

**Draft Minutes of the 29<sup>th</sup> Meeting of the  
INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD**

**Held on December 10-14, 2007 in Washington DC**

**Voting Members**

Present: John Kellas (Chairman)  
Denise Esdon (Deputy Chair)  
Phil Cowperthwaite  
Craig Crawford  
John Fogarty (Dec 10-13)  
Jan Bo Hansen  
Diana Hillier  
Susan Jones  
William Kinney  
Kjell Larsson  
Ian McPhee (except Dec 11,  
11.00 am–3.30 pm)  
Marcel Pheijffer  
Will Rainey (except Dec 11,  
afternoon)  
Makoto Shinohara  
David Swanney  
Roberto Tizzano  
Gérard Trémolière  
Abdullah Yusuf (except Dec 11,  
11.00 am-3.30 pm)

**Technical Advisors**

Kelly Ånerud (Mr. Larsson)  
Philip Ashton (Ms. Hillier)  
Josef Ferlings (Mr. Kinney)  
Jon Grant (Mr. Rainey)  
Maria Manasses (Ms. Jones)  
Jennifer Haskell (Mr. Hansen)  
Richard Mifsud (Mr. McPhee)  
Daniel Montgomery (Ms. Esdon)  
Greg Shields (Mr. Cowperthwaite)  
Sylvia Smith (Mr. Crawford)  
Hans Verkruijsse (Mr. Pheijffer)  
Sharon Walker (Mr. Fogarty)  
Sachiko Kai (Mr. Shinohara)

**Apologies:**

Michele Caso (Mr. Tizzano)  
Cédric Gélard (Mr. Trémolière)  
Shahid Hussain (Mr. Yusuf)

**Non-Voting Observers**

Present: Rebecca Todd McEnally (Dec 10-12)  
Jean-Philippe Rabine  
Jennifer Rand

Apologies: David Damant

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Public Interest Oversight Board (PIOB) Observers

Present: Stavros Thomadakis (December 12-14)  
Susana Novoa (December 12-14)

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**IAASB Technical Staff**

Present: Jim Sylph (Executive Director), James Gunn, Kathleen Kerrigan, Daria Koukhar  
(December 10-13), Michael Nugent, Alta Prinsloo, Ken Siong

## 1. Opening Remarks and Minutes

### WELCOME AND INTRODUCTIONS

Mr. Kellas welcomed the public observers to the meeting. He noted that Dr. Thomadakis, Chairman of the Public Interest Oversight Board (PIOB), would observe the meeting later in the week on behalf of the PIOB.

Apologies were received from Mr. Damant, Chairman of the IAASB Consultative Advisory Group (CAG). As permitted under the Terms of Reference of the IAASB CAG, Mr. Damant had appointed Ms. Todd McEnally as IAASB CAG observer. Mr. Kellas welcomed her.

Apologies were also received from Messrs. Caso, Gélard and Hussain, technical advisors to Messrs. Tizzano, Trémolière and Yusuf, respectively.

Mr. Kellas noted the recent appointment of Dr. Yamaura to the Board of Audit of Japan. This appointment was expected to be effective from February 2008. Accordingly, Dr. Yamaura has resigned from the position of the Japanese Financial Services Authority (FSA) observer to the IAASB and would not be attending the meeting. Congratulations have been sent to Dr. Yamaura on behalf of the IAASB. The Japanese FSA is expected to appoint a new observer in due course.

Mr. Kellas also congratulated Ms. Esdon on her recent appointment to the board of the Global Reporting Initiative (GRI). This appointment will give the profession an experienced voice in the deliberations of this important organization.

Mr. Kellas welcomed Mr. Tucker (former technical advisor to Ms. Esdon), who would present the ISAE 3402<sup>1</sup> agenda item as chair of this project later in the week. He also welcomed Ms. Kai as the new technical advisor to Mr. Shinohara, and Messrs. Agulhas (from the South African Independent Regulatory Board for Auditors) and Böhm (from the Institut der Wirtschaftsprüfer), both of whom would be providing drafting support to a number of items on the agenda.

Mr. Kellas noted that this would be the last meeting for four IAASB members (Messrs. Hansen, Rainey, Shinohara and Tizzano), who are rotating off at the end of the year. There would be an opportunity for the rest of the IAASB to bid farewell to them later in the week. He also indicated that this would be the last meeting for Mr. Ashton, who is retiring as technical advisor to Ms. Hillier.

Mr. Kellas welcomed a statement that the International Organization of Securities Commissions (IOSCO) issued on November 9, 2007, which indicates that IOSCO is currently evaluating under what conditions it could endorse ISAs for use for cross border purposes and the form of such an endorsement. This is a positive development in that it recognizes the importance of a set of high quality internationally-accepted auditing standards.

Mr. Kellas noted that requests had been received from some respondents for the comment period on the proposed redrafted ISA 700 to be extended from November 30, 2007 until January 15, 2008, the closing date for comment on the International Accounting Standards Board's proposed revised IAS 1. This is on the ground that the proposed ISA 700 makes reference to the proposed revised IAS 1 in relation to the issue of modified IFRS. Mr. Kellas indicated that a formal announcement of an extension at this point in time would probably not be worthwhile given the short remaining time to

<sup>1</sup> ISAE 3402, "Assurance Reports on Controls at a Third Party Service Organization."

January 15<sup>th</sup>, particularly with the upcoming year-end holidays. He noted, however, that respondents would be welcome to submit comment letters until January 15<sup>th</sup>.

Mr. Kellas finally noted that all matters regarding IFAC's governance had now been settled with the IFAC Regulatory Monitoring Group and the European Commission (EC). In addition, the two EC observers to the PIOB are now expected to become full members of the PIOB.

## MINUTES OF PREVIOUS MEETING

The minutes of the public session of the previous IAASB meeting were approved as presented, subject to indicating that Mr. Damant attended parts of the meeting.

## 2. Written Representations

Mr. Fogarty explained that the objective of the discussion was to approve proposed ISA 580 (Revised and Redrafted)<sup>2</sup> as a final standard, and proposed ISA 210 (Redrafted)<sup>3</sup> (and related conforming amendments to proposed ISA 200 (Revised and Redrafted)<sup>4</sup> and proposed ISA 700 (Redrafted))<sup>5</sup> as an exposure draft. In September 2007, the IAASB approved proposed ISA 210 (Redrafted) subject to conforming amendments as a result of proposed ISA 580 (Revised and Redrafted).

Mr. Fogarty summarized the main issues raised during the September 2007 IAASB and CAG meetings, and subsequently by the IFAC Small and Medium Practices (SMP) Committee, and the Task Force's recommendations.

The IAASB reviewed the Task Force's recommendations. In addition to editorial changes, the IAASB discussed / agreed the following:

### PROPOSED CONFORMING AMENDMENTS TO PROPOSED ISA 200 (REVISED AND REDRAFTED)

- The IAASB agreed that the phrase in italics should be reinstated, as it is not stated elsewhere in the ISAs and may be significant to some jurisdictions: "... ISAs do not impose responsibilities on management or those charged with governance, *and do not override laws and regulations that govern their responsibilities* ..." (paragraph 8).
- The IAASB debated whether the phrase in italics should be deleted: "... responsibility for the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework; this includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements *that are free from material misstatement, whether due to fraud or error*" (paragraph A8). It was agreed that the phrase should be retained. However, the following was added to the application material in proposed ISA 210 (Redrafted): "The entity's objective with regard to the reliability of financial reporting includes the preparation and presentation of financial statements that are in accordance with the applicable financial reporting framework and free from material misstatement."

<sup>2</sup> [Proposed] ISA 580 (Revised and Redrafted), "Written Representations."

<sup>3</sup> [Proposed] ISA 210 (Redrafted), "Agreeing the Terms of Audit Engagements."

<sup>4</sup> [Proposed] ISA 200 (Revised and Redrafted), "Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing."

<sup>5</sup> [Proposed] ISA 700 (Redrafted), "The Independent Auditor's Report on General Purpose Financial Statements."

- The IAASB agreed that the following guidance, which was to be deleted from ISA 700 (paragraph A 21), should be added to the application material (paragraph A2) of proposed ISA 200 (Revised and Redrafted): “The preparation of the financial statements requires management to exercise judgment in making accounting estimates that are reasonable in the circumstances, as well as to select and apply appropriate accounting policies. These judgments are made in the context of the applicable financial reporting framework.”

#### PROPOSED CONFORMING AMENDMENTS TO PROPOSED ISA 210 (REDRAFTED)

- The IAASB agreed that the proposed ISA should clarify that, although the terms of the audit engagement may not have to be recorded in an engagement letter or other suitable form of written agreement if law or regulation describes them in sufficient detail, the auditor always has to obtain management’s *written* agreement that it acknowledges and understands its responsibilities. It was also agreed that the revised requirements and related application material should be restructured to enhance the flow of the proposed ISA.
- The IAASB agreed that paragraph A13, which referred to proposed ISA 580 (Revised and Redrafted), should be aligned with the wording in that ISA, that is: “... written representations required by other ISAs and, where necessary, written representations *to support other audit evidence relevant to the financial statements or one or more* specific assertions in the financial statements.”
- The IAASB agreed that paragraph A17, which explains that books, records and systems are an integral part of internal control, should clarify that a description of management’s responsibilities using the wording of law or regulation may include a reference to books, records and systems *in addition to* a reference to internal control.
- Some members were concerned about the tone of the considerations specific to smaller entities (paragraphs A18-A19), and how these paragraphs might be interpreted. The IAASB agreed that the guidance should be limited to an explanation that, in the case of smaller entities (for example, when a third party has assisted with the preparation and presentation of the financial statements), agreement of the terms of the audit engagement may avoid misunderstanding about the respective responsibilities of management and the auditors.

#### PROPOSED ISA 580 (REVISED AND REDRAFTED)

- A member was concerned about the inconsistent use of the terms “written evidence,” “confirmation” and “written representation” in the proposed ISA. The IAASB agreed that the proposed ISA should refer to “written representations.”
- The IAASB agreed that the objective of the auditor in paragraph 7(a) should refer to the auditor obtaining written *representations* (as opposed to *evidence*) from management regarding its fulfillment of the fundamental responsibilities that *constitute* (as opposed to *included in*) the premise on which an audit is conducted. The latter was to avoid interpretation that the premise includes something else besides the fundamental responsibilities.
- The IAASB agreed that the objective of the auditor in paragraph 7(b), which dealt with other written representations, should also refer to written representations required by other ISAs. In addition, the objective of the auditor in paragraph 7(c), which dealt with the auditor’s response to written representations, should be revised to clearly distinguish between written representations

provided by management and circumstances where management did not provide the written representations.

- The members debated the Task Force's recommendation that the proposed requirement for a written representation about deficiencies in internal control be deleted. The IAASB agreed that the application material, under the heading Other Written Representations, should explain that, in addition to the written representation about information provided to the auditor, the auditor may consider it necessary to request management to provide a written representation that it has communicated to the auditor all deficiencies in internal control of which management is aware.
- The IAASB debated the Task Force's recommendation that the proposed ISA provide for the auditor, in exceptional circumstances, to accept written representations about management's responsibilities in a form other than a representation letter (paragraph 15). The IAASB agreed that the word "exceptionally" should be deleted and that the text of the requirement should be clarified by transferring text from the application material. It was also agreed that the application material should clarify that the exception relates to written representations about management's responsibilities only.
- A member was concerned that the link between the auditor's concerns about management's integrity and the reliability of written representations was not clear. The IAASB agreed that paragraph 20(a) should be revised to require the auditor to disclaim an opinion on the financial statements if the auditor concludes *that there is sufficient doubt about the integrity of management such* that the written representations about management's responsibilities are not reliable.
- A member noted that paragraph A24, which explained that obtaining audit evidence from different sources or of a different nature may indicate that an individual item of audit evidence is not reliable, was not clear. The IAASB agreed that the paragraph should be deleted and that paragraph A25 should be revised as follows: "In the case of identified inconsistencies *between one or more written representations and audit evidence obtained from another source*, the auditor may ..."

#### PROPOSED CONFORMING AMENDMENTS TO PROPOSED ISA 700 (REDRAFTED)

- Based on the flexibility introduced in the description of management's responsibilities, the IAASB agreed that paragraph 22 should require the auditor's report to *explain* management's responsibilities (as opposed to *state* management's responsibilities).
- The IAASB agreed that the phrase "To improve the reliability of the entity's financial reporting" in paragraph A21 should be deleted. It was unnecessary as the link between financial reporting and internal control is explained in proposed ISA 210 (Redrafted).

#### APPROVAL

After agreeing all necessary changes to the draft, the IAASB discussed whether there was a need for re-exposure of the proposed ISA. The IAASB agreed that the changes made to the exposure draft of proposed ISA 580 (Revised and Redrafted) were in response to the comments received on the exposure draft. It was recognized that the exposure draft had given rise to controversy, but the changes made in response to the comments received were designed to meet the criticisms while maintaining the essential features of the proposals. While some thought that the level of concern in

itself gave rise to a preference for re-exposure, others believed that having made the changes re-exposure would provide no new input that the IAASB had not already considered. On a vote, 12 IAASB members agreed that the changes did not warrant re-exposure. It was noted that some of the changes will be exposed as part of the proposed conforming amendments to proposed ISA 200 (Revised and Redrafted), proposed ISA 210 (Redrafted) and proposed ISA 700 (Redrafted). Mr. Sylph advised that the IAASB had adhered to its stated due process in finalizing the ISA.

The IAASB approved proposed ISA 580 (Revised and Redrafted) as a final ISA, and the proposed conforming amendments to proposed ISA 200 (Revised and Redrafted), proposed ISA 210 (Redrafted) and proposed ISA 700 (Redrafted) as a result of ISA 580 (Revised and Redrafted) with one member abstaining. The ISA is effective for audits of financial statements for periods beginning on or after December 15, 2009. The issue of the final ISA is subject to confirmation from the Public Interest Oversight Board that due process has been followed.

Mr. Tizzano abstained from voting in favor of ISA 580 (Revised and Redrafted). In his view, the requirement for the auditor to express a disclaimer of opinion when the auditor did not obtain the written representations about management's responsibilities, or when such written representations are unreliable, may conflict with the requirements and guidance relating to adverse opinions. The auditor may obtain enough information to express an adverse opinion, despite the fact that he/she did not obtain the written representations about management's responsibilities, or obtained unreliable written representations. This may give rise to auditors disclaiming opinions when adverse opinions are possible or required.

The IAASB agreed that the proposed conforming amendments to proposed ISA 200 (Revised and Redrafted), proposed ISA 210 (Redrafted) and proposed ISA 700 (Redrafted) as a result of ISA 580 (Revised and Redrafted) should be included in the exposure draft of proposed ISA 210 (Revised and Redrafted). The IAASB acknowledged that the finalization of proposed ISA 200 (Revised and Redrafted) and proposed ISA 210 (Redrafted) may give rise to conforming amendments to ISA 580 (Revised and Redrafted).

The IAASB unanimously approved proposed ISA 210 (Redrafted) as an exposure draft with a 90-day comment period.

### **3. Comparative Information**

Ms. Hillier introduced the proposed ISA 710 (Redrafted)<sup>6</sup>, noting that the draft reflects a number of changes arising from (a) conforming amendments from the revision of other ISAs, and (b) alignment with other recent exposure drafts of clarified ISAs. She also noted that the Task Force received input from representatives of the Clarity Task Force, IFAC SMP Committee, INTOSAI Clarity Reference Expert Group, and some IAASB members in advance of the meeting.

Except as noted in the following, the IAASB agreed the recommendations of the Task Force, including the proposed disposition of the present tense and redrafting of the material in extant ISA 710.<sup>7</sup>

<sup>6</sup> Proposed ISA 710 (Redrafted), "Comparative Information – Corresponding Figures and Comparative Financial Statements."

<sup>7</sup> ISA 710, "Comparatives."

## WORK EFFORT AND REPORTING FOR CORRESPONDING FIGURES AND COMPARATIVE FINANCIAL STATEMENTS

### *Audit Procedures*

It was noted that extant ISA 710 requires for both corresponding figures and comparative financial statements that the auditor obtains sufficient appropriate audit evidence that they meet the requirements of the applicable financial reporting framework. The related guidance indicated, however, that the work effort in respect of corresponding figures is significantly less and is limited to ensuring that the figures are correctly reported and appropriately classified.

The IAASB debated whether the work effort in these situations is in fact substantively different. If it is, then for purposes of clarity, it would be important to explain precisely what further work is necessary with respect to comparative financial statements. If it is not, then the guidance may be misleading. After further deliberation, including consideration of examples and the effect of the level of detail in the reporting information under both the corresponding figures and comparative financial statement approaches, the IAASB concluded that the work effort is substantially the same under both approaches, although the auditor's reporting responsibilities are different.

The IAASB did, however, recognize that in the case of comparative financial statements, the auditor should obtain written representations from management in respect of each period for which the comparative financial statements are presented. In the case of corresponding figures, written representations are required for the financial statements of the current period only, which includes the comparative information for the previous period. Although this requirement is established in ISA 580 (Revised and Redrafted), the IAASB considered it appropriate to include a cross reference to that requirement, and to explain in the application material the reasons for the difference in approach to written representations under corresponding figures and comparative financial statements.

Accordingly, the IAASB agreed:

- To structure the proposed redrafted ISA 710 such that the auditor's procedures are the same under the two different approaches to presenting comparative information.
- To remove from the application material the statement that the audit procedures performed on the corresponding figures are significantly less than for the audit of the current period figures.
- To require that the auditor request written representations for all periods referred to in the auditor's report, and to explain in the application material that in the case of comparative financial statements this is so because management needs to reaffirm that the written representations it previously made with respect to the prior period or periods remain appropriate. In the case of corresponding figures, the written representations are for the financial statements of the current period only because the auditor's opinion is on those financial statements, which include the corresponding figures. Under both approaches, however, the auditor may determine that it is necessary to obtain representations regarding any amendments made to resolve a material misstatement in the prior period financial statements.

### *Auditor Reporting*

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



- As the audit reporting requirements are different for the two approaches to presenting comparative information, the proposed redrafted ISA should be structured to set out separately the auditor's reporting responsibilities for each approach.
- The requirements for reporting under the comparative financial statements approach should be simplified when the prior period's financial statements were audited by a predecessor auditor, by combining the elements of the requirement and placing less emphasis on whether the predecessor auditor agrees to reissue the prior period auditor's report. The IAASB also agreed to retain the wording in the extant ISA for the additional paragraph that could be included in the auditor's report regarding adjustments made if the predecessor auditors do not reissue their report.
- The proposed "Other Matters" paragraph in Example E of the Appendix should be deleted as it is unnecessary.

#### OTHER MATTERS

In addition to other editorial changes, to avoid complexity in the drafting of the requirements, the IAASB also agreed that the 'Definitions' section should explain that for purposes of this ISA, references to "prior period" should be read as "prior periods" when the comparative information includes amounts and disclosures for more than one period.

#### APPROVAL

The IAASB unanimously approved proposed ISA 710 (Redrafted) for exposure with a 90-day comment period.

#### **4. Audit Evidence Regarding Specific Financial Statement Account Balances and Disclosures**

Mr. Crawford introduced the proposed ISA 501 (Redrafted),<sup>8</sup> noting that extant ISA 501<sup>9</sup> addresses a number of unrelated topics, and focuses on certain assertions and specific considerations in relation to those topics. He then led the IAASB through a review of the proposed clarified ISA.

Except as noted in the following, the IAASB agreed the recommendations of the Task Force, including the proposed disposition of the present tense and redrafting of the material in extant ISA 501.

#### MATERIAL ELEVATED TO REQUIREMENTS

A few members expressed concern that the proposed redrafted ISA is too procedural and detailed, and thereby inconsistent in form with the rest of the ISAs as a whole. Equally, they were concerned that the more specific requirements may suggest that they are a complete list of actions expected in the circumstances, which they are not. In addition, it was noted that the balance of the extant ISA is not well preserved in that there appears to be a disproportionate number of requirements with respect to the subject of inventory. It was suggested that the Task Force consider a more principles-based approach, such as that used in developing proposed ISA 220 (Redrafted)<sup>10</sup>, to avoid a sense of over prescription in the standard.

<sup>8</sup> Proposed ISA 501 (Redrafted), "Audit Evidence Regarding Specific Financial Statement Account Balances and Disclosures."

<sup>9</sup> ISA 501, "Audit Evidence – Additional Consideration for Specific Items."

<sup>10</sup> Proposed ISA 220 (Redrafted), "Quality Control for an Audit of Financial Statements."

Other members disagreed. It was argued that the extant ISA is in fact procedural in nature, and that the particular auditing procedures specified therein are generally expected to be applied in virtually all cases. Further, the subject of auditing inventory is so important as to warrant appropriate requirements to achieve consistent auditor performance. These members were comfortable with the balance of the ISA in terms of requirements and guidance. Mr. Kellas observed that the wording of the extant ISA is quite clear in terms of the expectations on auditors. He was of the view that the proposed requirements appear to be consistent with the original intent of the extant ISA to specify what the auditor needs to do under very specific circumstances.

After further debate, the IAASB agreed the following:

- The reference to evaluating management's instructions and procedures used to estimate physical quantities should be removed from the requirements, as it is adequately covered in principle by the related main requirement and the guidance in the application material.
- The auditor's considerations when the entity maintains a perpetual inventory system should be positioned as application material, as the new general requirement to obtain audit evidence about changes in inventory when the entity's physical count is conducted at a date other than the date of the financial statements adequately addresses the actions expected in the circumstances. The specific guidance dealing with circumstances where a perpetual inventory system is used simply provides guidance to the application of that requirement.
- The requirement for the auditor to communicate with the entity's external legal counsel but allowing the auditor to use either a letter of general or specific inquiry should be clarified, and the guidance describing the content of a letter of specific inquiry should be positioned as application material. Details of such letters may vary in the circumstances, and it is therefore inappropriate to seek to specify their content as a requirement.

#### LONG-TERM INVESTMENTS

The IAASB deliberated whether it is appropriate to retain the extant material relating to auditing the valuation and disclosure of long-term investments. It was noted that the term "long-term investments" is no longer prevalent under International Financial Reporting Standards or other major financial reporting frameworks. Further, current financial reporting requirements place less emphasis on whether an entity intends to hold an investment on a long term basis in accounting for impairments in value. Accordingly, the guidance in extant ISA 501 may be unhelpful or potentially misleading.

The IAASB was of the view that audit issues in connection with the valuation and disclosure of investments would arise principally where estimation uncertainty is involved. Proposed ISA 540 (Revised and Redrafted)<sup>11</sup> provides relevant requirements and guidance in this regard. In addition, proposed ISA 580 (Revised and Redrafted) provides guidance relevant to obtaining audit evidence about management's intentions where important to the valuation basis for investments. The IAASB therefore concluded that the material in extant ISA 501 regarding long-term investments be removed. This proposal, however, should be highlighted in the explanatory memorandum accompanying the exposure draft.

<sup>11</sup> Proposed ISA 540 (Revised and Redrafted), "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures."

## REFERENCE TO “WHEN MATERIAL TO THE FINANCIAL STATEMENTS”

The IAASB deliberated whether it is appropriate to retain the reference to ‘when material to the financial statements’ in the requirements of proposed ISA 501 (Redrafted). It was noted that similar references in recently redrafted ISAs have been expunged on the basis that the ISAs apply to material matters only in accordance with the proper application of the materiality and audit risk ISAs. After due consideration, the IAASB concluded that including of such references should be determined on a case-by-case basis. With respect to proposed ISA 501 (Redrafted), the IAASB agreed the following:

- Reference to materiality should be retained in connection with the requirements pertaining to inventory in light of the specificity and procedural nature of this particular standard, and to avoid any inadvertent change in practice or the scope of the requirements. In this regard, the IAASB agreed that reference to material should also be included in the requirement addressing inventory under the custody and control of a third party.
- Reference to materiality in the requirement addressing the presentation and disclosure of segment information in the financial statements in accordance with the applicable financial reporting framework is unnecessary and possibly misleading and, accordingly, should be deleted.

## SEGMENT INFORMATION

The IAASB expressed concern about the interrelationship of the proposed requirements addressing segment information. Specifically, it was questioned whether it is appropriate to suggest that the auditor undertake all three of the specified procedures: obtaining an understanding of the methods used by management; testing the application of such methods; and performing analytical procedures. The IAASB concluded that it would be more consistent with the extant ISA to require that the auditor perform analytical procedures and other audit procedures appropriate in the circumstances, the latter of which would include obtaining an understanding of the methods used by management and, where appropriate, testing the application of such methods.

## OTHER MATTERS

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

- The scope paragraph should refer specifically only to ISA 330 (Redrafted), rather than to both ISA 315 (Redrafted) and ISA 330 (Redrafted), as there is no clear link between the material in the proposed ISA to ISA 315 (Redrafted).
- The requirement for the auditor to obtain audit evidence about the status of litigation and claims involving the entity which may give rise to a risk of material misstatement should specify that it is “to the date of the auditor’s report” in line with the wording in the proposed ISA 560 (Redrafted).<sup>12</sup>

## APPROVAL

The IAASB unanimously approved proposed ISA 501 (Redrafted) for exposure with a 90-day comment period ending March 31, 2008.

<sup>12</sup> Proposed ISA 560 (Redrafted), “Subsequent Events.”

## 5. Analytical Procedures

Mr. McPhee led the discussion of the proposed ISA 520 (Redrafted),<sup>13</sup> noting that staff support for this project is being provided by Mr. Agulhas from the South African national standard setting body. He gave an overview of the structure of the proposed ISA, noting that the Task Force proposed to generalize and move some material from the extant IAPS 1005<sup>14</sup> to this proposed ISA. He also noted that the Task Force had received some input from the IFAC SMP Committee, the INTOSAI Clarity Reference Expert Group, and some IAASB members in advance of the meeting, and he would highlight these as appropriate during the discussion.

Except as noted below, the IAASB agreed the recommendations of the Task Force, including the proposed disposition of the present tense and redrafting of the material in extant ISA 520.<sup>15</sup>

### OBJECTIVES AND SCOPE

It was noted that the purpose of the ISA was unclear, as it seemed to deal more with the question of *how* to perform analytical procedures than with the question of *when* these should be performed. It was noted that the objective at each of the three levels of analytical procedures in an audit is different. It was therefore suggested that the objectives of the ISA should clearly specify the auditor's objective at each level. It was, however, observed that there was an element of overlap between the proposed ISA and ISA 315 (Redrafted)<sup>16</sup> as the latter already contains a requirement for the auditor to design and perform risk assessment procedures that include analytical procedures.

After further deliberation, the IAASB agreed that the scope of the ISA should only include analytical procedures as substantive procedures in response to assessed risks, and as part of forming the overall opinion on the financial statements. The IAASB agreed that the ISA should make clear that analytical procedures used as risk assessment procedures are dealt with in ISA 315 (Redrafted). Consequently, the IAASB agreed to delete the proposed requirement for the auditor to design and perform analytical procedures as risk assessment procedures, and to move the guidance relating to analytical procedures as risk assessment procedures to ISA 315 (Redrafted) by means of a conforming amendment. In addition, the IAASB agreed that the objectives of the ISA should be refocused on the use of analytical procedures as substantive procedures to effectively respond to assessed risks of material misstatement at the assertion level, and to assist in arriving at the overall conclusion on the audit of the financial statements.

### OTHER MATTERS

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

- In relation to performing analytical procedures as substantive procedures in response to assessed risks, there should be an explicit requirement for the auditor to develop an expectation of recorded amounts or ratios.
- The requirement to evaluate whether the expectation is sufficiently precise should focus on whether a misstatement will be identified at that level of precision that, when aggregated with

<sup>13</sup> Proposed ISA 520 (Redrafted), "Analytical Procedures."

<sup>14</sup> IAPS 1005, "The Special Considerations in the Audit of Small Entities."

<sup>15</sup> ISA 510, "Analytical Procedures."

<sup>16</sup> ISA 315 (Redrafted), "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment."

other misstatements, may cause the financial statements to be materially misstated, instead of whether a material misstatement will be identified at the desired level of assurance.

- In relation to the requirement to evaluate the reliability of data from which the expectation of recorded amounts or ratios is developed, it should be made clear in the application material that this encompasses the completeness, accuracy and validity of the data.
- Guidance to the effect that it may be effective to consider the results of analytical procedures performed by management should be deleted as it may be misinterpreted to imply that the auditor relies on management to perform analytical procedures.

#### APPROVAL

The IAASB unanimously approved the proposed ISA 520 (Redrafted) for exposure with a 90-day comment period.

### **6. Service Organizations – ISAE 3402**

Mr. Tucker introduced the topic, noting that the proposed ISAE 3402<sup>17</sup> is considerably longer than a typical ISA because the ISAE covers the entire assurance engagement, rather than only one element of it as in the case of an ISA.

#### CRITERIA AND MATERIALITY

The IAASB discussed whether the minimum characteristics of suitable criteria for each of the three opinions included in a Type B engagement were appropriate (the three opinions are: fair presentation of the description, suitability of design, and effectiveness of operation). Discussion focused on whether the descriptions of minimum characteristics in the draft were adequate to enable practitioners to understand the relative roles of risk, materiality and control objectives.

It was agreed that the proper presentation of control objectives in the description is part of the criteria for the fair presentation of that description, and that this should be given more prominence. Once control objectives have been established, management needs to consider what can go wrong in meeting those objectives, which is the context in which risk is mentioned as part of the criteria for the suitability of design. It was agreed that the paragraphs identifying minimum criteria for the suitability of design and the effectiveness of operation should include a reference to controls providing “reasonable assurance that the stated control objectives will be achieved.” This helps demonstrate the relationship between the control objectives and the criteria.

It was noted that the concept of reasonable assurance, as used here, could be thought of as having materiality embedded within it because using the term reasonable assurance makes it clear that controls cannot be expected to prevent or detect all errors in all circumstances. Also, the IAASB agreed that the discussion of materiality in the application material should be expanded to explain more clearly that:

- (a) The concept of materiality relates to the information being reported on, not the financial statements of user entities; and

<sup>17</sup> Proposed ISAE 3402, “Assurance Reports on Controls at a Third Party Service Organization.”

- (b) In applying the concept of materiality, the service auditor considers the fact that the service auditor's report is intended to meet the common information needs of a broad range of user entities and their auditors who have an understanding of the manner in which the system is being used in a particular user entity for financial reporting by that user entity.

#### LINK WITH ISAS

The IAASB noted that because service organization engagements seek to provide reasonable assurance, and in that respect are therefore comparable to a financial statement audit, it would be desirable for the proposed ISAE, taken with ISAE 3000,<sup>18</sup> to cover similar matters and at a similar level of detail as the ISAs to the extent practicable and relevant. Mr. Tucker noted that the task force had considered this matter in some detail and, based on Task Force members' practical experience with these types of engagements, had included additional material in this draft on certain topics covered by ISAs.

The IAASB agreed that the current draft, taken with ISAE 3000, adequately covers relevant matters addressed in the ISAs, and reconfirmed its previous decision not to require that all ISAs be applied, adapted as necessary in the circumstances of the engagement, because to do so would not result in sufficient clarity as to which requirements of the ISAs should be applied or how they ought to be adapted. It was agreed, however, that the explanatory memorandum accompanying the exposure draft should discuss this matter and specifically seek respondents' feedback on it, particularly with respect to using the work of the internal audit function, sampling, documentation, and using the work of a service auditor's expert.

#### INTERNAL AUDIT FUNCTION

The IAASB discussed whether the service auditor's report should refer to the internal audit function if the work of the internal audit function has been used in performing tests of controls. The IAASB agreed with the position adopted in the draft whereby:

- (a) In the case of a Type B report, that part of the service auditor's assurance report that describes the service auditor's tests of controls and the results thereof should include a description of the work performed by the internal audit function and of the service auditor's procedures with respect to it. This was seen as necessary to fully inform readers of the service auditor's report, in particular, user auditors; and
- (b) No reference should be made in the section of the service auditor's assurance report that contains the service auditor's opinion. The IAASB agreed to make it clear in the ISAE that the service auditor has sole responsibility for the opinion expressed in the service auditor's assurance report and, accordingly, that responsibility is not reduced by the service auditor's use of the work of the internal audit function.

The IAASB also agreed that a definition of "internal audit function," derived from text currently in a footnote in the draft, should be included in the definitions section of the ISAE.

#### DISCLOSURE OF SAMPLE SIZES

The IAASB discussed whether a service auditor's Type B report should include disclosure of sample sizes: in all cases; only when deviations are identified; or never. The IAASB concluded that the

<sup>18</sup> ISAE 3000, "Assurance Engagements."

disclosure of sample sizes may not provide, on its own, sufficient information to the intended users to understand the judgments made by the service auditor in their determination; therefore, there might be a risk that intended users may misinterpret the significance of different sample sizes as they relate to user entities. The IAASB also concluded, however, that disclosure of sample size when a deviation from controls is found provides intended users with relevant information as to the rate of deviation encountered in the sample. This information assists user auditors in the performance of their risk assessments.

It was agreed, therefore, that the description of tests of controls required to be included in a Type B report should not include the disclosure of sample sizes used by the service auditor unless a deviation from controls is found, which is consistent with current practice in most jurisdictions. It was also agreed that the explanatory memorandum should specifically seek respondents' comments on this proposed requirement.

#### OTHER MATTERS

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

- The opening paragraph should refer to application of the ISAE by a professional accountant, and a footnote to it should refer to the definition of this term in the IFAC Code of Ethics.
- The Effective Date paragraph need not say that earlier adoption of the ISAE is permissible, as that is already stated in the Preface.
- The wording of the objective should continue to parallel that in proposed ISA 200 (Revised and Redrafted), rather than including the added detail in proposed ISA 700 (Redrafted).
- The wording of the requirement in relation to independence requirements should be aligned with proposed ISA 200 (Revised and Redrafted), and the associated guidance regarding independence from each service entity should be placed in the application material.
- Application material should be added to make it clear that a service auditor is not precluded from using this ISAE where law or regulation requires the service auditor to undertake an engagement that he or she would not otherwise undertake.
- The requirement related to engagement acceptance and continuance should be revised to be consistent with proposed ISA 210 (Redrafted) and proposed ISA 580 (Revised and Redrafted), and should include a reference to the service organization's responsibility for stating, in the assertion, the criteria used.
- The draft text should be conformed to the wording in the most recent drafts of ISAs where similar matters are covered.
- The inconsistency between the requirement, the application material, and the example service auditor's assurance reports regarding identification of the report's purpose and intended users should be corrected. Also, the application material should cite the relevant requirement of ISAE 3000 and explain the rationale as to why a restriction is included in the case of a service auditor's assurance reports.
- The draft should include a requirement regarding the auditor's responsibility to be satisfied that any change to the terms of the engagement has a reasonable justification, and should provide

guidance for when a service organization wishes to convert a Type B to a Type A engagement because of the likelihood of a modified report with respect to operating effectiveness.

- The wording of the example Type B assurance report appended to the draft ISAE should be amended to make it clear that not all controls included in the description have been tested, but rather only those which were necessary to provide reasonable assurance that the control objectives stated in the description were achieved.
- The explanatory memorandum should mention that the service auditor's report is for both user entities and their auditors.
- The exposure draft should be distributed to a range of service organizations to seek their feedback on, in particular, whether there are any situations in which it would not be possible or practicable for an engagement to be "assertion-based." IAASB members were invited to notify staff of service organizations they would think appropriate for this purpose.

#### APPROVAL

The IAASB unanimously approved proposed ISAE 3402 and related proposed conforming amendments for exposure with a five month comment period.

### 7. Communicating Deficiencies in Internal Control

Mr. Ashton introduced the topic, noting that the Task Force had received input from the IAASB CAG, the IFAC SMP Committee and some IAASB members in advance of the meeting, and he would highlight these as appropriate during the discussion. He then led a discussion of the revised draft of the proposed ISA XXX.<sup>19</sup>

Except as noted in the following, the IAASB agreed the recommendations of the Task Force as set out in the issues paper.

#### OBJECTIVE OF THE AUDITOR AND DEFINITION OF SIGNIFICANT DEFICIENCY

The Task Force proposed that the objective of the auditor be to communicate appropriately to management and those charged with governance deficiencies in internal control relevant to the audit that the auditor has identified during the audit and that, in the auditor's professional judgment, are of sufficient importance to merit their attention. It was noted that this objective appeared to be focused on the communication of significant deficiencies only and not other deficiencies. It was suggested that it would be more appropriate to amend the suggested definition of significant deficiency so that it focuses specifically on *those charged with governance*, rather than on both management and those charged with governance. The IAASB concurred. With this amendment, the IAASB agreed that the objective should be revised accordingly to place a more general obligation on the auditor to communicate appropriately, to management *or* those charged with governance, deficiencies in internal control relevant to the audit that the auditor has identified during the audit and that, in the auditor's professional judgment, are of sufficient importance to merit their *respective* attentions.

#### COMMUNICATION OF DEFICIENCIES IN INTERNAL CONTROL

##### *Compensating Controls*

<sup>19</sup> [Proposed] ISA XXX, "Communicating Deficiencies in Internal Control."



A member questioned whether it would be necessary to communicate identified deficiencies if the auditor has obtained audit evidence regarding the design and implementation of “compensating controls” that would prevent, or detect and correct, misstatements arising from the deficiencies. The IAASB noted that unless the auditor has obtained sufficient appropriate audit evidence about the *operating effectiveness* of these other controls, the auditor would not have sufficient audit evidence to conclude that a deficiency does not exist. Accordingly, the IAASB agreed that the requirement to communicate to management should be qualified to make clear that the auditor should communicate identified deficiencies to management in all cases *unless* the auditor has obtained sufficient appropriate audit evidence about the operating effectiveness of relevant compensating controls. The IAASB also agreed that guidance should be provided to explain that audit evidence regarding the effective design and implementation of compensating controls is not in itself sufficient to support a conclusion that no deficiency exists.

#### *Deficiencies Involving Management*

In relation to this communication requirement, it was noted that there might be circumstances in which it would be inappropriate to communicate to management directly, for example, situations that call into question management’s integrity or competence. The IAASB agreed that the communication requirement should be further qualified in that respect, i.e. identified deficiencies should be communicated to management *unless* it would be inappropriate for the auditor to report directly to management in the circumstances. The IAASB agreed that guidance should be provided in the application material to explain this point.

#### *Communicating Identified Deficiencies in Writing to Management*

It was suggested that the requirement to communicate identified deficiencies to management should include a requirement for that communication to be in writing, as the relevant points might be lost with the passage of time, particularly if there is turnover of management personnel at the entity. The IAASB noted, however, that mandating a written communication to management for all audits would be unduly burdensome for practitioners, particularly when dealing with smaller entities. Some members were of the view that some flexibility in this regard would be helpful as it would facilitate effective communication between the auditor and management.

After further deliberation, the IAASB agreed that there should be a written requirement for the communication of significant deficiencies to those charged with governance but *not* for the communication of identified deficiencies to management.

#### OTHER MATTERS

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

- The proposed ISA should refer to *identified* deficiencies consistently throughout as opposed to deficiencies that have come to the auditor’s attention, as the former implies a more conscious judgment on the auditor’s part.
- In order to clarify why the ISA establishes communication responsibilities for the auditor regarding identified deficiencies in internal control, the introductory section should indicate that knowledge of such matters is relevant to management and those charged with governance in fulfilling their responsibilities in relation to the financial reporting process.

- The definition of a deficiency in internal control should include the case where a control is simply missing.
- The guidance dealing with the requirement to determine whether, on the basis of the audit work performed, the auditor has identified one or more deficiencies should be clarified to indicate that deficiencies in internal control may be identified at any stage of the audit.
- Consistent terminology should be used in referring to terms such as “compensating controls” and “mitigating controls.”
- The guidance should be re-ordered to more clearly explain the nature of the matters that the auditor may consider in determining whether a deficiency, or combination of deficiencies, constitutes a significant deficiency.
- The guidance indicating that the significance of a deficiency depends on the potential materiality of the misstatement that may occur should not refer to materiality but should instead focus on the *magnitude* of the misstatement.
- In relation to the auditor’s communication of significant deficiencies to those charged with governance, the guidance explaining that the auditor may include details of any proposed remedial action by management in the communication should be clarified to indicate that the communication should, in these circumstances, also include a statement as to whether the auditor has taken any steps to verify that such action has been implemented.
- In relation to the timing of the auditor’s written communication to those charged with governance, the guidance should be clarified to indicate that such timing would depend on the auditor’s consideration of whether receipt of the communication would be an important factor in enabling those charged with governance to fulfill their oversight responsibilities. In particular, for some listed entities, those charged with governance may need to receive the written communication before the financial statements are approved in order to discharge their responsibilities relating to internal control. In other cases, the communication may be submitted at a later date. The guidance should also indicate that in any event, the timing of the written communication is subject to the overriding requirement for the auditor to complete the assembly of the final audit file on a timely basis, as the written communication forms part of the audit file.

#### CONFORMING AMENDMENTS

Subject to editorial changes, the IAASB agreed the proposed conforming amendments as presented.

#### APPROVAL

The IAASB unanimously approved the proposed ISA for exposure with a 120-day comment period ending April 30, 2008. It was questioned whether there would be a need to hold a public forum to consult stakeholders on the proposals in the exposure draft. The IAASB agreed that this would be unnecessary as the issues are essentially focused on the definitions of the relevant terms and the proposed requirement to communicate with those charged with governance, which respondents would be able to address through the normal exposure process. To manage public expectations, the IAASB asked staff to make clear in the explanatory memorandum why the focus of the project has shifted from the evaluation of material weaknesses, as originally envisaged, to the communication of identified deficiencies.

The IAASB agreed that the proposed ISA should be placed in the communications series and be numbered 265.

## 8. Subsequent Events

Mr. Hansen introduced the topic. He noted that 46 comment letters were received on the exposure draft of proposed ISA 560 (Redrafted). Proposals by respondents that relate to the clarity drafting conventions in general have been referred to the Clarity Task Force, i.e., the matter of conditional requirements and the matter of a definition of “smaller entities.” Proposals by respondents that went beyond the application of the clarity drafting conventions have not been accepted by the task force as they would require a revision of the standard. Mr. Hansen also noted that it was proposed that the IAASB consider developing a standard on reporting on investment circulars, which is currently included in the consultation paper on the future strategy of the IAASB. The Task Force has referred this issue to the IAASB Steering Committee.

Mr. Hansen led a review of the proposed ISA. The IAASB considered and agreed the recommendations of the Task Force in light of the comments received on the exposure draft. In addition to editorial changes, the IAASB agreed the following:

- The definition of the “date of the approval of the financial statements” should be aligned with the text of proposed ISA 700 (Redrafted).
- The standard should clarify in the application material that the date that the financial statements are issued depends on the regulatory environment of the entity.
- The phrase “unless they are affected by subsequent events” in paragraph 6, which read as follows, should be deleted: “The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions unless they are affected by subsequent events.” The effect of subsequent events is dealt with in a later paragraph (paragraph 8).
- The requirement for the auditor to complete the required procedures as near as practicable to the date of the auditor’s report (paragraph 7) should be revised to indicate that the procedures need to cover the period from the date of the financial statements to the date of the auditor’s report, or as near as practicable thereto.
- To respond to a comment that the standard should address subsequent events procedures performed, in some cases, on transactions after the date of the financial statements, a sentence should be added in the application material, explaining that, depending on the auditor’s risk assessment, the procedures required by paragraph 6 of the ISA may include procedures necessary to obtain sufficient appropriate audit evidence, involving the review or testing of accounting records or transactions occurring between the date of the financial statements and the date of the auditor’s report. The addition of this sentence led to further clarification in the following sentence of the relationship between these procedures and other procedures that an auditor may perform for other purposes, but that provide evidence with respect to subsequent events.
- The requirement for the auditor to read the entity’s latest subsequent interim external financial statements and subsequent interim internal management financial statements, if any, (paragraph 7(d)) should be revised. It should not make reference to “internal” or “external” because it is

unlikely that interim external financial statements will be available before the annual financial statements have been issued.

- The reference to the fact that, in some jurisdictions, management may not be required by law, regulation or the financial reporting framework to issue amended financial statements in the paragraph that applies when management amends the financial statements (paragraph 11) should be moved to the beginning of the paragraph that applies when management does not amend the financial statements in circumstances where the auditor believes they need to be amended (paragraph 13).
- The paragraph permitting the auditor, when allowed by law, regulation or the financial reporting framework, to restrict the required audit procedures on subsequent events to the related amendment to the financial statements (paragraph 12), should be revised. It should refer to law, regulation or the financial reporting framework not prohibiting such restriction. Furthermore, the auditor should be permitted to amend the auditor's report to include an additional date restricted to that amendment, or to provide a new or amended auditor's report that includes a statement in an Emphasis of Matter or Other Matter(s) paragraph that conveys that the auditor's procedures on subsequent events are restricted to that amendment.
- The application material to the definition of the "date of the financial statements" (paragraph A2) should be deleted as it appears to repeat the definition and does not provide additional guidance. In addition, the application material relating to other definitions should be revised so that the text is aligned with that of proposed ISA 700 (Redrafted).
- The text of the additional audit procedure to consider whether specific written representations covering particular subsequent events may be necessary to corroborate other audit evidence (paragraph A9) should be aligned with the text of proposed ISA 580 (Revised and Redrafted).
- The small entity consideration explaining that more time may elapse between the date of the financial statements and the approval of the financial statements in the case of small entities than in the case of large entities (paragraph A10) should be deleted as the reference to owner-managed entities, other non listed entities and large entities in that paragraph may be confusing. In addition, the consideration (paragraph A11) applies to entities of all sizes and should therefore not be included under the heading Considerations Specific to Smaller Entities.
- Situations in which an auditor's report has been signed by the auditor with an appropriate auditor's report date, but not yet issued to the entity are very rare (paragraph A16). As a result, the related application material is not necessary and should be deleted.
- References to "issue" an auditor's report should be replaced with "provide" an auditor's report because the word "issuance" is used in this ISA in connection with the issuance of the financial statements and therefore causes confusion. Furthermore, the ISAs do not specify what the "issuance date" of the auditor's report is.

Concern was expressed that, in some jurisdictions in Europe, the auditor may have a legal responsibility to withdraw the auditor's report or have other legal responsibilities when management accedes to the auditor's request not to issue the financial statements (paragraph 13(b)). The IAASB believes that paragraph 13(b) is not prohibiting such action by the auditor, but agreed to develop application material, explaining that the auditor may need to fulfill additional legal obligations in

these circumstances. The IAASB also chose to move the material explaining the auditor's course of action pursuant to the second sentence in paragraph 13(b) to the application material. The treatment of the auditor's course of action elsewhere in the ISA was aligned accordingly.

#### APPROVAL

The IAASB agreed that the changes made to the exposure draft in response to the comments received from respondents did not warrant re-exposure. Mr. Sylph advised the IAASB that it had adhered to its stated due process in finalizing the ISA. He noted that the CAG had not had the opportunity to review the proposed exposure draft prior to issuance but it had subsequently discussed it. The IAASB unanimously approved the proposed ISA as a final ISA under the clarity drafting conventions, with an effective date for audits of financial statements for periods beginning on or after December 15, 2009. The issue of the final ISA is subject to confirmation from the Public Interest Oversight Board that due process has been followed.

### **9. Accounting Estimates, Including Fair Value Accounting Estimates**

Mr. Ashton introduced the topic, noting that the intent of the discussion was for the IAASB to approve the ISA as a final standard.

#### USE OF EXPERTS

Mr. Ashton noted that the most significant issue raised at the prior meeting was the need for the Task Force to clarify the requirement to determine whether to use an expert or another specialist. The Task Force had put forth a revision to the requirement in paragraph 14 in the agenda material, and included a new definition of accounting or auditing specialist to distinguish between an auditor's expert and additional personnel who may be used in an engagement team.

After some discussion, the IAASB agreed that the proposed definition of accounting or auditing specialist could be deleted. The requirement was redrafted from one that required the auditor to consider whether a specific person was required to obtain sufficient appropriate audit evidence to a requirement that the auditor shall consider whether specialized skills or knowledge was required in relation to one or more aspects of the accounting estimates. The change to the requirement and related application and other explanatory material now links it with the auditor's requirement in proposed ISA 220 (Redrafted) to be satisfied that the engagement team has the appropriate capabilities, competence and time to perform the audit engagement. Also, wording in the application and other explanatory material has been strengthened to indicate that for the majority of accounting estimates, even when there is estimation uncertainty, it is unlikely that specialized skills or knowledge will be required.

#### CONFORMING AMENDMENT TO ISA 240 (REDRAFTED)

The IAASB also supported the task force's proposal to include a conforming amendment to ISA 240 (Redrafted) in order to more closely link the retrospective review required by ISA 240 (Redrafted)<sup>20</sup> with what is required in paragraph 9 of ISA 540 (Revised and Redrafted).

<sup>20</sup> ISA 240 (Redrafted), "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements."

## OTHER CHANGES

In addition to the changes discussed above and minor editorial changes, the IAASB agreed the following:

- The requirement for the auditor to review the re-estimation of accounting estimates included in the prior period should be clarified so that it is clear that the purpose of doing so relates to the current period.
- An example taken from proposed ISA 501 (Redrafted)<sup>21</sup> relating to a provision against the carrying amount of an investment where there is uncertainty regarding its recoverability should be included as an example of an accounting estimate.
- Further application and other explanatory material that describes the auditor's considerations when obtaining and understanding of the entity and its environment should be included to link to ISA 315 (Redrafted).
- Further application and other explanatory material should be included to provide an example about the auditor's course of action if management changes the basis of making an accounting estimate.
- The definition of a significant assumption should be moved to the application and other explanatory material.

## RE-EXPOSURE

The IAASB discussed whether re-exposure of proposed ISA 540 (Revised and Redrafted) was necessary. The IAASB agreed with the task force's views that the changes to the exposure draft respond to the comments received, and that there are no substantive changes that have arisen from matters not aired in the exposure draft or previously deliberated by the IAASB.

## APPROVAL

The IAASB unanimously approved ISA 540 (Revised and Redrafted) as a final standard, subject to the PIOB's confirmation that due process has been followed. Due to the combination of extant ISA 540<sup>22</sup> and extant ISA 545,<sup>23</sup> the IAASB had previously acknowledged in the exposure draft that ISA 545 would need to be withdrawn when ISA 540 (Revised and Redrafted) becomes effective. The IAASB confirmed this decision unanimously.

## 10. Working Group on Fair Value Auditing Guidance

Mr. Kellas introduced the topic, noting that the Steering Committee and members of the IAASB CAG had reviewed the draft Terms of Reference for the Working Group on Fair Value Auditing Guidance. The formation of this group was discussed at the IAASB meeting in September 2007 to explore what may be possible. While there is certainly some enthusiasm for the IAASB to do something, it is not yet clear what is needed. Guidance will not be developed until a project proposal

<sup>21</sup> Proposed ISA 501 (Redrafted), "Audit Evidence Regarding Specific Financial Statement Account Balances and Disclosures."

<sup>22</sup> ISA 540, "Audit of Accounting Estimates."

<sup>23</sup> ISA 545, "Auditing Fair Value Measurements and Disclosures."

has been approved by the IAASB, which would address the form and scope of guidance that could be developed.

Mr. Kellas noted that if the IAASB agrees, there would be a meeting in early 2008 to bring interested parties, including some members of the IAASB CAG and others, together to develop a way forward.

Others have issued papers and guidance recently, including the Financial Stability Forum, IOSCO, the Basel Committee on Banking Supervision, and the U.S. Center for Audit Quality. In addition, it appears that firms intend to issue guidance, though this is likely to highlight important aspects of the accounting rules rather than being a discussion of the audit considerations. Mr. Kellas noted that it is not the role of the IAASB to be reminding people of the accounting rules, although it may be appropriate and helpful for others to do so.

The U.S. Public Company Accounting Oversight Board also recently released an alert reminding auditors of relevant guidance within the auditing standards that might be of particular importance in the current climate.

The IAASB was then asked for views on the matters set out in the Terms of Reference for the Working Group. The following matters were raised:

- While this activity was included in the IAASB's Consultation Paper, *Proposed Strategy for 2009-2011*, and the IAASB has not as yet finalized the strategy, preliminary analysis has indicated that there is an interest in this area and the IAASB should move forward with the Working Group.
- It is not yet clear what the potential output of the Working Group could be, but the IAASB should be proactive in this area in light of the current environment and the increasing use of fair value, in order to promote greater consistency in how the audits of fair value information is approached.
- While the Terms of Reference and the Consultation Paper describe the potential output as guidance, it will be left to the Working Group to determine the form of this guidance, including whether a new international pronouncement is necessary.
- Any meeting of interested parties should be as inclusive as possible, in order to get an appropriate range of expert opinion.
- The press release announcing the approval of proposed ISA 540 (Revised and Redrafted), while acknowledging that it is not yet effective, could encourage auditors to read the guidance in the ISAs for the current audit season, as it is more extensive than extant ISA 545.
- It was also suggested that further training for practitioners in this area is necessary; however, this would not be the IAASB's responsibility.

The PIOB is also keenly interested in this area, as it is an evolving topic, with models used to make fair value accounting estimates becoming more complex over time.

The IAASB agreed to move forward with the formation of the Working Group, and will receive a report back on the progress made to date at the March 2008 meeting.

## **11. Audit Considerations Relating to an Entity Using a Third Party Service Organization**

Ms. Esdon introduced the topic, noting the intent of the discussion was for the IAASB to approve the ISA as an exposure draft. She noted that the one outstanding issue from the September meeting was the view that the requirements as drafted did not clearly outline what a user auditor is required to do if the user auditor is unable to obtain a sufficient understanding of controls over the activities of the service organization through interaction with the user entity alone. A conditional requirement was added to specify that if the user auditor is unable to obtain the necessary understanding from the user entity alone, the user auditor should interact with the service organization. The IAASB agreed that the changes that were made by the Task Force were appropriate, and also concluded that the discussion of the interaction with proposed ISA 705 (Revised and Redrafted)<sup>24</sup> should be retained as application and other explanatory material.

Ms. Esdon also noted that comments had been received from the IFAC SMP Committee, and they were broadly satisfied with the proposed draft. While the IFAC SMP Committee suggested that the auditor's consideration as to the auditor of the service organization is similar in some respects to considerations required in ISA 600 (Group Audits), the IAASB did not believe that a parallel should be drawn between the two ISAs, as the service auditor's report covers controls at the service organization and the auditor does not typically have access to the service auditor's working papers.

Ms. Esdon also noted that the definitions contained in proposed ISA 402 (Revised and Redrafted) were reviewed by the Task Force to ensure they were consistent with those contained in proposed ISAE 3402.

### **APPROVAL**

The IAASB unanimously approved proposed ISA 402 (Revised and Redrafted) as an exposure draft with a 120-day exposure period.

## **12. International Standards on Review Engagements**

Ms. Esdon proposed minor amendments to the scope of ISRE 2400<sup>25</sup> and ISRE 2410.<sup>26</sup>

She explained that it had been brought to the IAASB's attention that ISRE 2410 only applies to a review of interim financial information by the entity's auditor, while ISRE 2400 applies to all reviews of historical financial information by a practitioner who is not the entity's auditor. Thus, there would appear to be no directly relevant standard for reviews of other historical financial information undertaken by the entity's auditor.

To resolve the issue, it was proposed that the scope of ISRE 2410 be amended to apply also to a review of other historical financial information by the entity's auditor. This maintains the principal distinction between ISRE 2400 and ISRE 2410, which is the application of audit-based knowledge of the entity when carrying out a review.

ISRE 2400 also indicates that it may be applied 'to the extent practicable' to engagements to review other information. As ISAE 3000 applies to assurance engagements 'other than reviews of historical

<sup>24</sup> [Proposed] ISA 705 (Revised and Redrafted), "Modifications to the Opinion in the Independent Auditor's Report."

<sup>25</sup> ISRE 2400, "Engagements to Review Financial Statements."

<sup>26</sup> ISRE 2410, "Review of Interim Financial Statements Performed by the Independent Auditor of the Entity."



financial information', it was proposed that the scope of ISRE 2400 be restricted to a review of historical financial information performed by a practitioner who is not the entity's auditor. As a result, the scopes of ISRE 2400, ISRE 2410 and ISAE 3000 are mutually exclusive.

The IAASB unanimously approved the proposed minor amendments to be effective immediately.

### **13. Related Parties**

Mr. Trémolière introduced the discussion of the significant comments received on the re-exposure draft (ED) of the proposed revised ISA 550,<sup>27</sup> noting that 50 comment letters had been received. Respondents were generally supportive of the revised proposals. Mr. Trémolière summarized the main issues raised by one respondent (IOSCO) who had submitted its comment letter after the Task Force had completed its deliberations on the papers to be presented at this meeting. He also indicated that the Task Force had received some input from the IAASB CAG and the IFAC SMP Committee, and he would highlight these as appropriate during the discussion.

Mr. Trémolière then led a review of the revised draft of the proposed ISA.

Except as noted in the following, the IAASB agreed the recommendations of the Task Force as set out in the issues paper.

#### **INHERENT LIMITATIONS**

Mr. Trémolière noted a suggestion from some respondents that the proposed ISA should place *further* emphasis on the difficulties in obtaining persuasive audit evidence regarding the completeness of related party relationships and transactions. He also indicated that other respondents had taken the opposite view that the proposed ISA appeared to place too much emphasis on the inherent limitations on the auditor's ability to detect material misstatements arising from related party relationships and transactions.

It was suggested that it would be more appropriate to centralize any discussion of inherent limitations in the proposed ISA 200 (Revised and Redrafted) to avoid over-emphasizing such limitations. It was noted, however, that doing so could result in the ISA giving the impression that the auditor would be able to overcome the inherent limitations by performing the procedures set out in the ISA. One member observed that there will be relatively few ISAs that will contain a discussion of inherent limitations, and that such discussion would provide an appropriate means to emphasize the importance of skepticism in those particular circumstances.

After further deliberation, the IAASB concluded that the material in the ED was appropriately balanced and that no changes should be made.

#### **OBJECTIVES**

Mr. Trémolière noted that a number of respondents had suggested that the objectives proposed in the ED would be clearer and their flow improved if the part on "...obtaining an understanding of related party relationships and transactions" were to precede the part dealing with "obtaining sufficient appropriate audit evidence about whether related party relationships and transactions have been appropriately accounted for and disclosed," as the latter depends on the auditor first obtaining an understanding of the entity and identify and assessing the risks of material misstatement. In addition,

<sup>27</sup> [Proposed] ISA 550 (Revised and Redrafted), "Related Parties."

IOSCO had commented that the objectives would be enhanced if they explicitly addressed the concept of identification.

One member commented that the objective of obtaining sufficient appropriate audit evidence is more closely related to the objective of “concluding on whether the financial statements... achieve fair presentation... and are not misleading.” Another member, however, noted that it is necessary to emphasize that the latter objective also applies where frameworks do not establish related party requirements.

The IAASB asked the Task Force to reconsider whether the flow of the objectives could be improved in light of the comments made. Notwithstanding this, the IAASB agreed that the objectives should include an explicit reference to identification.

#### DEFINITION OF A RELATED PARTY

Mr. Trémolière explained that the Task Force proposed to limit the common control part of the definition to fellow subsidiaries within a group in response to comments from respondents that it would be impracticable for the auditor to identify all parties under common control under the related party definition set out in the ED. A member noted that this would inappropriately narrow the scope of the definition. It was pointed out that management might very well be aware of other parties that are under common control (otherwise than in a group situation). By effectively not being required to make the initial inquiries of management regarding such parties, the auditor would be exposed to the risk that these parties would remain undetected, even though their existence was known and management had no intention of concealing them. Further, it was argued that fellow subsidiary cases are likely to be the least problematical in practice because transactions among them would be eliminated on consolidation.

After further deliberation, the IAASB asked the Task Force to consider removing the limitation on the common control part of the definition.

#### INSPECTION OF DOCUMENTS

Mr. Trémolière noted a comment from IOSCO that the second exposure draft seemed to have established a more modest standard for the identification and auditing of related party transactions compared with the first one. IOSCO commented, in particular, that while inquiries of management are required under the first and second exposure drafts, it appeared that the documents that were provided as two presumptively mandatory examples in the first exposure draft had now become the only documents the auditor is specifically required to review.

The IAASB acknowledged these concerns. Whilst the Task Force’s proposed inclusion of the phrase “at a minimum” in the revised draft supported a requirement for the auditor to inspect more than just the specific documents listed in the requirement, the IAASB agreed that the requirement could be reworded so as to place a more positive obligation on the auditor to inspect other documents that may contain information that may indicate the existence of previously unidentified or undisclosed related party relationships or transactions. It was noted, however, that any proposed rewording should include appropriate qualifying language to avoid establishing an open-ended requirement. The IAASB asked the Task Force to revise the requirement accordingly.

## SPECIAL PURPOSE ENTITIES

The IAASB took note of a concern from IOSCO that the ED did not seem to give sufficient attention to the potential complexities and risks associated with special purpose entities (SPEs), and that these should receive some mention in the requirements. The IAASB acknowledged that SPEs are a current issue of the day. Nevertheless, it also noted that there might well be other structures that could be devised in future that could also give rise to related party issues.

The IAASB agreed that SPEs are in fact already covered by the broad principles set out in the proposed ISA and other ISAs. Accordingly, the IAASB concluded that it would be inappropriate to emphasize SPEs in the Requirements section. The IAASB, however, asked the Task Force to consider placing additional emphasis on SPEs in the application material.

## OTHER COMMENTS

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

- The Task Force should consider moving the exemption for state-controlled enterprises upfront into the Definitions section instead of placing this in the application material, as the exemption is significant.
- In relation to the guidance on the auditor's inquiries of management regarding the identity of the entity's related parties where the framework has not established any related party requirements, it should be made clear that such guidance does not provide a dispensation from making the inquiries specified in the requirement.
- Arm's length assertions for related party transactions should not be treated as giving rise to significant risks by default. However, it should be made clear in the Requirements section that there may be practical difficulties that limit the auditor's ability to obtain audit evidence that all the terms and conditions of a related party transaction are equivalent to those prevailing in an arm's length transaction.
- A mention of implicit arm's length assertions should be made in the application material to alert readers to the existence of these assertions.
- As suggested by IOSCO in relation to the required responses when the auditor identifies related parties or significant related party transactions that management has not previously identified or disclosed to the auditor, the Task Force should include a requirement to respond to the risk that other unidentified or undisclosed related parties or significant related party transactions might exist.
- The Task Force should consider whether the descriptions of "control" and "significant influence" would be better placed in the Definitions section.
- In relation to the reference to risks of non-compliance with laws and regulations in the considerations specific to public sector entities, the Task Force should consider clarifying that such risks may relate, for example, to one entity exerting influence over another entity to take inappropriate or illegal actions.
- In relation to the considerations specific to smaller entities regarding obtaining an understanding of the related party relationships and transactions, and the entity's controls over these, the Task

Force should consider expanding the guidance to address the additional audit procedures that the auditor may perform beyond inquiry of management.

#### WAY FORWARD

The IAASB asked the Task Force to consider its comments and present a revised draft of the proposed ISA for approval as a final standard at the March 2008 meeting. For purposes of due process, the IAASB also asked the Task Force to prepare, as part of the meeting papers, a 3-way comparison showing the main changes from the first exposure draft to the second one, and from the second exposure draft to the proposed final wording.

### **14. Assurance Engagements on Carbon Emissions Information**

Messrs. Simnett and Nugent introduced the topic, noting that other IFAC boards and committees had notified their support for the project proposal, as had those members of the IFAC Transnational Auditors Committee (TAC) who had to date responded to a request for comment. TAC members had made it clear, however, that they did not want this project to delay the IAASB's completion of the Clarity project. Mr. Simnett also noted that a growing number of emissions disclosure requirements and trading schemes around the world were seeing assurance, or verification, as an important element in ensuring the rigor of measurements and other disclosures, and that the business case for the involvement of the profession is growing the more firms become involved in engagements of this kind. Mr. Sylph noted that the International Accounting Standards Board was currently considering whether to reactivate its project on emissions trading schemes.<sup>28</sup>

#### PUBLIC INTEREST

Some members expressed the concern that a profession predominantly made up of financial statement auditors may not be the appropriate profession to take the lead in developing a standard on this topic, nor in providing assurance service with respect to it.

It was noted, on the other hand, that firms are already successfully providing assurance services in this field by combining the assurance expertise of the accounting profession with the subject matter expertise of other professions. It was also observed that in many cases, those other professions are not well equipped to provide assurance services because they lack the depth of understanding that the financial statement auditors have built up over time regarding concepts such as sufficiency and appropriateness of evidence, levels of assurance, risk assessment, materiality and reporting. The IAASB acknowledged the major economic and social consequences of climate change and carbon trading, and noted that in an increasing number of cases, legislators and regulators are turning to the accounting profession for assistance in developing assurance aspects of disclosure and trading schemes.

The IAASB agreed that, in the absence of one profession that is fully equipped to address both the subject matter of carbon emissions and the concepts and methodologies underlying assurance, it appears to be in the public interest for the accounting profession to play a major role in developing standards or guidance on this topic. It was recognized, however, that this may require variations to the normal workings of the IAASB. For example, there would need to be greater interaction with subject matter experts and a building up of knowledge amongst IAASB members; the form of output

<sup>28</sup> The IASB subsequently decided to reactivate this project.

might differ (e.g., guidance rather than a standard); and interim steps such as pilot studies and consultation documents might need to be considered.

#### SCOPE OF TOPIC

The relationship of this topic to the broader theme of sustainability and corporate social responsibility was acknowledged. The IAASB discussed whether, in adopting a project in this field, it may be better to adopt a broader project, for example, assurance on sustainability reports. It was noted that a potentially significant impediment to adopting a broader project at this time is whether existing criteria are suitable, particularly when it comes to the question of the completeness of a sustainability report. It was also noted that a larger range of experts would be needed by practitioners for broader areas, which would heighten any remaining discomfort that members may have about the appropriateness of the auditing profession taking a leading role in this field. It was agreed that the narrower, more focused topic of carbon emissions information was a better starting point for the IAASB's involvement in this field.

The IAASB discussed whether the project should concentrate only on information used for emissions trading schemes, where the criteria might be expected to be more formulaic and rigid, or whether other carbon disclosures should be encompassed, for example, disclosures pursuant to legislative requirements that do not incorporate a trading element, and voluntary disclosures such as those many companies now make in their annual reports. The IAASB agreed that this issue should be researched by the project team and considered further at a later date.

#### OTHER MATTERS

The IAASB also noted the following:

- There is a growing convergence with respect to measurement criteria in various jurisdictions. Nonetheless, any standard or guidance developed by the IAASB should be generic enough to cater for criteria even where they are jurisdiction-specific, as long as they are "suitable."
- The Australian Auditing and Assurance Standards Board (AUASB) had considered the project proposal prior to the IAASB meeting and strongly supports its adoption.
- The membership of the Task Force should be considered by the Steering Committee, in particular whether it should include members from outside the accounting profession, e.g., engineers, regulators and trading scheme intermediaries.
- The preliminary analysis of responses to the IAASB's draft strategy document indicates strong support for this project.

#### APPROVAL

The IAASB unanimously approved the project proposal, subject to not committing at this stage to the form of output or the timetable outlined in the proposal. The IAASB asked that the Steering Committee and the IAASB be consulted as the above issues are researched and key decision points are reached.

#### **15. PIOB Observer's Remarks**

Dr. Thomadakis expressed his apologies for not being able to attend the meeting earlier in the week due to his prior commitment to attend a PIOB meeting.

Dr. Thomadakis reported that at its meeting, the PIOB confirmed that IAASB had followed due process in finalizing ISAs 230 (Redrafted), 260 (Revised and Redrafted) and 720 (Redrafted).<sup>29</sup> He noted that 2008 would be a challenging year for the IAASB and that pressure on the IAASB would also transmit pressure on the PIOB, particularly with regard to due process confirmation for final standards. In that regard, he indicated that the PIOB had agreed to reschedule its March and June 2008 meetings to minimize the time between IAASB's approval of standards and the PIOB's confirmation that due process had been followed in their development. He emphasized the importance that PIOB attaches to IAASB's adherence to due process, given external stakeholders' need for reassurance in that respect. He highlighted the need for the IAASB to improve its coordination with the IAASB CAG, as the PIOB had recently observed some minor instances where input from the CAG had not been sought where it would have been desirable. He also recommended that IAASB reach a consensus view at the next meeting regarding the issues raised by IOSCO in its comment letter on the Related Parties re-exposure draft.

Dr. Thomadakis noted that the move to parity between practitioners and non-practitioners would be a challenge for the IAASB in 2008, and that both sides should work closely together for a unified board. He highlighted, in particular, the need for non-practitioners to strengthen their engagement in the deliberations at IAASB meetings, and for practitioners to minimize the use of jargon during the discussions.

Finally, Dr. Thomadakis introduced Ms. Susana Novoa as a new senior PIOB staff member, who will assist the PIOB in carrying out its oversight mandate.

Mr. Kellas thanked Dr. Thomadakis for his support and encouragement.

## **16. Next Meeting**

The next meeting of the IAASB has been scheduled for March 10-14, 2008 in New York.

## **17. Closing Remarks**

Mr. Kellas expressed his appreciation for the tremendous effort that all members, technical advisors and staff have put in during the year in advancing the IAASB's work. In particular, he acknowledged the high level of commitment and dedication that the retiring IAASB members and technical advisors have shown during their terms, and thanked them for their contribution. He also thanked staff of national standard setters from Germany and South Africa for their support and contribution at this meeting. Mr. Kellas closed the meeting.

<sup>29</sup> ISA 230 (Redrafted), "Audit Documentation;" ISA 260 (Revised and Redrafted), "Communication with Those Charged with Governance;" and ISA 720 (Redrafted), "The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements."