Agenda Item 1-A

Draft Minutes of the 26th Meeting of the

INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD

Held on April 16-20, 2007 in Sydney

	Voting Members	**Technical Advisors**
Present:	John Kellas (Chairman)	Kelly Ånerud (Mr. Larsson)
	Denise Esdon (Deputy Chair)	Philip Ashton (Ms. Hillier)
	Phil Cowperthwaite	Michele Caso (Mr. Tizzano)
	Craig Crawford	Josef Ferlings (Mr. Kinney)
	John Fogarty	Cédric Gélard (Mr. Trémolière)
	Jan Bo Hansen	Jon Grant (Mr. Rainey)
	Diana Hillier	Jennifer Haskell (Mr. Hansen)
	Kjell Larsson	Shahid Hussain (Mr. Yusuf)
	Ian McPhee	Richard Mifsud (Mr. McPhee) (April 18-20)
	Marcel Pheijffer	Greg Shields (Mr. Cowperthwaite)
	Will Rainey	Sylvia Smith (Mr. Crawford)
	Makoto Shinohara	George Tucker (Ms. Esdon)
	David Swanney	Hans Verkruijsse (Mr. Pheijffer)
	Gérard Trémolière	Yuichi Yamamoto (Mr. Shinohara)
	Abdullah Yusuf	
Apologies:	Susan Jones	Sharon Walker (Mr. Fogarty)
	William Kinney	
	Roberto Tizzano	

	Proxy
Present:	John (Arch) Archambault (Susan Jones)

	Non-Voting Observers
Present:	Jennifer Rand
	Jurgen Tiedje
	Hisashi Yamaura
Apologies:	David Damant

	Public Interest Oversight Board (PIOB) Observer
Present:	Michael Hafeman

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. Michael Hafeman as the PIOB observer to the meeting.

Apologies were received from Ms. Jones, Ms Walker, and Messrs. Kinney, Tizzano and Damant.

Proxies were noted as follows: Mr. Archambault for Ms. Jones, Mr. Ferlings for Mr. Kinney, and Mr. Caso for Mr. Tizzano.

MINUTES OF PREVIOUS MEETING

The minutes of the public session of the previous IAASB meeting were approved.

OTHER MATTERS

PIOB Meeting

Mr. Kellas noted that he and Mr. Sylph attended the March 2007 meeting of the PIOB. They provided an update on the IAASB's activities. The PIOB focused on three matters: Firstly, in view of its responsibility to oversee that the IAASB's work program met the public interest, the PIOB inquired about the IAASB's current consultation on its future strategy. Secondly, the PIOB was in the process of formalizing a communication strategy and suggested that the IAASB likewise implement a more formal communication strategy. Thirdly, in relation to matters of due process, there was discussion regarding the process by which the IAASB addresses comments received on exposure drafts. In discussing the composition of the IAASB, the PIOB noted that the Board was moving towards a more even balance between practitioners and non-practitioners. The definition of non-practitioner has been agreed between the PIOB and the IFAC Nominating Committee.

IAASB Strategy Forum

Mr. Kellas reported on the strategy forum held on April 13, 2007 in Sydney. Varying views were expressed during the morning session. The discussions, however, yielded useful input into the development of the IAASB's future work program. In relation to the discussion of an alternative assurance service for SMEs during the afternoon session, participants from Australia indicated that there is very limited support for such a service. This was based on the outcome of a forum held by the national professional accountancy bodies in advance of the IAASB forum. Participants from New Zealand, however, reported that further progress had been made in that area in their jurisdiction, and that New Zealand was committed to an alternative to the audit for smaller entities.

A second forum has been scheduled for June 2007 in Brussels, for which a good turn-out was expected. CAG Representatives have been invited to the forum and will meet the following day to discuss the input received from the forum and provide feedback to the IAASB. Mr. Kellas noted that he will have an opportunity to meet national standard setters from South America to obtain input on the strategy when he attends the World Bank Latin America and Caribbean Conference in June 2007.

Admin Matters

The 2007 IFAC Handbook of International Auditing, Assurance, and Ethics Pronouncements and the 2006 IAASB Annual Report have been issued.

2. Quality Control

Mr. Cowperthwaite introduced proposed ISA 220 (Redrafted), "Quality Control for Audits of Historical Financial Information" noting that ISQC 1 "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance Engagements and Related Services Engagements" was also being presented in the clarity format; this followed direction from the IAASB at the previous meeting that the two documents should be considered together to ensure there were no discrepancies between them that would cause confusion. He noted also that the IFAC SMP Committee had suggested that (a) the two documents be exposed together, and (b) ISQC 1 be revised, rather than merely redrafted. On this latter point, the IAASB noted that a substantial revision would be beyond the scope of the clarity project, and that the guidance being prepared by the SMP Committee may help alleviate any difficulties that SMPs may be having in applying ISQC 1.

TERMINOLOGY

The IAASB debated whether the term "be satisfied," which is used in a number of places in extant ISA 220 (e.g. the engagement partner should be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and specific audit engagements have been followed) is appropriate, or whether it should be changed to, e.g., establish, determine or conclude.

The IAASB agreed that "be satisfied" will be the appropriate term in a number of cases because it properly states the desired outcome, rather than seeking to impose specific procedures to achieve that outcome. It was noted that using this term may also be appropriate in other ISAs where it is used in the extant text. The IAASB discussed if it would be possible, in reviewing compliance with ISAs, to determine whether, in fact, an auditor was satisfied with a particular matter. It was agreed that the ability to verify whether a requirement has been met is not an essential criterion for determining whether a requirement should be set, as it would likely lead to the removal of a number of requirements (e.g. the requirement to take responsibility for leadership), which would unnecessarily weaken the ISAs.

The IAASB also agreed to consider reviving the document drafted by the IAPC some years previously which attempted to define terms such as satisfied, assess, evaluate, establish, determine and conclude. Such a document may be useful to the IAASB in its final review of the clarified ISAs, and could also be made available to translators and others to assist with consistent interpretation of the ISAs.

PRESENT TENSE SENTENCES

Mr. Cowperthwaite noted that the task force had drafted the application material in ISA 220 and ISQC 1 to include a number of present tense sentences and was seeking the IAASB's guidance on whether they should be retained in that form. The IAASB agreed that where a present tense sentences is simply a statement of fact, it may be retained. However, where it is (a) a repetition of a requirement, it should be worded to make this clear, or (b) a list of matters for consideration, not all of which should be expected to apply in all, or nearly all, cases, the wording should indicate this (e.g., "the auditor may consider such matters as…").

AUTHORITY AND SCOPE OF ISQC 1

The IAASB considered a number of options for positioning the text that specifies the authority attaching to ISQC 1, including (a) preparing a separate preface for ISQCs, and (b) inserting the text in ISQC 1 itself: either in the introduction, the requirements or the application material, or splitting it between these sections. It was agreed that, consistent with the approach adopted in ISA 200, the text should be included in the requirements section of ISQC 1.

The IAASB also considered whether ISCQ 1 should apply only to audits of historical financial statements, with a separate document being developed for application to reviews and other assurance and related services engagements. It was noted that while such a split may be appropriate for the regulatory environment in some jurisdictions, e.g. the EU, it will not be for others and, where it is not, it would be unnecessarily cumbersome to have separate documents with virtually identical content. It was agreed, therefore, that ISCQ 1 should not be split into two documents.

PUBLIC INTEREST ENTITIES

It was noted that a current IESBA exposure draft proposes that requirements in the extant Code of Ethics that apply to listed entities should, in future, apply to "public interest entities." The IAASB considered whether this change should also be applied to the requirement in ISQC 1 that listed entities have an engagement quality control review, i.e. should all public interest entities be required to have a review? It was noted that the proposed Code does not define public interest entities but proposes this should be done by member bodies and therefore (a) the interpretation of such a requirement may not be consistent amongst member bodies, and (b) such a requirement may not be superior to the current requirement for the firm to establish criteria for determining which engagements will be subject to review.

While it may be expected that audits of regulated entities such as banks and insurance companies would be subject to an engagement quality control review, the term public interest entity might extend well beyond such entities and include entities for which the audit is not complex and does not warrant a review. It was agreed that to extend the requirement for reviews beyond listed entities would not be appropriate as part of the clarity project, but would be considered again when changes to the Code as a result of the IESBA exposure draft have been finalized. A decision on the matter at that time would have the benefit of being informed by feedback received by the IESBA on its exposure draft.

OTHER MATTERS

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

ISA220

- The introduction should state that it applies to audits of financial statements and note that it may be adapted for application in other engagements. The title of ISA should reflect this change.
- The introduction section of the draft should be revised to ensure the intent of the extant ISA is retained with respect to an engagement team's responsibility to implement quality control policies and procedures applicable to the engagement, and its entitlement to rely on the firm's quality control system. It was noted, however, that in explaining the relationship between quality

control policies and procedures at the engagement level and those at the firm level, care needs to be taken not to imply that a failure of an engagement team member to provide information for use in the firm's system with respect to independence, constitutes a failure to meet the requirements of the ISA.

- The draft should introduce a definition of "relevant ethical requirements" picking up the wording that has been used in recent documents to explain this term. It was noted that this wording includes the term "ordinarily," which is avoided where possible under the clarity drafting conventions. It was agreed that use of "ordinarily" in this case is appropriate.
- The draft should indicate that the definition of engagement team will be conformed to that ultimately agreed for use in the Code of Ethics, which is currently subject to exposure. The definition currently proposed for use in the Code was discussed further as part of the "Experts" (ISA620) agenda item (see minutes for agenda item 5).
- The definition of "engagement quality control reviewer" should make it clear that such person is independent of the engagement team.
- The requirement regarding the engagement partner's consideration of whether engagement team members have complied with relevant ethical requirements should be reworded by elevating the related application material, which is more explicit about the actions required of the engagement partner.
- It is unnecessary to have a requirement regarding the respective responsibilities of various partners involved in an engagement. This matter can be adequately dealt with in the application material.
- The requirements related to the conduct of an engagement quality review should clearly identify that the reviewer (a) evaluates both significant judgments and conclusions, (b) reviews selected documentation, and (c) does not do this through discussion alone.
- The documentation requirements relating to quality review, currently in ISQC 1, should be included in ISA 220.
- Determining review responsibilities on the basis that the work of a less experienced team member is reviewed by a more experienced team member should be elevated to a requirement.
- When an engagement partner takes over responsibility during the course of an audit, the requirements should include reviewing the work performed to the date of the change.

ISQC 1

- Where relevant, comments made by the IAASB with respect to ISA 220 should also be applied when redrafting ISQC 1.
- The paragraph stating the objective should, consistent with the ISAs, state the objective of the firm in following the ISQC rather than the objective of the ISQC itself.

The task force was asked to reconsider a number of changes proposed in the draft, e.g., the change to the definition of engagement quality control reviewer, and changing reference to the IFAC Code to relevant ethical requirements in a number of places. The task force was also asked to reconsider

whether certain sentences in the application material should be elevated to the requirements section, e.g., application material related to communication of the firm's system of quality control.

WAY FORWARD

The IAASB reviewed and commented on a revised version of ISA 220 on the final day of the meeting. A further version of ISA 220 be presented at the July meeting, with the expectation that no further substantive issues would need to be raised prior to voting on ISA 220 for approval as an exposure draft.

The IAASB asked the task force to also prepare a revised version of ISQC 1 for approval as an exposure draft at the July meeting.

3. Terms of Audit Engagements

Mr. McPhee introduced the topic of proposed ISA 210 (Redrafted), noting that this project is being supported by staff of the Australian Auditing and Assurance Standards Board. He indicated that the IFAC SMP Committee had provided some comments to the Task Force on the agenda papers. He noted that the SMP Committee was generally concerned about the increased number of requirements in the clarified ISA. In addition, it was of the view that the material relating to the acceptability of the applicable financial reporting framework was becoming complex.

Mr. McPhee also indicated that CAG Representatives had an opportunity to consider the proposed redrafted ISA at their April 2007 meeting and did not raise any significant comments. He then led a paragraph-by-paragraph review of the proposed ISA.

NECESSARY PRECONDITIONS FOR AN AUDIT

The Task Force proposed two means of assessing whether necessary preconditions for an audit are present. The IAASB noted that it was unclear what these preconditions are, as there was no link to them in the proposed ISA. Some members were concerned that the requirements, as proposed, did not reflect the logical thought process the auditor would go through in considering whether to accept an audit engagement and in agreeing the terms of the audit engagement. It was pointed out that some of the necessary preconditions were already included in the proposed requirements (although not designated as such), in terms of whether management and those charged with governance acknowledge their responsibilities for preparing and presenting the financial statements; for designing, implementing and maintaining internal control; and for providing complete information to the auditor. Accordingly, the IAASB agreed that the relevant requirements and guidance relating to necessary preconditions should be repositioned and clarified to better reflect the logical flow underlying acceptance of the audit engagement and agreement as to its terms.

OTHER MATTERS

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

- In the context of the proposed objective, the Task Force should reconsider the status of the text referring to other aspects of audit engagement acceptance and continuance being dealt with in ISA 220 (Redrafted), as this reference seemed more appropriate as application material.

- In the context of public sector audits, the task force should clarify that when law or regulation does not prescribe in sufficient detail the terms of the audit engagement, such terms as may have been agreed between the auditor and the entity would need to be recorded in an audit engagement letter.
- References to "agreeing terms with the entity" should be changed to "agreeing terms with management or, where appropriate, those charged with governance."
- In relation to financial reporting frameworks prescribed by law or regulation that the auditor determines to be unacceptable, the requirement for the auditor to accept the audit engagement only under the specified conditions should be stated more clearly. Further, the reference to "users of the financial statements being misled" should be reworded as it would be difficult to determine who the users might be. In addition, guidance should be provided to explain what the specified conditions might entail in the context of agreeing the terms of the audit engagement, such as the nature of the additional disclosures that management may need to provide in the financial statements to avoid their being misleading.
- The scope of the proposed requirement to determine whether it is appropriate to change the terms of the audit engagement prior to the audit engagement completion should be restricted to circumstances where the change is to an engagement that provides a *lower level of assurance*, consistent with the requirement in the extant ISA.
- Where the auditor is unable to agree to a change to the terms of the audit engagement, the requirement for the auditor to withdraw from the audit engagement and determine whether there is any obligation to report the underlying circumstances to appropriate parties should be conditional on law or regulation not prohibiting such withdrawal.
- The guidance suggesting points that could be made in the audit engagement letter should include a reference to any obligations the auditor may have to provide access to the auditor's audit documentation to other parties, such as for regulatory monitoring purposes.
- The illustrative audit engagement letter in the Appendix should be presented more as a template than a complete letter. The various sections of the letter should also be more clearly signposted to reflect the matters required to be included, such as the responsibilities of management and those charged with governance. In addition, the footnote should be deleted as the ISA is mainly concerned with audits of financial statements as opposed to audits of internal control over financial reporting.
- The title of the clarified ISA should be revised to better reflect the nature of the requirements.

Further, except for one item (see below), the IAASB agreed with the Task Force's overall recommendations as set out in the cover note to the agenda papers, including the recommendations for the elevation of present tense actions to requirements. The IAASB did not agree with the Task Force's proposal to move elsewhere (such as to ISA 700) the proposed requirement that the auditor determine whether any conflicts exist between financial reporting standards and legal and regulatory requirements where those standards are supplemented by law or regulation.

WAY FORWARD

The IAASB asked the Task Force to consider its comments and present a revised draft for approval for exposure at the July 2007 meeting.

4. Consideration of Laws and Regulation in an Audit of Financial Statements

Mr. McPhee introduced the topic of proposed ISA 250 (Redrafted), noting that the main discussions at the February 2007 meeting focused on the issue of how to better articulate the auditor's responsibilities relating to those laws and regulations that have a direct effect on the financial statements, and those other laws and regulations that *may* have a material effect on the financial statements. He reported that comments made by CAG Representatives at the April 2007 CAG meeting had reflected similar comments made by the IAASB previously. He also noted comments from the IFAC SMP Committee, which was concerned about the burden of the proposed requirements on auditors of smaller entities, as well as the nature of those laws and regulations that have an indirect effect on the financial statements.

Mr. McPhee then led a paragraph-by-paragraph review of the changes proposed in the revised draft of the ISA.

AUDITOR'S OBLIGATIONS WITH RESPECT TO THE DIFFERENT CATEGORIES OF LAWS AND REGULATIONS

Some members noted that the proposed objectives and requirements did not clearly reflect the different responsibilities of the auditor articulated in the introductory section with respect to those laws and regulations that have a direct effect on the financial statements, and those other laws and regulations that have only an indirect effect on those financial statements. In particular, it was pointed out that the first part of the objectives relating to the "obtaining of sufficient appropriate audit evidence that the financial statements are not materially misstated due to non-compliance with laws and regulations" would not, in itself, be achievable if it were to be taken literally. Other members were concerned about the wide scope and practicability of the proposed requirement that the auditor perform audit procedures to identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements.

After further debate, the IAASB concluded that the proposed objectives should be amended to reflect more clearly the auditor's responsibilities regarding the two categories of laws and regulations. Consequently, the first part of the objectives should relate to the obtaining of sufficient appropriate audit evidence that the financial statements are not materially misstated due to non-compliance with laws and regulations *that have a direct effect on the determination of material amounts and disclosures in the financial statements*. The second part should relate to the performance of specified procedures to help identify instances of non-compliance with *other laws and regulations that may have a material effect on the financial statements*. the third part should relate to responding appropriately to identified or suspected non-compliance with laws and regulations. The IAASB agreed that the wording of the auditor's responsibilities in the introductory section should more clearly distinguish between those laws and regulations that have a *direct* effect on the financial statements and those other laws and regulations that *do not* have a direct effect on those financial statements.

The IAASB also agreed that the proposed requirement to perform procedures to identify instances of non-compliance with the "indirect" laws and regulations should be limited to the two specified procedures in the requirement. Further, the requirement should be clarified to indicate that its purpose is to *help* identify instances of non-compliance.

OTHER MATTERS

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

- In relation to the subsection dealing with the auditor's responsibility in the introductory section, the statement that "the requirements in this ISA are designed to assist the auditor in identifying material misstatements due to non-compliance with laws and regulations, and the auditor is not, and cannot be held, responsible for preventing non-compliance" should be moved to the front of the subsection to give it due prominence. Further, in relation to why the unavoidable risk of material misstatements resulting from non-compliance with laws and regulations may be higher, it should be made clear that whether an act constitutes non-compliance is ultimately a matter for legal determination by a court of law, rather than a matter that is ordinarily beyond the auditor's competence to determine.
- The guidance stating that "in the absence of audit evidence to the contrary, the auditor is entitled to assume the entity is in compliance with laws and regulations for the purpose of the audit" should be deleted.
- In relation to the auditor's consideration of whether withdrawal from the engagement is necessary when the entity does not take the remedial action that the auditor considers necessary to address instances of non-compliance, the guidance should clarify that such withdrawal would be conditional on law or regulation not prohibiting it.

The IAASB also agreed with the Task Force's overall recommendations as set out in the cover note to the agenda papers.

APPROVAL

The IAASB unanimously approved the proposed ISA 250 (Redrafted) for public exposure for comment on the application of the clarity drafting conventions only, with a 90-day comment period.

5. ISA 200 - Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing

Mr. Kellas introduced the discussion, noting that the European Commission (EC) had provided the IAASB with helpful observations on the agenda papers in advance of the meeting. He indicated that the Task Force and the Steering Committee had not had time to consider these observations but that he would be raising them during the discussion. He also noted that the Task Force had received comments from the IFAC SMP Committee and that he would be appropriately highlighting those during the discussion. He then led a paragraph-by-paragraph review of the proposed ISA 200 (Revised and Redrafted).

OVERALL OBJECTIVE OF THE INDEPENDENT AUDITOR

Mr. Kellas noted that the EC had suggested that it would be helpful to include a broader discussion of the nature of an audit in the introductory section. The IAASB agreed with this suggestion, as it would

help readers understand the key audit concepts and how they interrelate in terms that would be more understandable to non-auditors. This would also help introduce related concepts.

OBLIGATION ATTACHING TO OBJECTIVES

In relation to the proposed obligation that in conducting an audit in accordance with ISAs, the auditor shall *aim to achieve* the objectives stated in individual ISAs, Mr. Kellas noted that the EC had observed that this obligation was unclear as the wording 'aim to achieve' suggested that the actual achievement of the objectives might be optional. This interpretation derived from the final sentence of paragraph 15 of the amended Preface which refers not only to cases where an objective 'cannot be achieved,' but also to where it 'has not been achieved.' He also noted that at the April 2007 IAASB CAG meeting, the IAASB had received strong advice that this impression, which was not intended by the IAASB, should be eliminated.

After careful debate, the IAASB concluded that the obligation should be restated to avoid any misinterpretation of the position. The IAASB agreed that the revised wording should state that to achieve the overall objective of the auditor, the auditor shall use the objectives to judge whether, having regard to the interrelationships amongst the ISAs and having complied with the requirements of the ISAs, sufficient appropriate audit evidence has been obtained in the context of the overall objective of the auditor, and whether other audit procedures need to be performed in pursuance of the objectives. Mr. Kellas noted that once the wording of this obligation has been finalized, the corresponding provision in the Preface could be deleted.

In response to the point made above regarding the phrase 'has not been achieved,' the IAASB also agreed to replace the wording 'has not been or cannot be achieved' with the phrase 'cannot be achieved' in relation to the consequence of a failure to achieve an objective. The IAASB reconfirmed its view that the auditor cannot be subjected to an absolute obligation to achieve an objective because of the inherent nature of an objective and the possibility that there may be circumstances that prevent its achievement. However, the IAASB agreed that the proposed ISA should make clear that the auditor shall either achieve the objectives or, where in the circumstances this is not possible, take appropriate action.

Finally, the IAASB agreed that the proposed ISA should make clear in the Requirements section that the failure to achieve an objective represents a significant matter requiring documentation in accordance with proposed ISA 230 (Redrafted). It also agreed that the application material should include guidance to the effect that in those circumstances where the auditor concludes that a failure to achieve an objective in a relevant ISA does not prevent the achievement of the overall objective of the auditor, the required documentation would include the basis for the auditor's conclusion and the significant professional judgments made in arriving at that conclusion.

OTHER MATTERS

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

- The title of the ISA should be changed to "Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing," to reflect the introduction of the relevant provisions of the amended Preface.

- The discussion of the responsibility for the preparation of the financial statements, auditor independence and reasonable assurance should be separated out from the list of concepts relevant to an audit of the financial statements, and presented under separate subsections in the 'Overall Objective' section for emphasis.
- The guidance explaining the circumstances when a requirement would not be relevant should be moved to the Requirements section and attached to the obligation for the auditor to comply with relevant requirements, as it is essential explanatory material for that obligation.
- The guidance addressing a departure from a requirement should be moved to the Requirements section, and the need to perform alternative audit procedures to achieve the aim of that requirement in those circumstances should be elevated to a requirement.
- The wording of the guidance addressing professional skepticism should be aligned with wording used in ISA 240 (Redrafted) in that respect.
- Certain of the examples of a single financial statement listed in the Appendix should be moved to become part of the footnote attached to the definition of the term "financial statements," and the Appendix should then be deleted.

The IAASB also agreed with the Task Force's overall recommendations as set out in the cover note to the agenda papers, particularly:

- The inclusion of the overarching bold type requirement in paragraph 2 of extant ISA 500 for the auditor to obtain sufficient appropriate audit evidence as a requirement in the proposed ISA; and
- The provision of further explanation regarding:
  - The auditor's consideration of objectives, including the need for the auditor to have regard to the interrelationships amongst the ISAs;
  - The consequence of a failure to achieve an objective; and
  - The consequence of a failure to obtain sufficient appropriate audit evidence.

APPROVAL

The IAASB approved the proposed ISA 200 (Revised and Redrafted) for exposure. Mr. Pheijffer abstained from voting. Although he agreed with the content of the proposed ISA, he believed that the structure of the ISA in terms of the discussion of an audit of the financial statements and related concepts could be improved.

To allow respondents sufficient time to consider the proposed changes, the IAASB agreed a 135-day exposure period.

6. Audit Evidence

Mr. Fogarty introduced proposed ISA 500 (Redrafted), "Audit Evidence," noting that, as agreed at the previous meeting, the draft now better covers both relevance and reliability and also includes those parts of ISA530 "Audit Sampling and Other Means of Testing" that do not relate to sampling. He also brought to the IAASB's attention comments raised at CAG, in particular whether the reference in the objective to procedures "capable of providing" evidence is appropriate and supported by the requirements.

FOCUS, TITLE AND OBJECTIVE

The IAASB noted that a number of key elements of extant ISA 500 have been included in the draft revised ISA 200, and discussed whether the remaining text covers the concept of sufficient appropriate audit evidence in the same way that extant ISA 500 does. It was agreed that while other ways of arranging the text are possible, e.g. moving portions of it into ISAs 315 and 330, they would leave some elements of the current draft ill-placed, and would not result in any particular improvement to the ISAs as a whole. It was agreed, therefore, to retain the focus of ISA 500 basically as drafted, but that to reflect the current content its title should be changed to "Considering the Relevance and Reliability of Audit Evidence", and that the scope and objective paragraphs should be reword accordingly.

INFORMATION PRODUCED BY THE ENTITY

The IAASB discussed the extent to which the auditor needs to evaluate the reliability of information produced by the entity that is to be used for the purposes of the audit, and the link between the requirement in the draft to do so and the requirements of the risk standards (ISAs 300, 315 and 330). In particular, the IAASB discussed (a) whether internal control needs to be considered in all cases, e.g. whether there is a difference between information in a schedule that has been produced by the entity specifically for audit purposes, and information contained in subsidiary ledgers, and (b) whether there is a difference between information used in planning the audit and assessing risks, and information used for further audit procedures. The IAASB agreed that the wording of the requirement in the draft, which includes the words "as necessary in the circumstances," adequately allows for differences in emphasis for different types of information and for information used at different stages of the audit, but agreed that the reference to internal control need not be in the requirement and is better placed as application material.

OTHER MATTERS

In addition to editorial changes, the IAASB agreed:

- To include the concepts of risk and of the quality of information in the definition of "sufficient."
- To remove references to computer assisted audit techniques because they are outdated.
- To remove any implication in the draft that if the application of a control activity is examined for a selection of specific items, the results can be extrapolated to all applications of the control activity.

APPROVAL OF EXPOSURE DRAFT

The IAASB approved the proposed ISA 500 (Redrafted) for exposure. Ms. Esdon abstained because in her view, while the draft is not incorrect, it does disassociate the concepts of sufficiency and appropriateness of audit evidence and instead focuses on relevance and reliability, with the result that it is less comprehensive in its coverage of the topic of audit evidence than extant ISA 500. The IAASB agreed that the draft should be exposed for the same period as ISA 200, and that the explanatory memorandum accompanying the draft should note its relationship with ISA 200 and with ISA 530, the comment period for which is expected to overlap with the comment period for ISA 500.

7. Experts

Mr. Ferlings introduced proposed ISA 620 (Redrafted), "Using the Work of an Auditor's Expert as Audit Evidence."

DEFINITION OF ENGAGEMENT TEAM

Mr. Ferlings noted that the IESBA had issued an exposure draft of a revised Code of Ethics which includes the following proposed definition of engagement team "All partners and staff performing the engagement, and any individuals contracted by the firm who provide services on the engagement that might otherwise be provided by a partner or staff of the firm." Mr. Kellas noted that the Steering Committee had discussed the proposed definition and was concerned that it may be open to misinterpretation, may include certain external experts for whom compliance with the independence requirements of the Code is impracticable, and may make it virtually impossible for experts to be engaged in many circumstances where they are necessary to the obtaining of sufficient appropriate audit evidence. The IAASB agreed that these concerns should be communicated to the IESBA, noting that ISA620 is the appropriate place to deal with the effect of an expert's objectivity on the quality of audit evidence.

EXPERTS EMPLOYED OR ENGAGED BY THE ENTITY

The IAASB discussed the extent to which the ISAs should address the auditor's procedures regarding experts employed or engaged by the entity (management's experts). As previously agreed, proposed conforming amendments to ISAs 315 and 330 (and a footnote referring to these ISAs) were included in the draft to deal with this issue, in particular the possibility of over-reliance on management's experts. It was noted that this issue is also dealt with in ISA 540 "Audit of Accounting Estimates." A view was expressed that the extent to which the auditor can use the work of an "independent" expert engaged by the entity, without necessarily employing or engaging an auditor's expert, is a significant issue in practice that the draft conforming amendments do not adequately cover. The IAASB debated whether this issue could be addressed effectively in ISA 620 or conforming amendments and, if not, whether a separate project should be undertaken on it. It was agreed that the proposed conforming amendments should be deleted, and the task force was asked to draft text to address management's experts, albeit briefly, in the introductory paragraphs of ISA 620. It was suggested that the explanatory memorandum accompanying the exposure draft could invite comment on whether this treatment of management's experts is satisfactory or whether a further project on it should be initiated.

APPLICATION OF REQUIREMENTS TO FULL RANGE OF CIRCUMSTANCES

The IAASB discussed whether the ISA should apply to the full range of circumstances in which an auditor may use an auditor's expert, including (a) differences in the extent of the expert's involvement in the audit, e.g., when a minor question is asked of a lawyer about a peripheral matter, versus when an actuary is involved fully in significant aspects of the audit of an insurance company, and (b) whether the expert is a partner or staff of the audit firm, or an external expert. The IAASB agreed that the ISA should apply to the full range of possible circumstances, but that the requirements section should explicitly state the fact that the nature, timing and extent of audit procedures will vary with the circumstances (i.e., a "sliding scale" applies). The sliding scale should recognize, in particular, that procedures regarding an expert's capabilities, competence and

objectivity will differ between experts who are members of the engagement team and those who are not because those who are members of the engagement team will be subject to the auditor's quality control policies and procedures. It was also agreed that other parts of the ISA should distinguish between internal and external experts where this assists the clarity of drafting.

OTHER MATTERS

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

- The footnote stating that parts of the ISA may be helpful when dealing with accounting and auditing experts is likely to be confusing and should be deleted.
- The objective should be less procedural and more outcome focused.
- The draft should continue to emphasise objectivity, rather than independence, as a factor influencing the persuasiveness of evidence gathered by an auditor's expert, because independence connotes compliance with specific rules, which will not be appropriate in all cases.
- The task force should consider replacing the requirement to evaluate the expert's capabilities, competence and objectivity with a more direct requirement to employ or engage an expert with the appropriate capabilities, competence and objectivity when an expert is needed.
- The task force was asked to consider a number of points made at CAG, including elevating to the requirements references to two-way communication and reporting currently in the communication section of the application material.
- The task force was asked to further consider a number of matters raised by the IAASB, including the positioning and wording of the application material dealing with the "sliding scale," the explanation of the link between the need for expertise in preparing the financial statements and the risks of misstatement, whether it is clear in the draft that in some cases a member of management may be an expert (rather than the entity engaging an external expert), whether the requirement in ISA 545 for the auditor to test source data should be replicated in ISA 620, and the focus of the application material dealing with the auditor's consideration of the methods used by the expert.
- The draft should remove the implication that the auditor is required to examine details of registration or quality control systems to which an external expert may be subject.

WAY FORWARD

The IAASB asked the Task Force to present a revised draft at the July 2007 meeting for approval as an exposure draft.

8. The Audit of Group Financial Statements

Mr. Hansen led the IAASB through a detailed review of proposed ISA 600 (Revised and Redrafted), "The Audit of Group Financial Statements." He also referred to the summary of significant comments on the exposure draft and the Task Force's proposed recommendations, and comments received from the IAASB CAG at its April 2007 meeting. In addition to editorial comments, the Task Force was asked to consider whether:

- The application material dealing with the application of the proposed ISA in audits of single entities and in the case of joint audits (paragraphs A1 and A2) should be moved to the Introduction section and the definition of "engagement partner" respectively.
- To clarify the link between the proposed ISA and proposed ISA 220 (Redrafted). It was noted that paragraph 3 in the Component Auditors section is confusing as it may be read that the proposed ISA applies only to component auditors who are not from the group engagement partner's firm, which is not the case.
- Part (b) of the objective in paragraph 6, referring to "effectively communicate" with component auditors, should be changed to refer to communication with component auditors "on a timely basis." An IAASB member was of the view that the term "effective" is subjective, while the application material deals with timely communication.
- The definition of "component auditor" (paragraph 7(b)) should be expanded to indicate that a component auditor performs work on the financial information of a component *at the request of the group engagement team*.
- The definition of "group engagement team" (paragraph 7(g)) should be changed so that it is not limited to partners and staff from the group engagement partner's firm, but also include partners and staff from a network firm who form an integral part of the group engagement team because of the tasks they perform on the group audit. This may be achieved by defining group engagement team in terms of its responsibilities, rather than the tasks it performs. As currently defined, the tasks are those performed by senior members of the group engagement team. They do not include procedures performed on the consolidation process and therefore may lead to a smaller team than intended. Mr. Kellas suggested that the group engagement team be defined in the context of the group engagement partner's responsibilities. For example, partners and staff (other than component auditors) who assist the group engagement partner in fulfilling his/her responsibilities for …"
- The reference to components that have no parent in the definition of "group financial statements" (paragraph 7(h)) should be changed to components that have no parent but are under common control / ownership.
- Paragraph 9, dealing with the group engagement partner's responsibility for the group audit opinion, should be redrafted to focus on the fact that an unmodified auditor's report on group financial statements should not refer to a component auditor (unless otherwise required by law or regulation). If redrafted, the paragraph should be moved to a section towards the end of the Requirements section.
- Paragraph 10, which requires the group engagement partner to determine whether appropriate procedures regarding acceptance and continuance have been followed in accordance with proposed ISA 220 (Redrafted), should be combined with paragraph 11, which requires the group engagement partner to determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained. In addition, consideration should be given as to whether the term "determine" in paragraph 11 should be replaced with the term "satisfied," as was the case in the exposure draft.

- Components that are not under the control of the parent are sufficiently taken account of in the requirements on acceptance and continuance. In those cases, access will be restricted by circumstances and not by management. The group engagement partner may therefore accept the engagement, but may still not be able to obtain sufficient appropriate audit evidence.
- The proposed ISA should be expanded to require the group engagement partner to approve the overall audit strategy and audit plan (paragraph 14).
- Application material should be developed to support the requirement that the group engagement team shall obtain an understanding of whether the component auditor operates in a regulatory environment that actively oversees and enforces the independence and professional competence of auditors, and the quality control systems of their firms (paragraph 17(d)).
- The requirements on materiality should be revised to clarify that the "third level of materiality" / "tolerable error at the component level" is in line with proposed ISA 320 (Revised and Redrafted), "Materiality in Planning and Performing an Audit," as it flows from the application of proposed ISA 320 (Revised and Redrafted) in the audit at the component level. Consideration should also be given as to whether the "second level of materiality" / "component materiality" and the "third level of materiality" / "tolerable error at the component level" could be combined in certain circumstances.
- The requirements on materiality should be limited to those in proposed ISA 320 (Revised and Redrafted) (i.e., materiality for the group financial statements as whole and component materiality (paragraphs 20 and 21)), and the additional requirements (paragraphs 22-23) moved to the application material. Although the proposed requirements are in line with proposed ISA 320 (Revised and Redrafted), they are far more detailed and procedural in nature, while different auditors may apply the concepts in proposed ISA 320 (Revised and Redrafted) in the context of a group audit in different ways. It may also help to move the application material on materiality to the Overall Audit Strategy and Audit Plan section.
- To clarify the application of materiality in the context of a review of financial statements.
- To clarify how the requirements on determining the type of work to be performed on the financial information of components should be applied in the case where a group does not have any significant components.
- To clarify how the requirements on determining the type of work to be performed on the financial information of components that are not significant components should be applied in practice. If the analytical procedures are performed at group level at or near the end of the group audit (paragraph 28) it may not leave sufficient time to perform work on the financial information of the components, should the group engagement team conclude that it has not obtained sufficient appropriate audit evidence (paragraph 29).
- Based on a comment from an IAASB CAG Representative, the Consolidation Process section should be expanded to deal with the group engagement team's understanding of the consolidation process and tests of control.

- The list of matters to be communicated by the component auditor to the group engagement team should include identified or suspected fraud (paragraph 41) and, if the case, whether this should include all such fraud irrespective of materiality.
- The requirements or guidance should be expanded / changed to clarify the group engagement partner's responsibility for review and documentation. Reference was made to Article 27 of the EC's 8th Directive.
- To expand the proposed ISA to include a requirement for the component auditor to cooperate with the group engagement team.
- To expand Appendix 1 to include an illustration of a group auditor's report that contains a disclaimer of opinion.

WAY FORWARD

The proposed ISA will be submitted for approval at the July IAASB meeting. The intention is to limit discussions at that meeting to the results of the Task Force's consideration of the IAASB recommendations.

9. Service Organizations

Ms. Esdon introduced the topic, noting the purpose of the discussion was to cover issues relating to the scope of the project and conduct a first read of the proposed revised and redrafted ISA. The IAASB had previously agreed to revise the ISA based on developments relating to service organizations and updates by other national standard setters. She explained that while the task force sought to align the revised ISA with ISA 315 (Redrafted) and ISA 330 (Redrafted), it was also mindful not to repeat the requirements but rather expand them to specifically address what the auditor should do when a user entity uses a service organization; the mapping of this was included in Agenda Paper 6-B. Agenda Paper 6-C was compiled to demonstrate that no requirements in extant ISA 402 had been omitted as a result of the revision to the ISA. With the exception of the matters noted below, the IAASB agreed with the Task Force's overall recommendations as set out in the cover note to the agenda papers.

SCOPE OF THE ISA

Ms. Esdon noted that the task force had discussed the scope of the project extensively, including consultation with CAG. All acknowledged that outsourcing is more broadly used every day, and while this ISA did cover certain types of outsourcing, the IAASB may need to look at outsourcing generally in a future project.

The IAASB also discussed whether it would be necessary to provide more detail about what type of transactions could be seen as service organizations, such as asset securitization and the controllership function; Ms. Esdon noted that the purpose of paragraph 3 was to direct the auditor to areas on which to focus in gaining an understanding of a user entity. The task force will determine if further application material is needed on this point.

One member questioned whether a user auditor should also seek to understand if substantive audit procedures had been carried out by a service auditor. Ms. Esdon explained that the ISA was meant to require the user auditor to understand the controls at the service organization; however, guidance has been included for the situation in which the user auditor in designing substantive procedures needed

to potentially engage the service auditor to perform some of these procedures or wished to rely on work done by a service auditor.

SIGNIFICANT MATTERS DISCUSSED

Ms. Esdon then walked the IAASB through the first read of proposed ISA 402 (Revised and Redrafted). She noted that the purpose of paragraph 4 was to address the applicability of the ISA to shared service centers. IAASB members were of the view that this reference was confusing; it was suggested that the title be modified to indicate the ISA was dealing with third-party service organizations, and after some debate the IAASB agreed that paragraph 4 should be deleted and the title of the ISA amended to specifically refer to third party service organizations.

Objective of the ISA

The objective of the ISA was discussed and it was determined that it should be revisited as it did not seem to be consistent with the ISA.

Requirements

One IAASB member felt that the ISA did not give appropriate weight to the user auditor's understanding and testing of controls in place at the user organization. He was of the view that the user auditor may be able to rely solely on controls at the user organization, or may determine that testing a combination of controls at both the user entity and service organization may be appropriate. Ms. Esdon agreed the task force will look at additional wording to describe the process by which the auditor applies judgment to determine what controls need to be understood and tested.

The IAASB debated the procedures that were necessary in evaluating the report of a service auditor in the event the service auditor "is not well known to the user auditor." (See paragraph 15). One IAASB member thought that this requirement should apply in all cases, regardless of whether the service auditor was unfamiliar to the user auditor. Ms. Esdon noted that the task force had agreed to this language, in particular because when a Type B report is from a large, well-known firm, it was unclear what, if anything, should be required and the extant ISA presents an issue in practice in that area. It was suggested that the requirement be changed to indicate that the user auditor shall be satisfied that the service auditor is competent in evaluating whether reliance can be placed on the service auditor's report; this and additional language will be considered by the task force in revising the ISA, including whether paragraph A28 should be elevated to a requirement.

The issue of service auditor independence was discussed; it was agreed that the service auditor should be independent of the service organization and would be required to be in order to be able to issue an assurance report. It was acknowledged that in many cases, it is impracticable for the service auditor to be independent of all user entities; as such, no requirement for independence reporting will be included in the ISA.

As noted in paragraph 14, when the user auditor intends to rely on tests of controls at the service organization that have been performed by the service auditor, the user auditor is required to evaluate the results of the tests of controls. It was noted that further prominence should be given to the need to evaluate the period covered by the testing, in order to determine if it is adequate as it relates to the

user entity's reporting period. Consideration should be given as to whether elevation of paragraph A18 in reference to appropriateness of the date of a Type A report for the user auditor's purposes

The IAASB also debated whether it was appropriate to mandate that a service auditor's report cover a six month period. They agreed that ISA 3402 should require a minimum period; however, ISA 402 should focus on how the auditor evaluates the period covered by the report in determining the level of reliance to be placed on it. Further application material will be developed to outline the process by which a user auditor could cover the period of reliance, by using service auditor's reports from more than one year, more substantive procedures, or inquiry as discussed in paragraph A26. In addition, the task force will consider if any guidance in ISA 315 (Redrafted) regarding rotational testing could be included.

It was debated whether additional documentation requirements should be specifically included in the revised ISA. The task force had initially concluded that no new requirements were needed in revised ISA 402; however, one member noted that the UK standard imposes a specific requirement for the auditor to document the contractual terms between the user entity and the service organization. The task force will consider if this is necessary for clarification in paragraphs A3 and A4.

The IAASB agreed to retain the Appendix to the ISA, with some thought to be given by the task force to including more user-friendly terminology and re-ordering the examples to position more common types of service organizations earlier in the list.

Type A Reports

The IAASB agreed that the user auditor may mistakenly rely on a Type A report as evidence about the operating effectiveness of controls. It was determined that the language in paragraph A17 should be elevated to a requirement and the wording changed to indicate that it does not provide evidence on operating effectiveness. As a result of this change, the order in which Type A and Type B reports are discussed in the Requirements section will be reviewed given that the Type A reports are used primarily as an input into the user auditor's risk assessment procedures.

OTHER MATTERS

After discussion by the IAASB, in addition to a number of editorial suggestions, it was agreed that the ISA 402 Task Force would consider the following points for the next version of the ISA:

- Paragraph 3 should be consistent with ISA 315 (Redrafted) or, if the task force believes a difference is appropriate, the rationale should be provided.
- Paragraph 5 should be revisited to ensure that the scoping out of certain service organizations is appropriate. The Task Force should also consider deleting the first sentence as it could introduce some ambiguity.
- Paragraph 8(b) should be amended to restrict the definition to an auditor who performs an assurance report on the controls of a service organization
- The ISA should state that the service auditor's report, either Type A or Type B report, is a reasonable assurance report. Any changes to the definitions by the ISAE 3402 task force will be carried through to ISA 402.

- Additional application material should be drafted to explain that the reports defined in paragraphs 8(g) and 8(h) are typically prepared under ISAE 3402 or an equivalent national standard.
- The guidance in A9 and A13 may need to be moved to the Requirements section to more clearly outline what the user auditor needs to do in considering all the information available regarding controls.
- A definition of "service organization's controls" as included in paragraph 12 may be needed in the Definitions section.
- Paragraph 14(c) may be clarified to note that the user auditor is responsible for obtaining sufficient appropriate audit evidence about the operating effectiveness of controls.
- Paragraph A35 may be more appropriately linked to understanding the controls at a service organization, if so, paragraph 19 may be deleted.
- Paragraph A5 will be reevaluated to determine if more linkage to ISA 315 could be made with regards to prior experience with clients who use the same service organization.
- The concept that a user auditor is responsible for obtaining sufficient appropriate audit evidence, as explained in paragraph A29, should be moved earlier in the document as it is a fundamental concept.

WAY FORWARD

The task force will make the appropriate revisions, and a revised ISA which incorporates concepts discussed by the ISAE 3402 task force will be presented for approval as an exposure draft at the September 2007 IAASB meeting.

10. Service Organizations – Assurance Reports (ISAE 3402)

Mr. Tucker introduced the topic, providing an overview of relevant decisions made by the IAASB when it discussed this project previously (September 2006 – Montréal), and noting that this project is being run one step behind the ISA 402 project because decisions on a number of issues with respect to ISA 402 will determine how related matters are treated in ISAE 3402. He also noted that the purpose of the discussion at this meeting is to provide feedback on issues outlined in the issues paper prepared by the task force, rather than review the preliminary draft Introduction and Requirements sections of the ISAE, and that the final ISAE is likely to look quite different from an ISA because it will deal with an entire assurance engagement, rather than just one particular aspect as does an ISA.

ASSERTION-BASED REPORTS

Mr. Tucker noted that, in practice, full reports on controls issued by service organizations are typically very long because they include a detailed description of controls (often including narratives, flowcharts and organizational charts), in addition to the service auditor's assurance report. The IAASB discussed the content of an example service auditor's assurance report, and in particular whether the scope paragraph and the opinion paragraph should refer to the service organization's assertions about controls, or to the substance of those assertions (i.e. that the description of controls is fairly stated, and that the controls exist, and are designed and operating effectively).

The IAASB agreed that it is desirable for a service organization to include assertions about these matters in the full report because publicly accepting responsibility for the description and the existence and effectiveness of controls makes it clear that it is the organization that is accountable for these matters, rather than the auditor. However, requiring such public assertions as a prerequisite for an assurance engagement would be a departure from current practice in many jurisdictions. The IAASB therefore:

(a) Agreed that "assertion-based" reporting should be encouraged but that "direct reporting" should not be prohibited, and

(b) Asked the task force to liaise with service organizations, and possibly user entities, about the implications of assertion-based reporting, in particular whether there would be any increased costs associated with it. For example, if a service organization needed to undertake significant additional monitoring activities to be satisfied that the assertions were correct, the cost of doing so may not be entirely offset by a corresponding reduction of audit effort resulting from "reliance" on that additional monitoring. The IAASB was generally of the view, however, that there should not be a need for additional monitoring by service organizations because ensuring the effectiveness of controls is central to a service organization's business, so they should already have a high degree of confidence about the matters covered by the assertions. It was also noted that service organizations already provide representations to their auditors about these matters.

POINT IN TIME VERSUS PERIOD OF TIME

The IAASB discussed the current practice for opinions in Type B reports about the description of controls and the existence of controls to be *as at a specified date* (usually year-end), whereas opinions about operating effectiveness are *for a specified period* (usually the full year). The Board agreed with the task force that it would be better for these opinions (i.e., description, existence and effectiveness of controls) to be prepared on a consistent basis, which should be *for a specified period*. It was noted however, that care would need to be taken in wording the assurance report with respect to this matter, e.g. it may be clearer to opine on existence "at a point in time plus changes over time", rather than opining on existence "throughout the period".

Current practice for Type A reports is for opinions about the description of controls and the existence of controls to be *as at a specified date*. Type A reports do not contain an opinion about effectiveness. The IAASB discussed the limitations of Type A reports, and the potential for users to misunderstand those limitations and therefore over-rely on Type A reports. The IAASB also discussed the task force's suggestions that:

(a) The primary focus of ISA 3402 should be on Type B reports, with Type A reports only being referred to in relation to certain instances when they may be appropriate, e.g., as a "readiness" report when a service organization is in start-up phase or as a first-time report for a service organization that has never had a report and that plans to use it as a base-line for future Type B reports; and

(b) Type A opinions be restricted to a point in time to emphasize their limitations, and better distinguish Type A reports from Type B reports.

It was noted, however, that when monitoring controls at the user entity are strong, it may be appropriate in terms of efficiency for a user auditor to request a Type A report rather than a Type B

report, and in such cases, it would be helpful for the opinions in the Type A report on the description of controls and the existence of controls to cover the entire period, rather than be as at period end only. The task force was asked to consider this matter further.

COMPONENTS OF INTERNAL CONTROL

The IAASB discussed the proposed definition of a service organization's controls as "those controls at the service organization that relate to the services covered by the service auditor's engagement which the service organization considers to be part of user entities' information systems relevant to financial reporting," and queried whether, in practice, a service organization would specifically consider which controls they perform are "part of user entities' information systems relevant to financial reporting". It was noted that determining which controls are included in a service organization's description was usually achieved in the first instance through discussion between the service organization and its auditor, and later refined through discussion between user entities and their auditors with subsequent communication back to the service organization.

The IAASB noted that service organizations' descriptions usually include aspects of the organization's control environment, and other components of internal control, e.g. monitoring controls operated by the service organization. The task force was asked to consider whether the draft definition adequately captures the fact that these broader aspects of a service organization's control are usually relevant to user a auditor's consideration of controls operated by the service organization. The task force was also asked to give particular consideration to the relationship between the definition and the service auditor's responsibilities with respect to the completeness of the service organization's description of controls.

CONTROL OBJECTIVES

The IAASB discussed whether examples of control objectives should be developed as part of ISAE 3402. Several members noted that it may be helpful to have examples of control objectives, perhaps as guidance accompanying the ISAE, particularly given the importance of their role as criteria.

The IAASB agreed that some examples of control objectives should be included in the ISAE to illustrate the level at which suitable objectives could be expected to be pitched, but that it would not be necessary for this purpose to include a comprehensive list of examples as doing so would introduce the problem of ensuring the list is regularly updated. It was noted that IFAC member bodies may decide to develop more comprehensive lists based on the examples included in the ISAE.

SUBJECT MATTER, CRITERIA, AND SUBJECT MATTER INFORMATION

The IAASB discussed how the concepts of subject matter, criteria, and subject matter information in the "International Framework for Assurance Engagements" apply to each of the four conclusions contained in a Type B report, i.e.: the conclusions about the description, the design effectiveness, the existence, and the operating effectiveness of controls. The Board noted the importance of ISAE 3402, as the first standard to be developed under the Framework, demonstrating its consistency with the Framework and with ISAE 3000 (or, if consistency were not possible, that the reason for it be clearly identified and the consequences for the Framework and ISAE 3000, as well as ISAE 3402, be properly addressed). It was noted that ISAE 3402 should provide guidance for practitioners on the

application of the concepts in the Framework, and the requirements of ISAE 3000, particularly with respect to identifying and assessing the suitability of criteria for each of the conclusions, and the wording of those conclusion in the service auditor's report (e.g., whether each conclusion needs to explicitly reference the criteria used).

OTHER MATTERS

The IAASB also agreed the following:

- The draft should remove the implication that the auditor is required to examine details of registration or quality control systems to which an external expert may be subject.
- The assurance report should state that the engagement was performed in accordance with ISAE 3402 "Assurance Reports on a Service Organization's Controls," rather than stating that it was performed "in accordance with ISAE 3000", or "in accordance with the IAASB's Standards for assurance reports on a service organization's controls".
- ISAE 3402 should be drafted so as to facilitate its application to controls other than controls over financial reporting, e.g. controls over compliance, which are common in the financial services industry in the UK. It was noted however, that this decision may need to be revised at a later date, when the wording of the full ISAE is available, to ensure it is capable of being consistently adapted by practitioners for application to other controls.
- The task force should review all ISAs to determine whether there are any key requirements that ought to be adapted for service organization engagements, and if so, the ISAE should include the adapted requirements rather than only a reference to the relevant ISA. In addition to the ISAs referred to by the task force in the issues paper (viz: ISAs 610 and 620, dealing with internal audit and experts respectively), it was noted that ISA 250 dealing with laws and regulations may be particularly important in this respect.

WAY FORWARD

IAASB members agreed to provide out-of-session to the task force any comments they may have on the preliminary draft of the Introduction and Requirements sections of the ISAE. The Task Force was asked to present a complete draft ISAE for a first read at a subsequent meeting.

11. Material Weaknesses

Mr. Ashton introduced the topic, summarizing the IAASB's major decisions on this project so far. He noted that the IAASB CAG was generally in agreement with the IAASB that the auditor should report a broader range of the control matters identified during the audit than is implied by material weaknesses as defined in the US standards. He also noted that the IFAC SMP Committee had expressed concern regarding the potential documentation burden on SMPs, and had suggested differential communication requirements for audits of listed entities and those of SMEs. In addition, he highlighted for the IAASB's consideration the question of whether the proposed ISA XXX should be treated more as a communication ISA (i.e. an addendum to ISA 260) than a risk-assessment ISA (i.e. an addendum to ISA 315), noting that this choice would have an effect on the wording of the ISA, particularly the objective.

He then invited comments on the preliminary draft of the proposed ISA.

DEFINITION OF MATERIAL WEAKNESS

In relation to the task force's proposed definition of material weakness, some members questioned the use of the term "reasonable possibility" and how that relates to the concept of likelihood. It was noted that the term was inherently very judgmental. Some concern was raised regarding the guidance equating a reasonable possibility of a misstatement occurring to a greater than acceptably low risk of the underlying control not preventing or detecting the misstatement on a timely basis. It was pointed out that it was unclear whether this would be setting a new level of assurance.

Others questioned why the proposed definition limited material weaknesses to only those material misstatements that could arise in the current financial statements being audited. It was observed that this would effectively prohibit or at least discourage the auditor from reporting potentially serious control issues that do not affect the current financial statements, and that this limitation would create an inconsistency with the definition the US PCAOB had proposed in its exposure draft of a new auditing standard on internal control (Auditing Standard 5). In addition, it was noted that the proposed definition was becoming unnecessarily complex, and that a more qualitative approach (such as based on the notion of the control issues being so serious as to require remedial action from management and those charged with governance as soon as practicable) would perhaps be more appropriate.

After further debate, the IAASB concluded that the way forward would depend on which of the following three options should be chosen:

(a) Establish a definition similar to the definition the PCAOB would establish in its new Auditing Standard 5, expected to be issued shortly after this meeting. The primary benefit of this approach would be the harmonization of the definition of "material weakness" internationally. The PCAOB definition is, however, intended to represent a "high hurdle" so that under this approach, weaknesses that are less serious might not get reported. Accordingly, under this approach, a lower threshold ("reportable weaknesses") might have to be developed to allow auditors to continue the current practice of reporting important (but not necessarily "material") weaknesses to management. However, the existence of two categories of weaknesses could result in increased auditor work effort, and it was noted that this could be of concern to the auditors of smaller entities;

(b) Adopt a lighter approach to the relevant definitions. Under this option, "material weaknesses" would be defined as those weaknesses the auditor would deem to be sufficiently serious to justify reporting to *those charged with governance*, and "reportable weaknesses" those other weaknesses that the auditor concludes should be reported to *management* but not necessarily to those charged with governance. This approach would still require an evaluation but it would be more judgmental. However, it could result in a different definition from the PCAOB's; or

(c) Change the requirement in the ISAs for the auditor to communicate material weaknesses to a requirement for the auditor to communicate "reportable weaknesses." This would acknowledge the fact that the ISAs have always intended material weaknesses to be a broad category of control issues that the auditor may find helpful to bring to the attention of management and those charged with governance. Under this approach, the ISAs would note that some jurisdictions may define the term "material weakness" for their own legal or regulatory purposes and, if so,

auditors would have to evaluate control weaknesses in accordance with these definitions. This option would effectively mean that the term "material weakness" would not need to be defined in the ISAs. However, it would leave individual jurisdictions with the flexibility to define the term for their own purposes.

OBJECTIVES AND REQUIREMENTS

In addition to the above matter, the IAASB asked the task force to reconsider the proposed objectives and supporting requirements as they seemed to convey a complex process of evaluation, which would be inconsistent with the significant reliance on the application of professional judgment expected on such matters. Further, the proposed objectives as worded appeared too focused on the process of evaluating identified control deficiencies than on an appropriate communication outcome.

WAY FORWARD

The IAASB agreed that the task force should take into account the relevant aspects of the PCAOB's Auditing Standard 5 when issued before bringing back a revised draft of the proposed ISA for first read at the September 2007 meeting. In addition, in view of the potential adoption of ISAs in the EU and the fact that the EU Statutory Audit Directive requires the auditor to communicate material weaknesses to the audit committee but does not define the term, it was suggested that it would assist the IAASB's deliberations if the European Commission could indicate whether, in light of the above options, it would like the term to be defined in the ISAs. In that regard, Mr. Tiedje asked the IAASB to write to the EC with a summary of the discussions. He cautioned that the EC would need some time to consider the matter and that a response might not be available before October 2007.

12. Meaning of "International Public Interest" from PIOB's Perspective

Mr. Hafeman briefed the IAASB on work that the PIOB is currently undertaking in exploring the various aspects and meaning of the concept of international public interest, which forms a core component of the PIOB's remit. He summarized the main elements that the PIOB has identified that make up the public interest, focusing on those areas where it has a role to play, namely (a) a focus on users of accountancy services; (b) appropriate international standards; (c) credible international standard setting; and (d) effective implementation of international standards.

13. PIOB Observer Comments

Mr. Hafeman thanked the members for the opportunity to share his observations of the meeting and the IAASB strategy forum he had attended the previous week in Sydney. He noted the good work that had been done by the IAASB, its task forces and staff, and highlighted the PIOB's acknowledgment of the IAASB's heavy work schedule and the impressive progress made to date, particularly on the clarity project. He stressed the importance of a clear prioritization of the IAASB's future work program after the completion of the latter.

Regarding the IAASB's deliberations at the meeting, Mr Hafeman commented on the following matters:

- the balance of the discussions between detail and broader issues;
- the desirability of affording an opportunity for respondents to review the complete set of ISA objectives;

- the frequency with which similar structural or drafting issues arose, and whether this might be minimized by having further specific drafting conventions;
- the use of issues papers, and the extent to which they or the draft ISAs presented to the meeting were discussed; and
- the involvement of members of the IAASB in the discussions.

Mr. Hafeman also referred to the fact that IAASB members had been invited in a number of cases to submit comments on papers between meetings. This was an acceptable way of facilitating business, as long as it was clear that decisions on material matters were made at IAASB meetings.

14. Next Meeting

The next meeting of the IAASB has been scheduled for July 9-13, 2007 in Warsaw. This will mark the 100th meeting of the IAPC/IAASB.

15. Closing Remarks

Mr. Kellas thanked the Australian Auditing and Assurance Standards Board for hosting the meeting and its staff for assisting with the meeting arrangements. He also bid farewell to Sara Clark, the IAASB Executive Assistant, who was attending her last IAASB meeting as she was leaving IFAC to pursue other opportunities. He expressed the IAASB's appreciation for the tremendous support she had provided to the IAASB since joining its staff.

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