that these comments did not give rise to amendments to the proposed ISA.

#### PROPOSED ISA 450 (REDRAFTED)

In addition to amendments of an editorial nature, comments included the following:

- Mr. Kellas requested that the phrase “whether the financial statements as a whole are free from material misstatement” be re-inserted in the objective as the IAASB had agreed not to develop a separate ISA on forming an opinion.
- A member noted that, although the objective referred to the auditor’s evaluation of misstatements identified during the audit, it does not refer to the auditor’s evaluation of the effect of identified misstatement on the scope of the audit. Another member was of the view that the reference to “misstatements identified during the audit” may imply that the auditor does not evaluate prior period uncorrected misstatements. The IAASB agreed that the objective should be amended to refer to the auditor’s evaluation of (a) the effect of identified misstatements on the audit, (b) the effect of uncorrected misstatements on the financial statements, and (c) whether the financial statements as a whole are free from material misstatement. The Task Force suggested that (b) and (c) be combined, as (a) relates to the audit and (b) and (c) to the financial statements.
- Mr. Kellas proposed that the requirement for the auditor to accumulate misstatements identified during the audit (paragraph 5) be expanded to require the auditor to distinguish between factual misstatements, judgmental misstatement and projected misstatements. Another member, however, was of the view that it is not necessary to categorize identified misstatements since the auditor is required to request management to correct all identified misstatements, irrespective of their category. Other members were of the view that the distinction facilitates communication of identified misstatements with management, as explained in the application material. It was agreed that the proposed requirement should be amended as proposed by Mr. Kellas.
- Mr. Kellas proposed that the requirement for the auditor to perform further audit procedures when management has examined a class of transactions, account balance or disclosure, and corrected misstatements that were found, (paragraph 8) be amended to clarify that it applies when management performs such examination in response to the auditor’s findings or at the request of the auditor.
- Concern was expressed about the word “important” in the application material relating to the application of a consistent approach when evaluating prior period uncorrected misstatements. It was agreed that the guidance should read as follows: “Using the same evaluation approach provides consistency from period to period.”
- It was agreed that a footnote to the effective date paragraph should indicate that the ISA will not become effective at a date earlier than December 15, 2008.

Ms. Esdon noted that the US Securities and Exchange Commission issued Staff Accounting Bulletin No. 108 in September 2006. According to the Bulletin, a registrant has to evaluate the effect of uncorrected misstatements related to prior periods by applying both the “iron curtain” and “rollover”



methods. A registrant's financial statements would require adjustment when either approach results in quantifying a misstatement that is material, after considering all relevant quantitative and qualitative factors. Ms. Esdon explained that the Task Force remains of the view that the IAASB cannot mandate an approach for the auditor to consider the effect of prior period uncorrected misstatements on the current period's financial statements. This is because of transitional provisions, which could only be mandated by a regulator or equivalent authority. Although the US SEC has taken a step in this direction, the matter has not been addressed by other national regulators or equivalent authorities. The Task Force therefore is of the view that the related requirement and guidance should not be affected by the Bulletin. The IAASB agreed with the Task Force's view.

#### APPROVAL

Proposed ISA 320 (Revised and Redrafted) and proposed ISA 450 (Redrafted) were unanimously approved by the IAASB for re-exposure under the Clarity project.

### **6. Other Information in Documents Containing Audited Financial Statements**

Mr. Rainey introduced the topic, noting that the purpose of the discussion was for the IAASB to provide the Task Force with guidance in relation to the proposed application of the clarity drafting conventions to the extant ISA 720, "Other Information in Documents Containing Audited Financial Statements." In addition, the Task Force would welcome guidance on the flow and wording of the draft ISA. Mr. Rainey expressed his gratitude to the individuals and organizations which had already made a significant contribution to the revision of ISA 720 by sharing their thoughts and providing detailed suggestions prior to the meeting.

Mr. Rainey highlighted three fundamental issues that the IAASB should consider:

- (a) What is the exact meaning of the term "other information"?
- (b) Does the IAASB concur with the position taken by the Task Force that the scope of the proposed ISA 720 should deal with other information included in a document, rather than other information available to the auditor?
- (c) Should misstatements of fact be elevated to be equivalent to material inconsistencies?

The IAASB debated these three issues and the other matters included in the agenda paper.

A concern was raised by several members that the Task Force was proposing improvement revisions to the extant ISA 720, rather than redrafting the ISA in accordance with the clarity drafting conventions. Mr. Rainey explained that the Task Force's position was "... to clarify the intent of what the original ISA 720 meant". In this regard, the IAASB debated the boundaries of the Task Force's mandate to clarify the ISAs. Mr. Kellas suggested assessing whether or not the procedures of the extant ISA were or were not being modified, as a dividing line for judgment. Mr. Kellas suggested that as long as the IAASB is not revising the procedures in the extant ISA, but seeking to explain them better, the ISA may be considered to have been redrafted in accordance with the clarity drafting conventions.

Mr. Trémolière raised a concern in relation to the scoping out of documents used in securities offerings from the introductory paragraph in the redrafted ISA 720. Mr. Trémolière emphasized that the stock market regulator in his jurisdiction relies on this ISA and he urged the IAASB to maintain it in the proposed ISA 720. Mr. Trémolière foresaw resistance from the French stock market regulator if

the IAASB were to proceed to scope it out. He also argued that the mandate of the Task Force was to redraft ISA 720 in the Clarity format. Another member expressed a similar view but noted that the way ISA 720 is presently drafted could be read as if the auditor is still required to read securities offerings and suggested that the Task Force needs to clarify this statement. Mr. Rainey replied that in addition to securities offerings, the Task Force also considered that press releases and website documents should be excluded from the scope of the ISA as the extant standard does not include them within its scope. Another consideration that had influenced the Task Force was the fact that securities offerings are addressed differently in various jurisdictions and it would have created more confusion to tie the auditors to this standard. Another matter to take into consideration is the issue of consent in terms of inclusion of the auditors report in the securities document.

The Task Force also thought that if the auditor wanted to scope in the securities offerings, he could do that based on the current draft. Nevertheless, some of the members were still of the view, that they would prefer to retain the reference to securities offerings in the text of the ISA.

Mr. Tiedje noted that it should be made perfectly clear what is included in the scope of the proposed ISA 720 to avoid possible ambiguity arising within member countries of the European Union.

Mr. Kellas remarked that the existing reference (to securities offerings) in the extant ISA 720 is ambiguous and misleading and that he could foresee resistance in those jurisdictions which have different standards relating to securities offerings. Therefore, he was comfortable with omission of this sentence. However, if the IAASB thought it desirable and envisaged that various jurisdictions would be applying this standard for securities offerings, the Task Force could consider the approach adopted in redrafted ISA 260, stating that the requirement "... may be adapted as necessary".

A member questioned whether the objective of the ISA should be amended to "...considering whether it is inconsistent". The Task Force agreed to reconsider the wording of this paragraph and make it consistent throughout the document.

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

- The title of the ISA should be amended to begin with the word "reading."
- The Task Force should clarify the scope of the redrafted ISA.
- The term "shareholders" should be replaced with the terms "users" or "owners".
- The definition of material inconsistency should be split into two parts, i.e. a definition of "inconsistency" and a paragraph in the Application Material to explain the meaning of material in the context of an inconsistency
- The definition of "other information" should be aligned with the Application Material (paragraph A1), which is restricted to the information identified in the audited financial statement, as in the view of some members there may be other types of the information which are entitled to be included in the "other information".
- To move the reference to "annual reports" to the application guidance
- The Task Force should develop an amendment to reflect the need for the auditor's report to be able to differentiate other information from the audited financial information.
- The Task Force should reconsider whether the wording about "...the auditor's obligation to report on the other information" should be included in the scope of the ISA.

The IAASB asked the Task Force to consider its comments, and to present a redrafted ISA 720 for discussions at the IAASB meeting in December.

## **7. Communication with Those Charged with Governance**

Mr. Nugent introduced the topic noting that the IAASB, at its May 2006 meeting, had approved the “close off” version, and agreed a near-final clarity version of ISA 260, “Communication with Those Charged with Governance” (Revised), including conforming amendments to ISA 570, “Going Concern”. Final approval of the clarity version had, however, been deferred until the clarity drafting conventions had been finalized, which occurred at the September IAASB meeting.

The IAASB reviewed the draft clarity version, agreeing the changes recommended by the Task Force and noting some further editorial and other minor changes. The IAASB unanimously approved ISA 260, “Communication with Those Charged with Governance” (Redrafted), including conforming amendments to ISA 570, “Going Concern,” for issue as an exposure draft with a 90 day comment period.

## **8. Experts**

Mr. Ferlings led a discussion of the second read of a revised draft of ISA 620, “Using the Work of an Auditor’s Expert.”

### **DEFINITION OF “ENGAGEMENT TEAM”**

The Task Force was asked to continue liaising with the Independence Task Force of the International Ethics Standards Board for Accountants regarding the proposed change to the definition of “engagement team” in the Code of Ethics, and to brief the IAASB on the impact of this change on the IAASB’s pronouncements.

### **ROLE OF THE AUDITOR’S EXPERT**

It was noted that the draft did not always clearly distinguish between situations in which the auditor’s expert reviews an estimate as prepared by management, versus those in which the auditor’s expert prepares an independent estimate for comparison with management’s estimate. It was agreed that the ISA should include consideration of both approaches, but that the distinction between them should be made clearer.

### **MANAGEMENT’S EXPERT**

The IAASB debated how the ISAs should deal with the auditor’s consideration of the work of experts employed or engaged by management. The draft stated that it “does not apply to the auditor’s consideration of management’s experts”; although a footnote added that parts of the ISA may be helpful when doing so. The IAASB reconfirmed that this ISA is not the appropriate place to deal with experts employed or engaged by management, but that the wording on this issue in the draft ISA was potentially confusing. The IAASB suggested that the ISA should clearly state that it applies (a) only in relation to the auditor’s procedures regarding the auditor’s own expert, and (b) whether or not management uses an expert (employed or engaged). The IAASB also asked the Task Force to consider whether conforming amendments to other ISAs will be necessary to address the auditor’s consideration of the work of experts employed or engaged by management, particularly the potential for over-reliance on the work of outside experts engaged by management, which was noted as an

important issue in practice. It was noted in this context that while applying procedures similar to that identified in the draft to experts employed or engaged by management will be appropriate in some circumstances, it will not always be so.

#### RESPONSIBILITIES OF THE AUDITOR

The IAASB discussed the wording and positioning of a section within the draft Introduction dealing with the responsibilities of the auditor when using the work of an auditor's expert. It was agreed that this section should remain as part of the Introduction, consistent with the positioning of analogous paragraphs in, e.g., ISA 240, but that it should be reworded to remove any implication that the auditor may rely on the work of an expert without first critically examining that work. The point was also made in connection with this paragraph, that the auditor needs to integrate an experts' work with other audit work, and that this may not be clear in the ISA as drafted.

#### DETERMINING THE NEED FOR AN AUDITOR'S EXPERT

The IAASB debated whether this ISA should include a requirement for the auditor to determine whether an expert is needed, or whether this matter is adequately covered in the Code, ISQC 1 and ISA 220. It was agreed that it is appropriate to have a specific requirement in this ISA to determine whether an expert is needed. The Task Force should, however, consider whether the ISA needs to be more closely aligned to the requirements of the Code, ISQC 1 and ISA 220, and to identify the fact that the auditor considers the need for expertise at engagement acceptance and also later in the audit.

#### STRUCTURE

The IAASB discussed the structure of the requirements section of the draft ISA noting that a number of the requirements relate to more than one stage of the audit, e.g., the auditor considers any quality control policies and procedures to which the expert is subject when initially selecting an expert as well as when determining the nature, timing and extent of procedures to evaluate the adequacy of the expert's work for the purposes of the audit. It was suggested that some restructuring of the requirements section to make this more apparent would be beneficial.

#### DOCUMENTATION

The IAASB questioned whether the ISA needs to have any specific documentation requirements. The matters identified in the draft were discussed, and it was agreed that where documentation should be required in relation to these matters, it would already be required by extant ISA 230 and, therefore, that the draft documentation requirements should be deleted. A possible exception to this is the draft requirement to document instances when an expert is not needed. The Task Force was asked to consider further whether this should remain a requirement and, if so, whether wording it in the negative (i.e. to when an expert is not needed) is appropriate.

#### OTHER MATTERS

Other matters noted for further consideration by the Task Force include:

- Whether the definition of "auditor's expert" should include both individuals and firms, and if so, whether the rest of the draft ISA appropriately caters for both.

- To include a requirement similar to that in paragraph 15 of extent ISA 620 dealing with the need for the auditor to resolve situations in which the results of the expert's work do not provide sufficient appropriate audit evidence or the results are not consistent with other audit evidence.

## **9. Material Weaknesses in Internal Control**

Mr. Ashton noted that at the September 2006 CAG meeting, CAG Representatives discussed the significant issues to be addressed in the development of enhanced guidance on material weaknesses in internal control, and considered the views the IAASB had expressed on these issues at its July meeting. He then proceeded to present the further issues arising from the CAG discussion.

### **CONTROL WEAKNESSES TO BE REPORTED**

Mr Ashton noted that the IAASB had generally agreed at the July meeting that it would not be in the public interest for the ISAs to limit the communication requirement to the reporting of only the most serious control issues. He reported that there was significant support from CAG Representatives for auditors to report more than just material weaknesses.

Members agreed that this was an appropriate approach. It was, however, noted that those charged with governance would likely want some prioritization of the issues reported to them. It was suggested there would be benefit in distinguishing the reporting requirement so that material weaknesses would be reported to those charged with governance and other reportable conditions to management. This would avoid overwhelming the former with large volumes of undifferentiated information. However, others noted that responsibilities and interests of those charged with governance vary and argued that it was important that auditors not be restricted in what they communicate regarding control weaknesses identified during the audit. It was suggested that one principle worthy of consideration is that the auditor should report control matters to those specific individuals within the entity who are empowered to deal with them.

Mr. Ashton noted that the IFAC SMP Committee had also suggested the adoption of a differential approach to the reporting requirement. That is, for a public interest entity, the auditor should report all control weaknesses that have come to the auditor's attention (other than those that are clearly trivial), and for other entities, it should be left to the auditor's judgment as to what to report beyond material weaknesses.

After further deliberation, the IAASB concluded that the auditor should report more than just material weaknesses but that the Task Force should consider how to differentiate, if at all, the reporting requirement between matters reported to those charged with governance and matters reported to management.

### **THRESHOLD FOR REPORTABLE CONDITIONS**

Mr Ashton reported that CAG Representatives agreed that professional judgment plays an important role in determining which control weaknesses are matters that should be reported. One member, however, questioned whether reliance on professional judgment alone in determining which control matters should be reported would provide a sufficient basis for ensuring consistent reporting among auditors. It was therefore argued that some consideration of factors such as likelihood and magnitude of outcome might appropriately form part of the evaluation framework. Another view expressed was that as the emphasis is on reporting non-trivial control matters of which the auditor has become

aware, the reporting threshold could be set by defining what is considered a trivial control matter that need not be reported. It was also suggested that the definition of the reporting threshold could be linked to the level of assurance that the auditor is able to obtain on the audited financial statements, i.e. in terms of a control weakness that leads to a greater than acceptably low level of risk of a material misstatement occurring in the financial statements being audited. However, not all members agreed that the level of assurance influences the definition.

The IAASB asked the Task Force to give further consideration to the approach to setting the reporting threshold in light of these comments. As a separate matter, the IAASB agreed that it would be appropriate to provide general guidance to illustrate circumstances in which the auditor would identify reportable conditions.

#### DEFINITION OF MATERIAL WEAKNESS

The Task Force proposed to define a material weakness in terms of whether it could clearly result, directly or indirectly, in a material misstatement of the financial statements that is not prevented or detected. It was noted that the adverb “clearly” would really only apply if the financial statements were in fact misstated. Accordingly, it was suggested that it would be more appropriate to word the definition in terms of material misstatements to which the material weakness may give rise.

One member noted that it could be confusing to have a definition of material weakness that is different from definitions of the same term established elsewhere, such as in the U.S. PCAOB’s Auditing Standard 2. It was argued that the creation of a new definition should be avoided if one is already available because this could introduce a new concept where none was intended. There was substantial support for this view. Another member disagreed, however, because the objective and scope of the auditor’s work on internal control in an audit performed in accordance with ISAs are different from those of an integrated audit. A more structured definition is needed in an integrated audit because the auditor must form a conclusion and report publicly on the effectiveness of internal control over financial reporting. By contrast, in an audit of financial statements alone, the reporting of control weaknesses identified in an ISA audit of financial statements is part of the auditor’s dialogue with those charged with governance. One option would be to use a different term altogether, but this was not viewed as practicable because the term “material weakness” is well entrenched in practice and regulation.

After further deliberation, the IAASB agreed that the term material weakness should be retained. The IAASB asked the Task Force to monitor the PCAOB’s current project to revise its Auditing Standard 2 and to consider whether the definitions in the revised standard may also be appropriate in an ISA context. The IAASB agreed that the meaning of the term as used in the ISAs will need to be clearly explained in relation to the scope and level of work effort to avoid creating an expectations gap. Further, to mitigate the risk of an expansion in the scope of the auditor’s work on controls, guidance could also be provided to make clear what is not intended by the revised definition.

#### TERMINOLOGY TO BE USED

The IAASB agreed that the term “significant deficiency” should not be used as it gives a spurious impression of accuracy that is not intended in an audit performed under the ISAs.

## WAY FORWARD

The IAASB agreed that the Task Force should develop the guidance within a new ISA to supplement ISA 315. The Task Force will present a first draft of the proposed guidance at the April 2007 meeting.

### 10. Presentations

Mr. Kellas noted that during the IAASB's initial discussions in September about the process for the development of IAASB's future standard setting priorities and work program, one avenue for obtaining input might be to arrange for presentations to the IAASB by representatives of particular segments of the profession and the public on matters that may be relevant to the IAASB's considerations. For this purpose, presentations by representatives from the US Public Company Accounting Oversight Board (PCAOB), the AICPA's Auditing Standards Board (ASB) and the US Government Accountability Office (GAO) would be relevant.

Mr. Kellas welcomed Mr. Ray, the Chief Auditor and Director of Professional Standards of the PCAOB and Mr. Walker, the Comptroller General of the United States. He thanked Mr. Fogarty for agreeing to speak on behalf of the ASB.

Mr. Ray summarized, in his view, the current and short term priorities of the PCAOB. These included the continued focus on Section 404 of the Sarbanes-Oxley Act, including further consideration of the PCAOB's standard on an audit of internal control over financial reporting performed in conjunction with an audit of financial statements. Others areas of priorities include development of standards dealing with engagement quality control review, and risk assessment standards, including how best to integrate the auditor's fraud risk assessment within them and to encourage the right behavior by auditors in this area. Looking forward, he indicated other areas of the PCAOB's priorities may include consideration of the standards on audit of related parties, specifically looking at fraud risk, and standards and guidance on confirmations and using the work of specialists. Other areas might be estimates and fair values. In terms of areas that the IAASB might consider in formulating its future priorities, he indicated the area of other assurance standards, for example dealing with assurance on financial information prepared in XBRL format, as one where standard setting attention could be placed.

Mr. Fogarty informed the IAASB about the recent decision of the ASB to align its work program with that of the IAASB as part of its harmonization and convergence project. This decision will make the ASB contribution to the IAASB work more efficient and beneficial to its own members by allowing the ASB to deliberate the same issues at the same time. In the view of Mr Fogarty, this move will result in the ASB's and the IAASB's standards eventually becoming virtually identical, with the exception of certain national issues and perhaps the form of presentation of the standards.

Mr. Fogarty shared his views on the general challenges that the auditing profession is presently facing. Amongst them: effectiveness of detection and prevention of fraud; complexity of business and accounting frameworks; cost benefits consideration of audits and related regulation; the increased pressure on SME's and SMP's resulting from change of standards and regulatory requirements; and the increasing difficulty of retaining talented resources. Mr Fogarty also indicated that it is extremely important in his view to obtain the feedback from practitioners regarding the implementation of the issued standards.

Mr. Walker spoke both on behalf of the GAO, and as one of the 190 members of INTOSAI. In the area of auditing standards, he explained that the recent focus of GAO was on creating the U.S. Auditing Standards Coordinating Forum, focusing on promulgating and updating Government Auditing Standards. The key objectives of the U.S. Auditing Standards Coordinating Forum are to maximize complementary standards-setting agendas, minimize duplicative or competing efforts, identify any significant gaps not being addressed and develop strategies for overcoming challenges and barriers to modernizing the auditing profession in the U.S. He also noted that the focus of attention is on audit quality assurance, monitoring, inspection and peer reviews. The GAO is also looking at the ways of implementing the quality internal annual inspection programs rather than the current periodic peer review program.

Mr. Walker noted the need exists to review and revise the existing audit reporting model to recognize that the opinion should address whether the financial statements are fairly presented in all material respects and prepared in accordance with authoritative accounting principles, to expand the auditor's report to include key value and risk-based performance and projection information over time and as appropriate, and to enhance reporting concerning issues relating to going concern. He also suggested the need to develop a portfolio of economic, social, and environmental outcome-based measures that could be used to help assess the nations' and other governmental jurisdictions' position and progress.

Mr. Kellas thanked Messrs Ray, Fogarty and Walker for their presentations and sharing some of their thoughts with the IAASB.

## **11. Next Meeting**

The next meeting of the IAASB has been scheduled for December 4-8, 2006 in London.

## **12. Closing Remarks**

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