

**Minutes of the 30<sup>th</sup> Meeting of the  
INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD**

**Held on March 10-14, 2008 in New York**

**Voting Members**

Present: John Kellas (Chairman)  
Denise Esdon (Deputy Chair)  
Phil Cowperthwaite  
Craig Crawford (Mar 12 pm –  
Mar 14)  
Josef Ferlings (Mar 10 - 14 am)  
John Fogarty  
Jon Grant  
Diana Hillier  
Susan Jones  
William Kinney  
Kjell Larsson  
Caithlin McCabe  
Ian McPhee  
Marcel Pheijffer  
David Swanney  
Jianhua Tang  
Gérard Trémolière

Apologies: Abdullah Yusuf

**Technical Advisors**

Kelly Ånerud (Mr. Larsson)  
Wolfgang Böhm (Mr. Ferlings)  
Cédric Gélard (Mr. Trémolière)  
Ashif Kassam (Mr. Kinney)  
Maria Manasses (Ms. Jones)  
Richard Mifsud (Mr. McPhee)  
Daniel Montgomery (Ms. Esdon)  
Jon Rowden (Ms. Hillier)  
Tania Sergott (Ms. McCabe)  
Ali Asad Shah (Mr. Yusuf)  
Greg Shields (Mr. Cowperthwaite) (Mar 10  
pm - 14)  
Sylvia Smith (Mr. Crawford)  
Hans Verkruijsse (Mr. Pheijffer)  
Sharon Walker (Mr. Fogarty)

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**Non-Voting Observers**

Present: Norio Igarashi, Jean-Philippe Rabine, and Jennifer Rand

Apologies: David Damant

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

Present: David Brown (March 11-13)  
Susana Novoa

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**IAASB Technical Staff**

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

## 1. Opening Remarks and Minutes

### WELCOME AND INTRODUCTIONS

Mr. Kellas welcomed the new IAASB members to the meeting: Messrs. Ferlings, Grant and Tang, and Ms. McCabe. Mr. Crawford had been re-appointed. With the new appointments, parity between practitioners and non-practitioners has now been achieved on the IAASB.

Mr. Kellas welcomed Mr. Igarashi, the new observer from the Japanese Financial Services Agency, and the new technical advisors: Messrs. Böhm, Kassam, Rowden and Shah, and Ms. Sergott. He also welcomed Ms. Novoa, observing on behalf of the Public Interest Oversight Board (PIOB), and noted that Mr. Brown, PIOB member, would join the meeting the following day.

Apologies were received from Messrs. Crawford (for partial absence), Damant (Chairman of the IAASB Consultative Advisory Group (CAG)), and Yusuf.

Mr. Kellas indicated that Messrs. Agulhas (from the South African Independent Regulatory Board for Auditors), Böhm (from the Institut der Wirtschaftsprüfer), and Mifsud (from the Australian Auditing and Assurance Standards Board), and Ms. Walker (from the American Institute of Certified Public Accountants' Auditing Standards Board) would be providing drafting support for a number of items on the agenda.

Mr. Kellas reminded all IAASB members of their responsibility to act in the public interest. He also reminded the technical advisors of their role in providing support to their respective members.

Mr. Kellas noted that ISA 540 (Revised and Redrafted)<sup>1</sup> was issued as a final standard in February 2008 after the PIOB had fast-tracked its review and approval of the due process applied. The PIOB's review of due process for ISAs 560 (Redrafted) and 580 (Revised and Redrafted) has been scheduled for the March 2008 PIOB meeting. To facilitate access to the version of a standard approved by IAASB but awaiting PIOB review of due process, staff now posts on the IAASB website<sup>2</sup> the IAASB-approved version of the final standard as an updated agenda item, pending confirmation of due process from the PIOB.

Mr. Kellas noted that the International Organization of Securities Commissions (IOSCO) had issued a statement on February 6, 2008 urging publicly traded companies to provide investors with clear and accurate information on the accounting standards used in the preparation of their accounts. IOSCO has been concerned that, with the convergence of global accounting standards, investors may assume that all company accounts are generally comparable, even when these are prepared in accordance with quite different financial reporting frameworks. This situation commonly arises when national standards assert that they are based on but do not fully implement IFRS. IOSCO's view is similar to the position taken by the International Accounting Standards Board on this issue.

Mr. Kellas noted that Ms. Jessie Wong will join IFAC as a new staff member at the end of March 2008 to support the IAASB. She will share her time with the International Ethics Standards Board for

<sup>1</sup> ISA 540 (Revised and Redrafted), "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures."

<sup>2</sup> IAASB-approved standards are posted under the "Meeting Material – Updated Agenda Items" section of the meeting at which the standard is approved.

Accountants. Mr. Kellas indicated that Ms. Daria Koukhar had transferred within IFAC to support the Compliance Advisory Panel, and he thanked her for her contribution to the IAASB.

Finally, Mr. Kellas reported that the 2007 IAASB annual report and 2008 Handbook had been finalized and are available for download from the IAASB website.

#### MINUTES OF PREVIOUS MEETING

In relation to the matter of consultations on the ISAE 3402<sup>3</sup> project, Mr. Kellas reported that efforts were being made to reach out to service organizations. In addition, individual IAASB members had been asked to assist in this process.

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

## 2. Related Parties

Mr. Trémolière introduced the topic, noting that the CAG had discussed the project earlier in March 2008. He reported that the CAG working group for Related Parties was supportive of how the Task Force had addressed its previous comments, and that it saw no need for re-exposure.

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.

#### RELATED PARTY DEFINITION

In relation to the Task Force's proposed qualifier that an entity that is under common control with the reporting entity be deemed to be related *provided that* both entities have engaged in significant transactions or shared resources to a significant extent with one another, it was noted that this would unreasonably preclude the auditor from giving consideration to the existence of such an entity before it has entered into any transaction with the reporting entity. It was argued that without the auditor making the appropriate initial inquiries, the auditor would not be able to establish the appropriate universe of related parties for the audit work. Other IAASB members shared a similar view, noting that it is the conceptual relationship that matters for the purposes of the definition. In addition, it was pointed out that there could be inconsistency arising from the proposed approach as the auditor might treat an entity under common control as a related party in one period if it has entered into significant transactions with the reporting entity, but not in a subsequent period if there have been no such transactions.

After further deliberations, the IAASB agreed that the proposed qualifier should be deleted from the common control part of the definition. Nevertheless, the IAASB agreed that the proposed ISA should explain in the application material that in the particular case of common control relationships, as management is more likely to be aware of such relationships if they have economic significance to the entity, the auditor's inquiries are likely to be more effective if they are focused on whether parties with which the entity engages into significant transactions, or shares resources to a significant degree, are related parties. The IAASB also agreed the following:

<sup>3</sup> Proposed ISAE 3402, "Assurance Reports on Controls at a Third Party Service Organization."

- The related party definition would be clearer if it were to state firstly that a related party is as defined in the applicable financial reporting framework, and then specify the principles-based definition that should apply if the framework establishes minimal or no related party requirements.
- Entities that are under common control by a state should not be considered related unless they engage in significant transactions or share resources to a significant extent with one another.

#### OTHER MATTERS

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

- In relation to the introductory material dealing with inherent limitations, the proposed ISA should clarify that it is the *potential effects* of inherent limitations on the auditor's ability to detect material misstatements that are greater in the context of related parties, instead of the inherent limitations themselves.
- The proposed ISA should indicate that as part of the ISA 330 (Redrafted)<sup>4</sup> requirement that the auditor respond to assessed risks, the auditor designs and performs further audit procedures *to obtain sufficient appropriate audit evidence about* the assessed risks of material misstatement associated with related party relationships and transactions, in order to better support the objective for the auditor to obtain sufficient appropriate audit evidence about whether related party relationships and transactions have been appropriately identified, accounted for and disclosed in the financial statements in accordance with the framework.
- The requirement for the auditor to inquire of management regarding the identity of the entity's related parties should include a requirement to inquire about changes from the prior period. In addition, the guidance for this requirement should explain that for recurring engagements, making such inquiries provides a basis for comparing the information supplied by management with the auditor's record of related parties noted in previous audits.
- The requirement to inspect records or documents for indications of the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor should include *such other records or documents as the auditor considers necessary in the circumstances of the entity*. In addition, the proposed ISA should require the auditor to remain alert during the audit, *when inspecting records or documents*, for arrangements or other information that may indicate the existence of previously unidentified or undisclosed related party relationships or transactions.
- The requirement for the auditor to consider the implications for the audit, including the auditor's report, if management refuses to delete or modify an arm's length assertion for which the auditor has been unable to obtain sufficient appropriate audit evidence, should be deleted, as it is unnecessary given that the auditor should be allowed to determine the most appropriate course of action in the circumstances.
- The illustrative guidance relating to when the financial statements can be misleading in the context of a compliance framework should be clarified to indicate that even if non-disclosure of related party transactions in the financial statements is in compliance with the framework and

<sup>4</sup> ISA 330 (Redrafted), "The Auditor's Responses to Assessed Risks."

applicable law or regulation, the financial statements could still be misleading if the entity derives a very substantial portion of its revenue from transactions with related parties, and that fact is not disclosed.

- The guidance explaining the inter-relationship between related parties and dominant influence should be clarified to indicate that related parties, by virtue of their ability to exert control or significant influence, may be in a position to exert dominant influence over the entity or its management. It should also emphasize that consideration of such behavior is relevant when identifying and assessing the risks of material misstatement due to fraud.
- In relation to the issue of special-purpose entities (SPEs), there should be a conforming amendment to paragraph 11(b)(iii) of ISA 315 (Redrafted)<sup>5</sup> to require the auditor to obtain an understanding of the types of investments that the entity is making and plans to make, *including investments in special-purpose entities*. In addition, the proposed guidance explaining the nature of an SPE should be moved to ISA 315 (Redrafted) to support this conforming amendment. Finally, to highlight the relevance of the issue of SPEs in the context of related parties, the application material in the proposed ISA should explain that in some circumstances, an SPE may be a related party of the entity because the entity may in substance control it, even if the entity owns little or none of the SPE's equity.
- The guidance addressing matters that may be discussed among the engagement team should include, among the list of suggested items, the records or documents that may indicate the existence of related party relationships or transactions.
- The proposed guidance addressing the nature of the risks of material misstatement associated with related party relationships and transactions should be deleted as it is unnecessary and could potentially cause confusion.

#### APPROVAL

After agreeing all necessary changes to the draft, the IAASB discussed whether there was a need to re-expose the proposed ISA. The IAASB agreed that the changes made to the exposure draft were in response to the comments received from respondents, and accordingly, re-exposure was unnecessary. Mr. Sylph advised the IAASB that it had adhered to its stated due process in finalizing the ISA. The IAASB unanimously approved proposed ISA 550 (Revised and Redrafted) as a final ISA, and the proposed conforming amendments to ISA 315 (Redrafted). 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. Kellas noted that as a procedural matter, the IAASB will undertake at the December 2008 meeting an overall review of all conforming amendments arising from this and other ISA revision or redrafting projects to ensure that all these conforming amendments are consistent.

<sup>5</sup> ISA 315 (Redrafted), "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment."

### 3. Going Concern

Ms. Esdon introduced the revised draft of the proposed ISA 570 (Redrafted).<sup>6</sup> She noted that the Task Force received comments from the IFAC Small and Medium Practices (SMP) Committee, which expressed general satisfaction with the revised draft. She also noted that the CAG discussed the topic at its March 2008 meeting with no significant concerns being raised.

She noted that comments from respondents to Exposure Draft (ED)-ISA 570 that went beyond the application of the clarity drafting conventions have not been accepted by the Task Force as they would constitute a revision of the ISA. These have been noted for future consideration by the IAASB.

Ms. Esdon led a review of the proposed ISA, drawing the IAASB's attention to significant comments received on exposure. Except as noted in the following, the IAASB considered and agreed the recommendations of the Task Force in addressing the comments received on ED-ISA 570.

#### MANAGEMENT AND AUDITOR RESPONSIBILITIES

The view was expressed that some of the material in the Introduction section on the auditor's responsibilities, in particular the material relating to inherent limitations, may suggest a disclaimer of responsibility. It was suggested that any discussion of auditor responsibilities would be better placed in proposed ISA 200 (Revised and Redrafted).<sup>7</sup> Ms. Esdon noted that the material is consistent with the extant ISA and that it provides relevant context to the requirements of the ISA. It was agreed that the material on inherent limitations should be retained in the ISA with a cross reference from proposed ISA 200 (Revised and Redrafted) so as not to suggest that new inherent limitations are being introduced.

The IAASB also agreed that the discussion in the Introduction section to management's responsibilities should be made in the context of its responsibility for the preparation and presentation of the financial statements. This makes clear that the ISA is not setting out specific responsibilities of management in connection with the assessment of the entity's ability to continue as a going concern, particularly in the absence of a requirement to do so in the applicable financial reporting framework.

#### OBJECTIVES

Some IAASB members felt that the proposed objectives were too procedural and not sufficiently concise and outcome-oriented. Other IAASB members, however, were of the view that making the objectives too outcome-oriented results in them being insufficiently specific to establish what is expected of the auditor. In addition, there could be a lack of linkage between the objectives and the requirements.

Some IAASB members were unsure whether the objective to obtain sufficient appropriate audit evidence was appropriate in the context of the going concern assumption, and whether there was any difference in evidence between the circumstances where it was appropriate to use the assumption and

<sup>6</sup> Proposed ISA 570 (Redrafted), "Going Concern."

<sup>7</sup> Proposed ISA 200 (Revised and Redrafted), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with ISAs."

those where there was material uncertainty. Others IAASB members, however, were of the view that the proposed objectives are consistent with the substance of the extant ISA.

After further consideration, IAASB agreed that the objectives as proposed are appropriate and consistent with the extant ISA, that they express valid expected outcomes, and are consistent with how objectives in others ISAs are drafted.

#### MANAGEMENT'S ASSESSMENT

The IAASB requested clarification on the relationship of the requirements addressing management's assessment of the entity's ability to continue as a going concern, in particular the risk assessment procedures, the evaluation of management's assessment, and the additional audit procedures when events or conditions are identified that may cast doubt on the entity's ability to continue as a going concern and whether management had to have carried out its assessment when the auditor performed the risk assessment procedures. The IAASB agreed that the ISA should refer to management's *preliminary assessment* in relation to the auditor's risk assessment procedures, as it is how this assessment is referred to in the extant ISA. This would also draw a better distinction between the requirements and make clear the fact that management may not have completed its assessment at the time the auditor performs the risks assessment procedures.

#### FEASIBILITY OF MANAGEMENT'S PLANS FOR FUTURE ACTIONS

The IAASB questioned whether it is appropriate to require the auditor to obtain sufficient appropriate audit evidence about whether management's plans for future actions are feasible. The IAASB concluded that it is not appropriate as part of the redrafting exercise to elaborate on what the necessary procedures might be or what may constitute sufficient appropriate audit evidence in this regard. However, the IAASB agreed that it would be appropriate to include the auditor's consideration of the feasibility of management's plans as part of the auditor's evaluation of management's plans in general.

#### CIRCUMSTANCES WHERE MANAGEMENT IS UNWILLING TO MAKE OR EXTEND ITS ASSESSMENT

The IAASB noted that the requirement assumed that management's unwillingness to make or extend its assessment would always result in a limitation on the scope of the audit. There may be situations however where the auditor may be able to obtain sufficient appropriate audit evidence by other means. The requirement was revised to a consideration of the implications for the auditor's report, with conforming changes to the application material.

#### OTHER MATTERS

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

- To reposition material presented as essential explanation of the requirements in paragraphs 12 and 15 to the application material section of the ISA.
- To reposition substantive text in footnote 1 and 3 to the application material section of the ISA.

In addition to those identified in the Task Force's issues paper, the IAASB noted a number of considerations that may be relevant to a future revision of ISA 570 (Redrafted):

- Whether there is a need to explain the meaning of "significant delay" in respect of the approval of the financial statements by management.

- Whether there is a need to provide illustrative wording for financial statement disclosure in circumstance where there is a material uncertainty.
- Whether there is a need for additional guidance regarding the auditor's consideration of the feasibility of management's plans for future actions.

#### APPROVAL

The IAASB agreed that the changes made to ED-ISA 570 were in response to the comments received on exposure and that the changes did not warrant re-exposure. Mr. Sylph advised the IAASB that it had adhered to its stated due process in finalizing the ISA. 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.

#### 4. Laws and Regulations

Mr. McPhee introduced the revised draft of the proposed ISA 250 (Redrafted).<sup>8</sup> He noted that the Task Force received comments from the SMP Committee and that the CAG discussed the topic at its March meeting. Mr. McPhee then led a review of the proposed ISA, drawing the IAASB's attention to significant comments received on exposure and comments received from the CAG and SMP Committee.

Except as noted in the following, the IAASB considered and agreed the recommendations of the Task Force in addressing the comments received on Exposure Draft (ED)-ISA 250.

#### CATEGORIES OF LAWS AND REGULATIONS

Some IAASB members were of the view that how the ISA describes the different categories of laws and regulations is unclear, partly due to inconsistency in wording within the ISA. It was also noted that different interpretations exist regarding the types of laws and regulation that might be considered to have a 'direct' or an 'indirect' effect on the financial statements and, accordingly, to which category they relate. After further deliberation, the IAASB agreed editorial changes that clarify and align the wording within the ISA, and to repeat relevant text where appropriate to ensure there is no misunderstanding about which category is being referred to. In addition, the IAASB agreed to clarify the distinction between 'direct' and 'indirect' by specifying the differing responsibilities of the auditor for each of the two categories of laws and regulations.

The IAASB also agreed to further clarify the distinction between the two categories by explaining in the application material that even though non compliance with 'other laws and regulations' may result in fines, litigation or other consequences for the entity which need to be provided for in the financial statements, such laws and regulations are not considered to have a direct effect on the financial statements.

#### MANAGEMENT AND AUDITOR RESPONSIBILITIES

The IAASB noted concern by some respondents that references in ED-ISA 250 regarding management's responsibility for the detection of non-compliance with laws and regulations were too

<sup>8</sup> Proposed ISA 250 (Redrafted), "Consideration of Laws and Regulations in an Audit of Financial Statements."

onerous. The IAASB concluded that it would be inappropriate to suggest that management is capable of detecting all instances of non-compliance and, accordingly, agreed to delete the statement that management is responsible for systems designed to prevent, or detect and correct, non-compliance with laws and regulations. The IAASB noted that the responsibilities of management are adequately described in the ISA in relation to ensuring that the entity's operations are conducted in accordance with laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements.

The view was expressed that some of the material in the Introduction section on the auditor's responsibilities, in particular the statement that the auditor cannot be expected to detect non-compliance with all laws and regulations and the material relating to inherent limitations, may suggest a disclaimer of responsibility. It was suggested that any discussion of auditor responsibilities would be better placed in proposed ISA 200 (Revised and Redrafted).<sup>7</sup> Mr. McPhee noted that the material is consistent with the extant ISA and that it provides relevant context to the requirements of the ISA. It was agreed that the material on inherent limitations should be retained in the ISAs with a cross reference from proposed ISA 200 (Revised and Redrafted) so as not to suggest that new inherent limitation are being introduced.

#### OBJECTIVES

Mr. McPhee noted that several respondents to ED-ISA 250 were concerned that the objectives were too procedural and not sufficiently outcome-oriented. The IAASB acknowledged that it is desirable for objectives to be expressed in terms of 'outcomes.' However, it concluded that such an approach would not be appropriate in the case of ISA 250. The nature of the auditor's responsibilities with respect to other laws and regulations is such that more specificity in the objective is required to ensure a close linkage with the requirements of ISA 250, thereby making clear precisely what is expected of the auditor.

The IAASB observed that the first objective (paragraph 8(a)) was expressed in the negative. Several members were of the view that the objective should be expressed in a positive form. Other members, however, were of the view that doing so would focus the auditor's efforts on compliance auditing rather than on addressing risks of material misstatement. After further deliberation, the IAASB concluded that there should be a positive obligation on the auditor to obtain sufficient appropriate audit evidence regarding compliance with provisions of those laws and regulation generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements. The IAASB noted that this treatment is consistent with the extant ISA.

The Task Force noted that some concern was expressed that the second objective (paragraph 8(b)) implied that the auditor would be required to identify all instances of non-compliance with other laws and regulations that may have a material effect on the financial statements. It was suggested that this objective could be restricted by requiring the auditor to identify only those instances of non-compliance with other laws and regulations 'that are known to the entity'. On reviewing this suggestion, the IAASB concluded that the inclusion of the phrase, 'that are known to the entity', would not in fact deal with the concern and may have the unintended effect of restricting the scope of the auditor's consideration, thereby changing the approach under extant ISA 250. Accordingly, the IAASB agreed to retain the wording proposed in ED-ISA 250.

## OTHER MATTERS

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

- To clarify that the guidance addressing the policies and procedures that may assist the entity in the prevention and detection of non-compliance with laws and regulations represents examples of the type that may be implemented.
- To broaden the scope of the guidance addressing circumstances where withdrawal from the engagement is prohibited to include all financial statement audit engagements, as it is relevant to more than audits of public sector entities only.

## APPROVAL

The IAASB agreed that the changes made to ED-ISA 250 were in response to the comments received on exposure and that the changes did not warrant re-exposure. Mr. Sylph advised the IAASB that it had adhered to its stated due process in finalizing the ISA. 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.

## 5. Materiality and Misstatements

Ms. Esdon introduced the Summary of Significant Comments and Task Force Recommendations, and proposed final ISAs 320 (Revised and Redrafted)<sup>9</sup> and 450 (Revised and Redrafted).<sup>10</sup> She noted that the CAG Representatives did not have comments on the matters highlighted for their consideration at the March 3-4, 2008 meeting. She also noted that the Task Force received input from the SMP Committee and some IAASB members in advance of the meeting.

Except as noted in the following, the IAASB agreed the recommendations of the Task Force.

### *ISA 320 (Revised and Redrafted)*

- It was questioned whether the reference to “the auditor’s responsibility” in the Scope of this ISA paragraph is appropriate. Staff confirmed that the paragraph is in line with the IAASB’s drafting conventions. The IAASB agreed not to amend the paragraph.
- A few IAASB members were concerned that the reference to the fact that “judgments about materiality are made in relation to the relevant financial reporting period” in the description of materiality may be read as an attempt to address materiality in the context of interim financial information. The IAASB concluded that the matter is explained sufficiently in the Application and Other Explanatory Material section. The IAASB agreed that the reference should be deleted.
- It was questioned whether the text “... this ISA is written on the basis that users ...” may be interpreted as saying that the ISA does not apply when users do not have the described characteristics, which may be the case in an SME. The IAASB agreed that the exposure draft wording should be reinstated, i.e., “... it is reasonable for the auditor to assume that users ...”

<sup>9</sup> Proposed ISA 320 (Revised and Redrafted), “Materiality in Planning and Performing an Audit.”

<sup>10</sup> Proposed ISA 450 (Revised and Redrafted), “Evaluation of Misstatements Identified during the Audit.”

- The view was expressed that some of the text in the Introduction section could be moved to the Application and Other Explanatory Material section. Ms. Esdon explained that the text was carefully drafted in finalizing the close off document of ISA 320 (Revised), and that the responses to the exposure draft of the proposed redrafted ISA did not contain similar views. An IAASB member noted that other clarity redrafted ISAs contain similar introductory material. Another explained that the material provides context to the requirements that follow. The IAASB agreed not to move the text.
- It was noted that the Objective refers to "... apply materiality ...," while the requirements also address the determination of materiality. Ms. Esdon was of the view that the determination of materiality is a subset of its application. To clarify the matter, the IAASB agreed that the Objective should be amended to refer to "... the concept of materiality ..."
- The IAASB debated the proposed definitions of "materiality" and "operational materiality." The IAASB agreed that:
  - The proposed definition of "materiality" should be deleted, as it is not a definition of the term, but rather an indication of what the term refers to. The phrase "materiality for the financial statements as a whole" (as opposed to "materiality") should be used in the body of the ISA.
  - Staff should consider the effect of the deletion of the extant definition of "materiality" from the Glossary of Terms, as the term is used in other ISAs. The term will be deleted as the revised and redrafted ISA provides a description of materiality, while the extant ISA contains a definition.
  - The term "operational materiality" should be replaced with "performance materiality." The definition should clarify that it is an amount *or amounts* set at less than materiality for the financial statements as whole and, *if applicable, it may also refer to the amount or amounts set at less than the materiality level or levels for particular classes of transactions, account balances or disclosures.*
- The IAASB debated whether the requirement to determine materiality for particular classes of transactions, account balances or disclosures in the described circumstances should be moved to the Application and Other Explanatory Material section. The IAASB agreed that the requirement should be retained; however, it should be presented in the same paragraph as the requirement to determine materiality for the financial statements as a whole, and redrafted so as to clearly indicate that it is conditional. The requirements and guidance in the ISA should be redrafted to indicate that they apply to the materiality level or levels for particular classes of transactions, account balances or disclosures.
- The IAASB agreed that the Considerations Specific to Public Sector Entities in paragraphs A1 and A3 should be combined as they are similar.
- The IAASB agreed that "revenue" should be added to the elements of the financial statements under the factors that may affect the identification of an appropriate benchmark.
- An IAASB member noted that the example in the guidance on operational materiality may not be correct. The example stated that, for an entity with a history of large or numerous misstatements accumulated in previous audits, operational materiality would be lower than if such

misstatements were not present. He was of the view that operational materiality is unaffected by prior period misstatements; however, the amount of work the auditor performs is affected. Others were of the view that operational materiality is affected not only by the prior year misstatements but by the auditor's expectation of misstatements in the current period. The IAASB agreed to clarify this point and to delete the example.

- An IAASB member questioned whether the ISA provides, or should provide, for the allocation of materiality. If this is the case, it should be made clear.
- Staff was requested to consider any conforming amendments to other ISAs that may arise as a result of the amendments to the ISA.

#### *ISA 450 (Revised and Redrafted)*

- The IAASB agreed that the Task Force responsible for proposed ISA 700 (Redrafted)<sup>11</sup> should consider the limited comments received on the paragraphs in the exposure draft of proposed ISA 450 (Revised and Redrafted) that were moved to proposed ISA 700 (Redrafted).
- The IAASB agreed that the definition of "error" should be deleted as the term is not used in the ISA.
- Paragraph 9 stated that, if management refuses to correct some or all of the misstatements communicated by the auditor, the auditor shall obtain an understanding of management's reasons for not making the corrections and shall take that understanding into account when evaluating, in accordance with [proposed] ISA 700 (Redrafted), whether the financial statements as a whole are free from material misstatement. An IAASB member noted that respondents to the exposure draft were concerned that this requirement may be weak, as it may be read as implying that management's reasons could change the auditor's conclusion about the financial statements. Ms. Esdon explained that management's reasons may affect the auditor's consideration of indicators of bias in management's judgments. The IAASB agreed that this should be explained in the Application and Other Explanatory Material section.
- The IAASB agreed that the documentation requirement should be described in a manner similar to that in other redrafted ISAs.
- The IAASB agreed that the requirement for the auditor to document "the auditor's conclusion as to whether uncorrected misstatements ... cause the financial statements as a whole to be materially misstated ..." should be deleted as that conclusion forms part of proposed ISA 700 (Redrafted). The related application material was amended accordingly.
- An IAASB member was of the view that the examples of misstatements in paragraph A1 focus on misstatement arising from errors. The IAASB agreed that the paragraph should indicate that examples of misstatements arising from fraud are provided in ISA 240 (Redrafted).<sup>12</sup>
- The IAASB agreed that text presented in footnotes other than references to other ISAs should be moved to the Application and Other Explanatory Material section.

<sup>11</sup> Proposed ISA 700 (Redrafted), "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements."

<sup>12</sup> ISA 240 (Redrafted), "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements," paragraphs A1-A6.

WAY FORWARD The IAASB agreed the majority of changes to the text proposed by the Task Force in response to the discussion. However, because of the need to clarify a matter related to performance materiality, the proposed final ISAs will be submitted for approval at the June 2008 IAASB meeting. It was agreed that revised drafts should be circulated to the IAASB for review in advance of that meeting.

## 6. Opening Balances

Ms. Hillier introduced the topic, noting that the SMP committee had commented that it was satisfied with the revised draft of the proposed ISA. She also noted that one respondent, IOSCO, had submitted its comment letter after the Task Force had finalized the agenda papers for the meeting. She indicated that she would highlight significant comments raised by IOSCO during the discussion, and asked the IAASB to consider the letter prior to finalizing the proposed ISA. Finally, she noted that the CAG had discussed the project earlier in March 2008 and that the comments made at the meeting were similar to comments received from IOSCO.

Ms. Hillier 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.

### PROCEDURES TO OBTAIN SUFFICIENT APPROPRIATE AUDIT EVIDENCE ABOUT OPENING BALANCES

Ms. Hillier noted that a number of comments had been received on the requirement defining the auditor's work effort. For example, some had suggested moving the sub-points to application material. However, the Task Force believed that it was necessary to perform one or more of the procedures in order to obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements. Thus, the Task Force proposed that the requirement should include the auditor performing one or more of the following:

- (i) Review the predecessor auditor's working papers to obtain information relevant to the current period's financial statements and evaluate whether further audit evidence may need to be obtained in order to obtain sufficient appropriate evidence regarding the current period's financial statements;
- (ii) Evaluate whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
- (iii) Perform specific audit procedures to obtain evidence regarding the opening balances.

An IAASB member suggested that the structure of the requirement should be reconsidered as it seemed more logical that the auditor should first undertake procedure (i), and *if that does not work*, then procedure (ii), and finally procedure (iii), as opposed to the auditor performing any one or more of procedures (i) to (iii). It was, however, noted the auditor may not be able to obtain access to the predecessor auditor's working papers in all circumstances. Another member suggested that the auditor should first attempt to perform procedures (i) and (ii) (as the extant ISA seemed to suggest), and if these do not yield sufficient appropriate audit evidence, then procedure (iii). IOSCO had recommended that it could be made explicit that, if the previous year's financial statements had not been audited, (iii) would be necessary. However, it was argued that the ISA should be neutral in

terms of approach in this context, as the order of the procedures should not matter given that the most important consideration for the auditor is to obtain sufficient appropriate audit evidence.

After further deliberation, the IAASB concluded that no change should be made to the approach set out in the proposed ISA. The IAASB, however, agreed that the indicated purpose of the review in procedure (i) (i.e. “to obtain information relevant to the current period’s financial statements and evaluate ...”) should be deleted as this dealt with matters beyond opening balances.

Ms. Hillier noted that IOSCO had recommended including a required procedure that the auditor should read the most recent financial statements, if any, and the auditor’s report thereon, if any, as they may provide relevant information relating to the opening balances, including disclosures. The IAASB agreed to include this suggested change. It was noted, however, that this procedure should not be limited to audit reports but should also include review reports as the previous financial statements may only have been subject to a review and not an audit.

#### OTHER MATTERS

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

- The scope paragraph should indicate that ISA 300 (Redrafted)<sup>13</sup> includes additional requirements and guidance regarding activities prior to starting an initial audit, as had been suggested by IOSCO.
- In relation to the requirement to evaluate relevant information in the predecessor auditor’s report, the reference to an Emphasis of Matter paragraph or an Other Matter(s) paragraph should be deleted as it is modifications to the auditor’s opinion that would influence the auditor’s risk assessments.
- In relation to the guidance illustrating the factors that affect the nature and extent of audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances, the reference to the materiality of the opening balances should be changed to the *significance* of the opening balances, as opening balances may include disclosures.
- In relation to the guidance addressing audit evidence that may be obtained for non-current assets and liabilities, the proposed ISA should clarify that in certain cases, the auditor may be able to obtain *some audit evidence regarding opening balances* through confirmation with third parties (as had been suggested by IOSCO).
- In relation to guidance addressing a split opinion when the auditor is unable to obtain sufficient appropriate audit evidence regarding opening balances, the proposed ISA should clarify that *unless prohibited by law or regulation*, the auditor may issue an opinion which is qualified or disclaimed, as appropriate, regarding the results of operations, *and cash flows, where relevant*, and unmodified regarding financial position.
- The proposed ISA should include illustrative auditor’s reports for jurisdictions where law and regulations prohibit a split opinion and those where it is not prohibited when the auditor is unable to obtain sufficient appropriate audit evidence regarding opening balances.

<sup>13</sup> ISA 300 (Redrafted), “Planning an Audit of Financial Statements.”

## APPROVAL

After agreeing all necessary changes to the draft, the IAASB discussed whether there was a need to re-expose the proposed ISA. The IAASB agreed that the changes made to the exposure draft were in response to the comments received from respondents, and accordingly, re-exposure was unnecessary. Mr. Sylph advised the IAASB that it had adhered to its stated due process in finalizing the ISA. The IAASB unanimously approved proposed ISA 510 (Redrafted)<sup>14</sup> as a final ISA. 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.

## 7. IAASB Strategy and Work Program

Mr. Kellas introduced the topic, noting that the strategy as presented to the IAASB is based on the consultation paper<sup>15</sup> issued by the IAASB in October 2007. The proposed work program is drawn from the strategy and, as noted in the documents, each particular project will be supported by a detailed project proposal to be approved by the IAASB.

The work program will be presented to the PIOB. Having reviewed the work program, the PIOB can request the IAASB to add additional items to the work program and indicate the priority for such projects.

The CAG discussed the proposed strategy and work program at their March meeting. Areas on which their input was expressly sought included: the extent to which to revise certain ISAs that had not been revised during the Clarity project, the proposed post-implementation review; implementation guidance, including fair value auditing guidance; alternative assurance services for SMEs; and the development of a conceptual framework. The views expressed by the CAG are included in the individual sections where applicable.

### OVERALL VIEWS OF THE TONE OF THE STRATEGY

An IAASB member suggested that the topic of audit quality could be dealt with earlier in the strategy rather than as a component of the IAASB's Communication plan. Mr. Kellas noted that IOSCO and the EC had commented on the importance of audit quality in forming their views as to whether the IAASB should focus more on auditing standards at the expense of other topics. In his view, the phrase "audit quality" is used without much explanation. Some jurisdictions have done work in this area to try to establish a common definition of audit quality and perhaps there is a communication that could be prepared by the IAASB to build on the work of others and indicate what its view of audit quality is, while indicating that audit quality relates to more than just compliance with standards.

An IAASB member questioned whether the strategy as presented was ambitious enough – in particular, whether the IAASB should set out its longer-term strategy. This IAASB member was supported by another, who noted the points raised by IOSCO and the EC that ISAs should remain the priority of the IAASB. It is unclear whether the strategy indicates that the IAASB has sufficient direction to clearly understand its priorities and priority areas. In her view, the success of the Clarity

<sup>14</sup> ISA 510 (Redrafted), "Initial Audit Engagements—Opening Balances."

<sup>15</sup> Consultation Paper, "Proposed Strategy for 2009-2011."

project is critical to the IAASB's success, and it may be that attention needs to shift away from projects and move more towards discussing and facilitating adoption and implementation of the ISAs and convergence. This could be more defined in the proposed strategy as critical success factors.

Mr. Kellas' view was that the objective of the IAASB is fairly clearly set out within the proposed strategy, and to go beyond what has been said with regard to convergence may result in specifying things that are beyond the control of the IAASB. While he supported the IOSCO view that some focus should be on adoption by jurisdictions and the barriers to this, he believes that including more specificity, in particular on timing, may only serve to create potentially unachievable goals.

Another IAASB member noted that, in his particular jurisdiction, the view is that the IAASB has spent enough time developing standards and should now work with audit oversight bodies to see how the ISAs are being implemented. This IAASB member also stressed that more needs to be done in the areas of education and training. It was also suggested that SMPs may struggle with quality in implementation of the ISAs, and capacity building is important for global acceptance – which may be a role for IFAC rather than the IAASB.

Members discussed how the IAASB would monitor the adoption and implementation of ISAs. An IAASB member was of the view that the IAASB should commit itself to doing a self-assessment of the Clarity project in two years' time. Another IAASB member was unsure of how quickly the IAASB could conduct any implementation reviews in the shorter term. His view was that this would not be possible until the full set of clarified ISAs had been in effect for at least two years. Another view was that implementation reviews designed to contribute to the effectiveness of the ISAs need not await the implementation of the clarified standards; for example, much could be done on the implementations of standards revised over the past few years.

The IAASB was reminded of its Terms of Reference and some IAASB members acknowledged that in light of this, as well as the limited resources, the IAASB should aim to be as sharp as possible in its focus to respond to the needs in the public interest. The IAASB was encouraged to liaise with others in order to keep within its mandate while continuing to support the adoption and implementation of the ISAs. This is particularly true in the areas of education and training, and pertains to relationship with those in the profession, including national audit standard setters and member bodies.

The IAASB briefly discussed the role of the Compliance Advisory Panel within IFAC as a useful resource in identifying the barriers to implementation of the ISAs. The draft strategy acknowledges that more feedback is needed from individual jurisdictions to identify impediments to adoption and implementation issues, and the IAASB supported the notion of more frequent communication and interaction with professional bodies, jurisdictions, national audit standard setters, and audit oversight bodies.

#### REVISION OF ISA 610<sup>16</sup> AND ISA 720<sup>17</sup>

The CAG had discussed whether the IAASB should be revising all the ISAs that had not been revised during the Clarity project. While there was some support for this to be done over time, the

<sup>16</sup> Proposed ISA 610 (Redrafted), "Using the Work of Internal Auditors."

<sup>17</sup> ISA 720 (Redrafted), "The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements."

CAG was of the view it would be more appropriate to consider whether revisions were necessary to ISA 210,<sup>18</sup> ISA 250,<sup>8</sup> ISA 510<sup>14</sup> and ISA 710.<sup>19</sup> It was suggested by an IAASB member that, for any revisions, the IAASB should seek to gather views on how a particular standard should be improved directly from regulatory monitoring agencies and practitioners.

#### RESEARCH ON ISA 700<sup>20</sup>

Work is being undertaken by the UK's Auditing Practices Board to look at possible revisions to the wording and content of the audit report. The CFA Institute has also undertaken work in this area as well, and intends to make their report available to the IAASB and the CAG. The Committee of European Securities Regulators has also issued a report on audit communications, with the conclusion that communications may need to improve, and the suggestion that others do additional work in this area. In addition, it seems that some jurisdictions appear to be reluctant to adopt the latest version of ISA 700 because of concern over the required wording of the audit report. As a result, this project has been given a high priority on the IAASB's proposed agenda.

#### NEW TECHNOLOGIES

The IAASB acknowledged that XBRL is receiving more regulatory support and something may need to be done to develop guidance for auditors in this area. An IAASB member noted that it may be appropriate to give some guidance on the nature of evidence in a more electronic world.

#### PROFESSIONAL JUDGMENT

Another topic for further exploration is professional judgment. It was noted that the Committee on Improvements to Financial Reporting (CIFIIR) recently issued a proposal relating to accounting judgments which had been discussed at a recent PCAOB Standing Advisory Group meeting. While proposed ISA 200 (Revised and Redrafted)<sup>7</sup> addresses professional judgment, it may be that more guidance could be developed. An IAASB member suggested that topics of this nature could benefit from the use of thought leadership papers issued by the IAASB. Mr. Kellas noted that other bodies have done a significant amount of work in this area, and the IAASB could seek to improve its means of communicating what has been done by national auditing standard setters.

#### PROSPECTUSES

The IAASB discussed the proposal to develop an assurance standard on pro forma financial information as a separate agenda topic.

#### REVISION TO ISAE 3000<sup>21</sup>

Mr. Kellas noted this topic was not included in the original consultation document. However, in working on proposed ISAE 3402,<sup>2</sup> the IAASB has had to deal with certain matters (such as documentation) that are common to all assurance engagements. The question remains whether the IAASB should revise ISAE 3000 to expand upon such topics or, alternatively, supplement ISAE

<sup>18</sup> Proposed ISA 210 (Redrafted), "Agreeing the Terms of Audit Engagements."

<sup>19</sup> Proposed ISA 710 (Redrafted), "Comparative Information—Corresponding Figures and Comparative Financial Statements."

<sup>20</sup> ISA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements."

<sup>21</sup> ISAE 3000, "Assurance Engagements Other than Audits or Reviews of Historical Financial Information."

3000 so that there is no need to duplicate guidance when issuing ISAEs on specific types of assurance engagement.

An IAASB member noted that revisions to ISAE 3000 were preferable to developing new assurance standards, as it would be difficult for the IAASB to satisfy itself on the global demand for specific standards. This approach would make ISAE 3000 more usable in specific instances. Another IAASB member suggested that it may be possible for the IAASB to develop more guidance on the form of reports issued under ISAE 3000 in particular circumstances. Further guidance could also be issued within ISAE 3000 about the suitability of criteria and the nature of evidence.

The IAASB also discussed whether there was a need for guidance for auditors reporting on internal control. The IAASB members had mixed views as to whether this was necessary; some cited regulators calling for this type of assurance, while others noted there may be specific legal requirements for the auditor to do so. There is also a demand in the public sector for compliance reporting. Those who cautioned against developing something noted that it would be important for the IAASB to assess the demand before embarking on a project that would be difficult and time consuming. An IAASB member suggested that more work could be done in the area of shared service centers, including reporting on controls as well as the evidence considerations when an entity uses a shared service center.

#### IMPLEMENTATION GUIDANCE

Mr. Kellas noted that the CAG discussion on implementation guidance focused on fair value auditing. It is difficult to gauge the demand for implementation guidance more broadly, and it is one particular area where more liaison with national standard setters may be possible in order to facilitate what is already available. This would also be a topic to be discussed with the national auditing standard setters at their meeting to be held shortly after the IAASB meeting.

#### IMPACT ASSESSMENTS

Mr. Kellas noted that the CAG had received a presentation on the work currently being contemplated by the IFAC Board on impact assessments. The topic will be discussed further with the IAASB as it progresses.

#### SMEs

The plans to revise the standards governing review and compilation engagements may alleviate the demand for a further alternative assurance engagement for SMEs. The CAG noted that in some jurisdictions audit thresholds are being increased and that this may in part reflect the fact that the same standards apply equally to the audits of large and small entities. The question was raised whether the 'audit is an audit' view, which could be driving this trend in audit thresholds, might in fact work against quality in financial reporting by reducing the attractiveness of audit at the lower end of the scale.

#### CONCEPTUAL FRAMEWORK

An IAASB member suggested that the development of a conceptual framework should be part of the IAASB's longer-term objectives. The observer from the EC noted that any attempt to develop a conceptual framework should not be done before the conclusion of the Clarity project. Mr. Kellas noted that there were a number of respondents who were of the view that the IAASB should start to

develop a conceptual framework, believing that it would assist the IAASB in writing principles-based standards. He noted, however, that the call for a conceptual framework did not seem to be coming from all sections of the stakeholder community.

An IAASB member who strongly supported the development of a conceptual framework was of the view that it is interrelated with proposed ISA 200 (Revised and Redrafted). Another IAASB member felt that a conceptual framework would better clarify the relationship between all the standards.

Those who did not support the development of a conceptual framework were of the view that it was not appropriate to devote significant time to such a broad topic in light of the IAASB's resources.

Other IAASB members were not sure what such a framework would be used for or how it would expand upon the concepts of proposed ISA 200 (Revised and Redrafted) and the assurance framework as it currently exists. An IAASB member suggested that it could be that what is being called for actually exists within the ISAs, albeit in different places, and suggested that material in proposed ISA 200 (Revised and Redrafted) could be moved to a separate paper. He was of the view that there may be things included in that ISA that may be construed as defensive (as noted by some regulators) that do need to be communicated to users of audits but which may be better communicated outside the ISAs.

In order to promote effective audits around the world, an IAASB member felt it is necessary that the ISAs bring things to an actionable level, rather than a conceptual one. As auditing deals with behavioral issues, it may not be as straightforward to develop a conceptual framework for auditing as compared with one for accounting (itself a difficult enough exercise). An IAASB member suggested that further explanation of the bases of audit quality may be more appropriate, while it was also noted that further work on certain specific conceptual matters such as the nature of professional judgment or audit evidence may alleviate the demand for a conceptual framework.

After some debate, the IAASB concluded that a focus on some elements of a conceptual framework, such as professional judgment and audit evidence, are areas which could be incorporated into the proposed work program for further research and discussion. The debate confirmed the initial view that it is not always clear what is being requested when the term "conceptual framework" is used. An IAASB member suggested that starting with a few topics could assist the IAASB in deciding in the future whether a conceptual framework could be developed in the longer term.

#### GLOBAL ACCEPTANCE AND PARTNERSHIP

The IAASB agreed that further liaison with national auditing standard setters may be helpful. It was suggested that the NSS meetings could be expanded to promote more interaction with some of the standard setters in smaller jurisdictions. Mr. Kellas noted this is a topic for discussion at the NSS meeting, and that perhaps regional meetings or an annual global standard setters meeting could be held to assist in identifying barriers to adoption of the ISAs.

#### COMMUNICATION

An IAASB member believed the IAASB has a role in managing the expectations gap about what an audit is, in light of the changing nature of financial reporting. It is important that the IAASB acknowledges that the expectations of the public are increasing, and working to explain the concepts of professional judgment and the inherent limitations of an audit would help to increase the credibility of auditors. The IAASB could issue communications about what an audit is in order to

assist people in understanding the fundamental concepts – this also may help those who are requesting the IAASB develop a conceptual framework.

#### WAY FORWARD

As a result of the discussion, the IAASB agreed there should be a clearer articulation of the role of the IAASB on matters of adoption, implementation, education and training in the strategy itself. A revised draft of both the strategy and the work program will be circulated to the IAASB for comment in advance of the June IAASB meeting, with the goal of approving the final strategy and work program at that meeting.

### 8. Using the Work of Internal Auditors

Mr. Crawford introduced the topic, noting that the exposure draft (ED-ISA 610) was approved in December 2006. 48 comment letters were received upon exposure, and the matters for IAASB consideration were outlined in Agenda Item 10-A; the IAASB supported the position taken by the Task Force, except where noted below.

#### REQUIREMENTS

*Split between Proposed ISA 610 (Redrafted)<sup>16</sup> and ISA 315 (Redrafted)<sup>5</sup>*

The first matter for discussion related to the level of the auditor's necessary understanding of the internal audit function. As a result of respondents' comments, the Task Force proposed to move the material in paragraph 7 of ED-ISA 610 to ISA 315 (Redrafted), linking it to the auditor's understanding of the entity's monitoring activities.

While the IAASB agreed that further linkage to ISA 315 (Redrafted) was appropriate, there were mixed views on how this could be accomplished. Mr. Crawford noted that the change proposed by the Task Force would move the requirement for the auditor to gain an understanding and determine the relevance of internal audit to ISA 315 (Redrafted). Proposed ISA 610, as revised, now applies where the entity has an internal audit function whose activities have been determined to be relevant. The Task Force was asked to revisit the split between the two ISAs, as some IAASB members were of the view that the requirement in paragraph 7 of revised ISA 610 to perform a preliminary evaluation of the internal audit function overlapped with the material in the conforming amendment to ISA 315 (Redrafted). Some IAASB members questioned the placement of the auditor's consideration of whether it is likely to be effective or efficient to use the work of internal auditors in the risk assessment standards. An IAASB member noted that the auditor would always have a choice whether to use the work of the internal audit function, even if it were deemed to be relevant to the audit. The Task Force was also asked to provide further explanation as to what is meant by the phrase "relevant to the audit."

#### OTHER MATTERS

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

- The language in the ISA should be able to accommodate situations in cases where the role of the internal audit function is determined by those charged with governance, in particular listed entities. However, the ISA acknowledges that the internal audit function is not independent of

management because the term “independent” within the ISAs is driven by the IFAC Code of Ethics.

- As currently drafted, the objective allows for the auditor to use the work of internal auditors after determining whether the work is adequate for the purposes of the audit. It was suggested that the objective be expanded to specifically note the need for the auditor to obtain sufficient appropriate audit evidence when using the work of internal auditors. The IAASB was, however, of the view that the requirements adequately deal with this matter and therefore no changes were needed to the objective.
- The definition of the internal audit function is to be changed to “a monitoring activity established as a service to the entity, and conducted by an internal audit department or an equivalent function.”
- The Task Force was asked to clarify the notion of reperformance. To some, the use of the phrase “specific work” was confusing – an IAASB member questioned whether this was intended to mean that testing had to be done on each piece of work done by the internal audit function, or whether the auditor could do something more broadly to determine the adequacy of the internal audit function’s work. This view was supported by others, in particular that there should be some flexibility allowed rather than mandating reperformance, examination or observation.
- The IAASB agreed that the inclusion of a documentation requirement was appropriate in this ISA.

#### WAY FORWARD

The IAASB will discuss a revised draft of the ISA for final approval at its June 2008 meeting. It is anticipated that this revised draft will be circulated to the IAASB members for comment in April to facilitate the discussion in June.

### 9. Overall Objectives of the Independent Auditor

Mr. Kellas introduced the proposed revised draft of ISA 200 (Revised and Redrafted).<sup>7</sup> He explained that the objective of the session is to review significant comments received on Exposure Draft (ED)-ISA 200 and to obtain the views of the IAASB on the Task Force’s recommendations. He noted that the Task Force received comments from the SMP Committee and some IAASB members in advance of the meeting, and that the CAG discussed the topic at its March 2008 meeting.

Regarding the March CAG meeting, Mr. Kellas indicated that the general view was that the revised draft of ISA 200 is an improvement from the ED, and that the Task Force has demonstrated responsiveness to the comments received on exposure. One topic was of particular interest to the CAG, namely the inherent limitations of an audit. Mr. Kellas circulated, at the request of the CAG chairman, a copy of staff’s draft notes on the CAG’s discussion on this topic. He also noted that, following the March 2008 CAG meeting, a letter was received from the Fédération des Experts Comptables Européens (FEE) which stressed its support for the draft as presented.

Mr. Kellas led a review of the proposed ISA, drawing the IAASB’s attention to significant comments received on exposure and from the CAG and the SMP Committee. Except as noted in the following, the IAASB considered and agreed the recommendations of the Task Force in addressing the comments received on ED-ISA 200.

## AN AUDIT OF FINANCIAL STATEMENTS

*Purpose of an Audit*

Mr. Kellas noted that several CAG Representatives suggested that the purpose of an audit, as described in paragraph 3 of the ISA, should be “to enhance the credibility of the financial statements.” A few CAG Representatives cautioned against change to the original wording to avoid unintended consequences, including questions of liability. Mr. Kellas noted that, while the Task Force will give further consideration to this suggestion, it may be appropriate to retain consistency with the wording of the IAASB’s Assurance Framework in this regard.

*Reasonable Assurance*

Several IAASB members expressed concern that the discussion of reasonable assurance in the Introduction section does not give adequate emphasis to the inherent limitations of an audit, which are essential to a proper understanding of reasonable assurance. Further, it was observed that the Introduction section does not adequately guide readers to the fuller discussion of the inherent limitations in the ISA. Other IAASB members, however, were of the view that the draft is clear and appropriate balanced. After further discussion, the IAASB agreed that the draft should be refined to clarify how the inherent limitations and reasonable assurance relate, and for the Introduction section to cross refer to the relevant paragraphs in the application material that further discuss the inherent limitations.

*Auditor’s Reporting and Communication Responsibilities*

The IAASB asked the Task Force to consider revising the final paragraphs in the Introduction section describing the other reporting and communication responsibilities of the auditor, to make clear they relate to matters flowing from the audit.

## REQUIREMENT TO READ AND UNDERSTAND ENTIRE TEXT OF AN ISA

Some IAASB members expressed concern about the proposed change to require that the auditor “shall *read and understand* the entire text...” They were of the view that this wording may suggest the need to read all the ISAs as part of every audit, and that it does not give recognition to other means by which the content of the ISAs may be communicated (i.e., through methodology). Further, it may be unreasonable to require an ‘understanding’, that being a matter of mental capacity. Other IAASB members, however, were of the view that the change helps foster an appropriate environment for the profession. Mr. Kellas noted that the intent of the Task Force was to make clear the authority of the application guidance and other explanatory material in the ISAs and to ensure that such material is not overlooked. After further discussion, the Task Force was asked to consider alternative wording, such as ‘the auditor shall *take account of* the entire text’, provided that it achieves the intended effect.

## OBLIGATION RELATING TO OBJECTIVES STATED IN INDIVIDUAL ISAS

An IAASB member expressed strong concern about the auditor’s obligations with respect to individual objectives and the documentation of a failure to achieve an objective. It was argued that the effect of the material in the ISA may be to focus the auditor on the achievement of the individual objectives, rather than the overall objectives of the auditor while taking account of the ISAs collectively. In addition, it was argued that the proposed deletion of certain essential explanatory

material dealing with the required use of objectives (for example, the statements in ED-ISA 200 that *“These objectives support the overall objective of the auditor...”* and *“The proper application of the requirements of the ISAs will ordinarily provide a sufficient basis for the auditor’s achievement of the objectives.”*) is substantive in terms of loss of relevant context.

Other IAASB members, however, accepted the basis for the Task Force’s proposed changes to ED-ISA 200. It was noted that it is not in the public interest to lead the auditor to believe that mere compliance with the requirements of the ISAs is all that is expected, nor to give the auditor a false sense of security that the ISAs address the procedures necessary in all circumstances. Nevertheless, the Task Force was asked to consider whether it had gone too far, and to consider how some boundaries with respect to the expected use of the objectives might be expressed. In addition, the Task Force was asked to consider further whether the link between the achievement of objectives and the inherent limitations of an audit is clear.

Regarding the failure to achieve an objective, an IAASB member was of the view that the proposed application material may suggest the need to document the achievement of individual objectives. The implication is to drive a checklist approach and constrain how objectives might be used in audit. Other IAASB members were content with the Task Force’s proposals – which included an express statement that documentation of the achievement of individual objectives was not required – but suggested that the requirement addressing the failure to achieve an objective state clearly the consequence of such a failure.

#### PROFESSIONAL JUDGMENT

The IAASB expressed concern about the ‘test’ of professional judgment, in particular the phrase “most other experienced auditors.” The public interest importance of getting this ‘test’ right was noted: it is not appropriate to suggest that the auditor need find only one other auditor who would support the judgment made; on the other hand, it is impracticable to suggest considering a majority view. The Task Force was asked to consider whether the phrase could be deleted, or whether a parallel could be drawn to the guidance in the Code of Ethics. In addition, the Task Force was asked to review whether the requirement to exercise professional judgment and the proposed ‘test’ are drafted broadly enough to cover the auditor’s responsibilities under the ISAs as well as the Code.

The Task Force was also asked to consider broadening the statement that professional judgment is not to be used as the justification for decisions that are not otherwise adequately supported, to avoid limiting its scope to matters related directly to the evidence gathering process (i.e., to encompass judgments relating to matters such as materiality, etc.).

#### INHERENT LIMITATIONS

Mr. Kellas indicated that respondents to ED-ISA 200 were generally concerned about the tone and balance of the material on the inherent limitations of an audit, as well as its overall length. He noted that the CAG acknowledged that progress has been made in refining the draft, and that, while some CAG Representatives suggested that the Task Force could have gone further, there was support for the proposal of the Task Force.

In general, the IAASB was of the view that a good balance has been achieved between factual content and length in the discussion of inherent limitations of an audit, and that the material provides clear explanation of the limitations, their sources and consequences, and the responsibilities

established by ISAs that counterbalance the limitations. However, the IAASB asked the Task Force to consider whether further refinement might make the material more concise and less defensive in tone, particularly in relation to the inherent limitations arising from the nature of the financial reporting and the discussion of the inherent limitations with respect to fraud.

In addition to editorial changes, the IAASB also asked that the Task Force consider the following:

- In regard to the inherent limitations arising from the nature of financial reporting, whether the example of fair value measurements is necessary and accurately drafted.
- In regard to the inherent limitations arising from the nature of audit procedures, whether reference to legal powers of search is necessary and accurately drafted.
- Further opportunities to eliminate repetition, for example the material on authentication of documents which is contained both in the discussion of professional skepticism and inherent limitations.

#### SPECIAL CONSIDERATIONS IN THE AUDIT OF SMES

The IAASB asked the Task Force to consider whether the application of the ISAs' guidance for audits of smaller entities (SMEs) should, or should not, explicitly exclude smaller listed entities. While it was accepted that the SME considerations did not alter in any way the auditor's obligation to comply with the ISAs, at least one IAASB member considered that it may be appropriate to exclude their application from the audit of listed entities. In addition, other drafting changes were suggested to improve the qualitative characteristics typical of SMEs.

#### STRUCTURE OF THE ISA

An IAASB member, who had been concerned about the structure of ED-ISA 200, indicated that while the structure was better and the content was satisfactory he remained concerned about the inclusion of explanations of conceptual matters in the ISA. He considered that an alternative document – a conceptual framework, or an explanation of the nature of an audit – would be more appropriate. The IAASB accepted the proposed revised draft of ISA 200, however, recognizing that, in the absence of alternative locations for the material at present, it is important that the material should be available to users of the ISAs in whatever form they may be adopted by jurisdictions.

#### OTHER MATTERS

In addition to editorial changes, the IAASB agreed that the Task Force should consider the following:

- Revising the current Glossary definition of “auditor”, as it is confusing and unnecessarily complex.
- Revisiting whether the proposed reference to independence in the requirement for the auditor to comply with relevant ethical requirements is appropriate and necessary. In regard to the related application material, the Task Force was asked to consider whether reference to proposed ISQC 1 (Redrafted)<sup>22</sup> is necessary, and if so, whether greater emphasis could be given to the responsibilities of the auditor under proposed ISA 220 (Redrafted).<sup>23</sup>

<sup>22</sup> Proposed ISQC 1 (Redrafted), “Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements.”

<sup>23</sup> Proposed ISA 220 (Redrafted), “Quality Control for an Audit of Financial Statements.”

- Re-instating, as per ED-ISA 200, reference to reasonable assurance in the requirement for the auditor to obtain sufficient appropriate audit evidence.
- Reviewing the clarity of the material in the section ‘Scope of the Auditor’s Opinion’ pertaining to the auditor’s responsibilities with respect to the going concern assumption and its consistency with ISA 570 (Redrafted).<sup>6</sup>
- Using another ISA instead of ISA 510 (Redrafted)<sup>14</sup> as an example of an ISA that may not be relevant in the circumstances of all audits.

#### WAY FORWARD

The IAASB asked the Task Force to consider its comments and present a revised draft of ISA 200 (Revised and Redrafted) for approval at the June 2008 IAASB meeting.

### 10. Audit Evidence

Mr. Fogarty introduced the proposed ISA 500 (Redrafted),<sup>24</sup> noting that 45 responses to the exposure draft had been considered by the Task Force in preparing the agenda papers for this meeting. One further response (IOSCO) had been received since the agenda papers were prepared. That response was tabled at the meeting.

#### SUFFICIENCY AND APPROPRIATENESS

An issue noted in the Explanatory Memorandum to the exposure draft was whether the ISA should deal only with appropriateness of audit evidence (i.e., its relevance and reliability), or whether it should deal with sufficiency as well. Linked to this issue was whether the ISA should repeat text describing aspects of sufficiency and appropriateness that had been moved from extant ISA 500 to proposed ISA 200 (Revised and Redrafted).<sup>7</sup> The IAASB agreed with the clear majority of respondents who provided detailed comment on these matters and who favored proposed ISA 500 (Redrafted) covering both sufficiency and appropriateness of audit evidence, and repeating relevant text from proposed ISA 200 (Revised and Redrafted). The IAASB also agreed that to reflect this broader scope, the title of the redrafted ISA should be changed to “Audit Evidence,” consistent with the extant ISA, and the objective of the redrafted ISA should be amended as proposed by the Task Force.

#### SELECTING ITEMS FOR TESTING

The exposure draft included material, previously included in ISA 530,<sup>25</sup> that deals with the selection of items for testing by means other than sampling. Respondents had mixed views on the placement of this material. The IAASB agreed that while this material could reasonably be put in a number of different ISAs, it does suit the flow of proposed ISA 500 (Redrafted) and should remain there.

#### OTHER MATTERS

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

- The list of procedures (i.e. inspection, observation, confirmation, etc.) should be left in the Application Material rather than being mandated through a new requirement.

<sup>24</sup> Proposed ISA 500 (Redrafted), “Audit Evidence.”

<sup>25</sup> ISA 530, “Audit Sampling and Other Means of Testing.”

- Separate definitions of sufficiency and appropriateness should be retained, which in proposed ISA 200 (Revised and Redrafted) are grouped together under the definition of audit evidence.
- The term “for the auditor’s purposes” should be replaced with “for the purposes of the audit” or “for audit purposes.”
- The Task Force should consider whether:
  - Information to be “used”, should be information to be “obtained” (paragraph 11);
  - Relevance, as well as reliability, should be mentioned in connection with information produced by the entity (paragraph 12);
  - The word ‘sufficiently’, previously used to qualify the words ‘precise’, ‘detailed’, and ‘reliable’, should be reinstated (paragraph 12); and
  - Repetition of the following caveat should be deleted since it also appears in proposed ISA 200 (Revised and Redrafted) and ISA 240 (Redrafted)<sup>26</sup>: “The auditor’s consideration of the reliability of audit evidence rarely involves the authentication of documents” (paragraph A24).

#### WAY FORWARD

The IAASB asked the Task Force to present a revised draft of the ISA at the June 2008 IAASB meeting for approval as a final standard, subject only to final approval of conforming amendments arising from the revisions of the ISAs addressing the use of experts and external confirmations that are subject to separate due process.

### 11. Audit Sampling

Mr. Fogarty introduced the proposed ISA 530 (Redrafted),<sup>27</sup> noting that the primary purpose of the session was to provide direction to the Task Force on the major issues raised by respondents to the exposure draft, rather than discussing the wording of the revised draft.

#### REVERSAL OF SOME CHANGES

Mr. Fogarty noted that a number of respondents were concerned that the extent and nature of some of the proposed changes had gone beyond the scope of the IAASB’s clarity project and the drafting conventions established by the IAASB, and that some useful guidance had been lost in the redrafting. In response, the Task Force was recommending the reversal of some of the changes to the extant ISA made in the exposure draft. The IAASB agreed with the Task Force’s recommended action.

#### EQUAL CHANCE OF SELECTION

Mr. Fogarty noted that some respondents had asked whether the requirement regarding sample selection should state that each sampling unit should have an *equal* chance of selection. The IAASB noted that such a requirement would lead to inefficiencies as it would preclude the use of stratified sampling, and sampling that takes account of the fact that some sampling units have a higher risk of misstatement attaching to them than others. Accordingly, the IAASB agreed not to require that each sampling unit have an *equal* chance of selection.

<sup>26</sup> ISA 240 (Redrafted), “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements.”

<sup>27</sup> Proposed ISA 530 (Redrafted), “Audit Sampling.”

## PROJECTING MISSTATEMENTS

The IAASB discussed whether proposed ISA 530 (Redrafted), when read in conjunction with proposed ISA 450 (Revised and Redrafted)<sup>10</sup> (in particular, paragraph A3), provides adequate guidance regarding the need for robust estimates when management accounts for changes that are initially detected through audit sampling. It was noted that proposed ISA 530 (Redrafted) provides specific guidance on this matter, in particular with respect to requesting “management to first investigate misstatements or deviations that have been identified and the potential for further misstatements or deviations.” The IAASB agreed that this guidance, along with the requirements in proposed ISA 530 (Redrafted), and the requirements and guidance in proposed ISA 450 (Revised and Redrafted), are adequate to address this issue.

## PERFORMANCE MATERIALITY

The IAASB discussed the relationship between tolerable misstatement, as used in this ISA, and performance materiality, as used in proposed ISA 320 (Revised and Redrafted).<sup>9</sup> Issues considered included: whether tolerable error would always equal performance materiality, or whether it is more correctly thought of as the equivalent of performance materiality at the level of a particular sample or procedure; and whether the requirement regarding the projected misstatement being less than tolerable misstatement should refer to, for example, “estimated maximum misstatement.” The IAASB agreed that this matter should be considered further by the Task Force, in consultation with the Materiality and Misstatements Task Force, with a view to including in this ISA an explanation of the relationship between tolerable error and performance materiality.

## OTHER MATTERS

In addition to editorial changes, the IAASB asked the Task Force to consider whether:

- The term “extremely rare” in relation to anomalies should be retained (the IAASB’s preliminary view was that it should).
- The text in the introductory section is consistent with the most recent version of proposed ISA 500 (Redrafted).<sup>24</sup>
- The wording used throughout this ISA and in other ISAs with respect to “conclusions” is consistent, in particular whether conclusions should be consistently described as reasonable, or appropriate.
- The discussion of non-sampling risk (including the definition) should be moved into the introductory section of the ISA.
- The definition of “statistical sampling” should include a reference to determining sample size.
- The thought contained in the footnote to the definition of projected misstatements should be moved into the body of the definition.
- The selection of replacement items should be done using the same method used to select the original item (paragraph 10).
- It is consistent with the scope of the ISA to consider “other procedures” when evaluating sample results (paragraph 16).

- The sentence “The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement” should be deleted (paragraph A17).
- The headings “Information on Which Audit Procedures are Based” (above paragraph A8), and “Projecting Misstatements” (above paragraph A17) could be more clearly expressed.
- Use of “materially misstated” (paragraph A20), which implies materiality in the context of the financial statements taken as a whole, should be replaced with, for example, the phrase “exceeds tolerable error.”
- A link should be made in this ISA to the material regarding selecting items for testing by means other than sampling, which was moved to proposed ISA 500 (Redrafted) from extant ISA 530.
- Some guidance is needed in the ISA regarding extrapolating deviations discovered when testing controls.

#### WAY FORWARD

The IAASB asked the Task Force to present a revised ISA for final approval at the June 2008 IAASB meeting.

### 12. Project Proposal – Assurance Reports on Prospectus Information

Mr. Swanney introduced the topic, noting that the background and rationale for undertaking the project was broadly discussed by the IAASB at its February 2007 meeting. A working group was formed to consider the issues to be addressed and to develop the project proposal. The working group initially began looking at a broad spectrum of issues, but later concluded that the scope of the project should initially be limited to the development of an assurance standard for engagements to report on pro forma financial information included in prospectuses. Once the proposed project has been completed, the working group believes other related matters could be addressed, particularly the revision of ISAE 3400.<sup>28</sup> The CAG discussed the project proposal at its March 2008 meeting, and is generally supportive of the project.

The cross-border nature of transactions has created a desire for a common standard of reports that can be consistently applied in each jurisdiction. With the introduction of the Prospectuses Directive and Prospectus Regulation, a European regime for prospectuses became effective on July 1, 2005. While the working group believes it would be possible to develop an international standard, the IAASB was asked for their views.

A few IAASB members questioned whether the focus on pro forma financial information is appropriate. An IAASB member felt that, although this standard would bridge the gap between the standards that already exist for pro forma financial information, it may be more appropriate to start with prospective financial information. Another IAASB member noted that standards already exist in Canada based on the Canadian regulatory environment and, therefore, new international standards in this area may not be as appropriate.

Mixed views were expressed as to whether it was appropriate to embark on such a project by starting with a particular jurisdiction. Those IAASB members who favored starting with the European requirements believed that having a well-defined definition of pro forma financial information and an

<sup>28</sup> ISAE 3400, “The Examination of Prospective Financial Information.”

accepted meaning of what a compilation entailed would provide a strong basis for the standard. In addition, there is active support for this project from the European securities regulators. Other IAASB members felt it was important for the project to be regarded as one that goes beyond Europe. It was suggested that further research be done as to how such a standard would be used in other jurisdictions such as Africa and Hong Kong. Some IAASB members were concerned that starting with a broader scope could result in a standard that would not be useful for any particular jurisdiction.

It was suggested by some that further research was necessary before a project proposal could be approved. The IAASB agreed that most of the work in this area would be concentrated in a small number of countries. Reviewing the different requirements in those countries would provide insight into how difficult it may be to develop an international, framework-neutral standard.

An IAASB member noted that the project would be beneficial as various national standard setters have set standards on compilation of pro forma financial information and the work level underlying the auditor's reporting is different.

The proposal that a consultation paper be issued prior to the development of an exposure draft was wellreceived by the IAASB. The benefits of this were seen to outweigh the impact the extra step would have on the project timetable.

The IAASB agreed that the project proposal should be modified as follows to acknowledge the fact that as further work is undertaken, it would be clearer whether a global standard would indeed be feasible:

“The ultimate goal of the project is to develop an internationally accepted standard for assurance engagements on pro forma information in prospectuses. The development approach is to use an international task force to focus on a single market model (EU), and: (a) identify principal issues for this market; (b) obtain input on the applicability and relevance of these issues and a project standard on the subject in a more global context; and (c) determine steps in progressing the development of the standard.

Because of the nature of the subject, the task force will consider specifically whether a consultation paper would be appropriate to obtain necessary input before issue of the draft ISAE.

In progressing the project, the task force is to present to the IAASB its proposals for: (a) a consultation paper, for approval prior to public dissemination; and (b) specific recommendations on relevance and feasibility in a global context.”

The IAASB agreed that these principles should govern the way forward on the project, and unanimously approved the project proposal as revised. It is anticipated that the Task Force will report back to the IAASB by its March 2009 meeting.

### **13. Fair Value Audit Guidance**

Mr. Fogarty briefed the IAASB on the steps that had been taken to consider whether the IAASB should develop further guidance relative to fair values. A meeting was held on February 12, 2008 with a group of preparers, users, national standard setters, auditors and regulators as a first step for the IAASB to gain a better understanding of what was being requested and the type of guidance

needed. A discussion paper was distributed in advance of the meeting to guide the discussion during the meeting.

Participants at the meeting generally felt that there was not an immediate need for authoritative guidance given that ISA 540 (Revised and Redrafted)<sup>1</sup> had just been approved by the IAASB. Many believed that there is good guidance in the revised standard that should not be undermined. However, it was acknowledged that there are some topics which could be explored, such as the use of broker quotes in establishing fair values when there are no observable market prices. Those who supported this view noted that material that would promote awareness or educate in the nearer term may be useful, recognizing that in the future there may be a need for more authoritative guidance.

The CAG also received a report back on this project, and a number of CAG representatives had participated in this initial meeting. Their advice was to consider the lessons to be learned from auditors' experience in the past audit season and use this as a basis for determining what, if anything, should be done by the IAASB. The next step is to approach auditors to seek their input on areas where further guidance could be issued in the interest of achieving consistency in performance. The IAASB supported this view.

An IAASB member noted that the initial requests for guidance appeared to be more industry/sector-specific. Mr. Fogarty noted that, while this initially appeared to be the case, it is difficult to restrict the need to one particular area, such as the use of models or the audits of derivatives. It was acknowledged that some may view the issues as primarily banking or financial sector-related, given the relative size of the figures being reported in those sectors; however, auditors in other sectors may need guidance as they may have less expertise with complex financial instruments.

The Task Force will brief the IAASB on the progress of its discussions with auditors.

#### **14. Next Meeting**

The next meeting of the IAASB has been scheduled for June 16-20, 2008 in Athens.

#### **15. Closing Remarks**

Mr. Kellas expressed his appreciation for the contributions of all members to the deliberations during the week. He thanked the AICPA for hosting the meeting and closed the meeting.