

# IAASB CAG PAPER



**International Federation of Accountants**

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## Agenda Item

# A

**Committee:** IAASB Consultative Advisory Group

**Meeting Location:** Paris

**Meeting Date:** May 11-12, 2006

**Draft Minutes of the Meeting of the  
INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD  
CONSULTATIVE ADVISORY GROUP (CAG)**

**Held on November 30-December 1, 2005  
London, United Kingdom**

### Members

David Damant	Chair
Gerald Edwards	Basel Committee on Banking Supervision (December 1 only)
Marc Picqueur	Basel Committee on Banking Supervision (December 1 only)
Linda de Beer	Eastern Central and Southern African Federation of Accountants
Ndung'u Gathinji	Eastern Central and Southern African Federation of Accountants
Federico Diomeda	European Federation of Accountants and Auditors for SMEs
Georges Couvois	European Federation of Financial Executives Institutes
Jean-Philippe Rabine	European Commission
Hilde Blomme	Fédération des Experts Comptables Européens
Andrew Popham	Fédération des Experts Comptables Européens
David Morris	Financial Executives International
Robert Roussey	Information Systems Audit and Control Association
Sam Gutterman	International Actuarial Association
Claude Lamoureux	International Corporate Governance Network
John Carchrae	International Organization of Securities Commissions (December 1 only)
Susan Koski-Grafer	International Organization of Securities Commissions
Tomokazu Sekiguchi	International Organization of Securities Commissions
Pat Sucher	International Organization of Securities Commissions
Filip Cassel	International Organization of Supreme Audit Institutions
Heriot Prentice	Institute of Internal Auditors
Mohini Singh	Institute of International Finance
Rifaat Karim	Islamic Financial Services Board
Hayanari Uchino	Japan Securities Dealers Association
Hisashi Yamaura	Japanese Financial Services Agency
Yoseph Asmelash	United Nations Conference on Trade and Development
Frederic Gielen	World Bank
Thomas Krantz	World Federation of Exchanges

### IAASB

John Kellas Chairman

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Denise Esdon

Philip Ashton

Josef Ferlings

Jan Bo Hansen

Deputy Chair

Member (November 30 only)

Member (December 1 only)

Member (November 30 only)

### **Public Interest Oversight Board**

David Brown

### **IFAC Staff**

Jim Sylph

James Gunn

Alta Prinsloo

IAASB Technical Director

IAASB Senior Technical Manager

IAASB Senior Technical Manager

### **By Invitation**

Dale Gislason

Brian Warnes FCA

IFAC Small and Medium-Sized Practices Committee

Business Dynamics LTD

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### **Introduction**

Mr. Damant opened the meeting and welcomed the Representatives. He welcomed Mr. Brown from the Public Interest Oversight Board (PIOB), who observed the meeting. He also welcomed those attending the CAG for the first time.

### **Previous Minutes (Agenda Item A)**

Mr. Gathinji noted that the draft minutes did not accurately reflect his view about whether CAG meetings should be held in public in future. He provided IAASB Staff with his view in writing. The draft minutes were approved, subject to this change.

Mr. Karim noted that the minutes did not reflect his concern that objectives in the ISAs should be expressed in the form of the relevant element of the *audit process*, rather than in terms of an expectation of *the auditor*. He raised this concern during the discussion of the IAASB Clarity Project session at the previous meeting. It was proposed that this matter be noted during the IAASB Clarity Project session at this meeting.

### **IAASB CAG Terms of Reference and Roles and Responsibilities of the IAASB CAG Chair (Agenda Item B)**

The CAG reviewed the proposed changes to the IAASB CAG Terms of Reference and Roles and Responsibilities of the IAASB CAG Chair based on discussion with the Public Interest Oversight Board (PIOB).

Mr. Damant noted that he had received written comment from Mr. Pickeur, and that Mr. Pickeur's comments and any comments raised by other Representatives will be forwarded to the PIOB for consideration.

Mr. Roussey referred to the fact that paragraph 2 of the Terms of Reference states that the CAG Chair is an individual. He asked whether the CAG Chair did not represent a Member Organization. If that is the case, he is excluded from paragraph 1. Mr. Damant noted that he normally would not have a technical view, as opposed to an organizational view, and that his roles and responsibilities are described in the Roles and Responsibilities of the IAASB CAG Chair. It was suggested that paragraph 2 be expanded to refer to that document.

Some Representatives felt that replacing the words "provide input to" with "assist" in paragraph 1 of the Terms of Reference weakened CAG's position. Mr. Kellas explained that the words were changed to describe the process that is being followed. Mr. Damant suggested that the text be changed to "provide input to and assist." He also agreed with a suggestion that the word "views" in the bullets that follow paragraph 1 be replaced with "advise."

Mr. Krantz commented on the fact that the Terms of Reference only provide for the PIOB to consult CAG – it does not explicitly provide for CAG to consult the PIOB. Mr. Pickeur also noted this matter.

Mr. Sekiguchi asked about the process followed in appointing the members of the CAG Membership Panel, and the process followed by the Panel in considering nominations of potential Member Organizations and Representatives. Mr. Damant explained that he

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decided on the membership of the CAG Membership Panel, which, in addition to Messrs. Damant, Kellas and Sylph, includes Messrs. Pickeur and Roussey. To date, Mr. Damant has been approaching potential Membership Organizations based on the need to address the geographical distribution and stakeholder representation of the CAG membership. Although future invitations for nominations are possible, it is important that CAG remains of a reasonable size.

With regard the Roles and Responsibilities of the IAASB CAG Chair, Mr. Gutterman suggested that the second bullet under Leader of CAG be changed as follows: “Actively identify and evaluate the impact of emerging issues bearing on the profession in order to provide ~~direction to the work of~~ advice to the IAASB.”

### **IAASB CAG Working Groups and Feedback Mechanism (Agenda Item C)**

CAG reviewed the Process for IAASB CAG Working Groups and Feedback Mechanism prepared by Mr. Damant.

Mr. Kellas commented on the stages when CAG’s input into IAASB projects is most valuable. In addition to the CAG’s advice on the IAASB’s agenda, these included the project proposal stage; before an exposure draft is approved; and when the comments received on an exposure draft are being considered. He noted that it should normally not be necessary to discuss a project during the exposure draft stage. At that stage, Member Organizations should provide comments in their respective comment letters.

Ms. Koski-Grafer noted that the CAG Chair, IAASB Chair and others, when reporting back on CAG discussions at IAASB meetings, sometimes refer to “CAG’s views.” This is not accurate, as Representatives often have diverse views on the same subject. She asked that care be taken to identify the views as “views of some Representatives,” unless there truly was a universal CAG view.

### **IAASB Report Back on Proposals by CAG**

Mr. Damant explained the purpose of this session was to report how the relevant IAASB Task Forces and the IAASB have responded to CAG views raised on individual subjects at the June 6-7, 2005 meeting. **The two reports discussed at the CAG meeting are attached to these minutes for reference.**

### **AUDIT DOCUMENTATION (AGENDA ITEM D)**

Mr. Kellas provided a brief report back on the June 6-7, 2005 proposals of CAG on ISA 230 (Revised), “Audit Documentation,” and on significant changes processed before the IAASB approved the final ISA at its September 2005 meeting. The revised ISA is effective for audits of financial information for periods beginning on or after June 15, 2006.

Mr. Kellas noted that Agenda Item D does not accurately reflect the IAASB’s response to Ms. Koski-Grafer’s question as to whether an external inspector, for example, needs to have detailed knowledge of the industry in which the audited entity operates. Her question was asked in the context of the definition of “experienced auditor.” Mr. Kellas explained that the IAASB did not accept the Task Force’s proposal to qualify the extent of knowledge by reference to its sufficiency for the purposes of inspection (which was inadvertently reflected in Agenda Item D). Instead, the IAASB agreed to amend the ISA to

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provide for the understanding of relevant matters to be “reasonable.”

During the IAASB Clarity Project session, Mr. Popham reiterated his concern that the requirements in ISA 230 (Revised), “Audit Documentation,” may not be well understood. He urged the IAASB to clarify their intended meaning.

### RELATED PARTIES (AGENDA ITEM E)

Mr. Kellas provided a brief report back on the June 6-7, 2005 proposals of CAG on proposed ISA 550 (Revised), “Related Parties,” and on significant changes processed after the October 2005 IAASB meeting. The proposed revised ISA will be considered for approval to be issued as an exposure draft at the December 2005 IAASB meeting.

Mr. Roussey noted that he was satisfied with the way in which the IAASB responded to his comment on the guidance on financial reporting frameworks that do not require related party disclosures. He emphasized again that the IAASB should not take the role of accounting standard setter, i.e., where the applicable financial reporting framework does not provide for related party disclosures.

Referring to his comment at the June 6-7, 2005 meeting on the over-emphasis of high-risk related parties, Mr. Popham suggested that the application material clarify that the auditor does not have to perform further audit procedures in relation to related parties if the risk of material misstatement of the financial statements due to related parties is low – as may be the case where there are many routine related party transactions, such as might arise in wholly-owned subsidiaries.

Mr. Popham referred to the list of procedures that the auditor is required to perform to identify related party relationships and transactions not identified or disclosed by management (paragraph 18 of proposed ISA 550 (Revised), “Related Parties”). He noted that it was not clear why the records and documents referred to in paragraph 18(b) are specified as ones that the auditor has to review in all cases. A case could be made for other records being more important, depending on the circumstances of the engagement. He suggested that the requirement be redrafted to follow a principles-based approach, requiring the auditor first to identify and then to examine the records most likely to be of use in disclosing related parties. Ms. Koski-Grafer asked why the requirement to review the tax return had been omitted when the other items were brought forward from the previous list. Mr. Kellas responded that it was because the tax return might not be relevant in all audits.

### Special Reports (Agenda Item F)

Ms. Blomme explained that the CAG Working Group on Special Reports discussed the exposure draft of proposed ISA 701, “The Independent Auditor’s Report on Other Historical Financial Information” and proposed ISA 800, “The Independent Auditor’s Report on Summary Audited Financial Statements” during telephone conferences, and highlighted matters for CAG’s consideration. These matters included the following:

#### PROPOSED ISA 701

- The description of the applicable financial reporting framework in proposed ISA 701 (which is not the same as that in ISA 200, “Objectives and General Principles

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Governing an audit of Financial Statements,” in particular, the authority of and conflicts among the sources referred to in paragraph 10 of ISA 701, and the fact that it could lead to inconsistency in practice. The Working Group was of the view that more guidance should be provided on the determination of the acceptability of the financial reporting framework.

- The requirements and guidance on the form of opinion in proposed ISA 701. Reference was made to issues relating to the equivalent use of the phrases “true and fair” and “present fairly, in all materiality respects,” and to expressing such an opinion on elements of financial statements.
- The completeness of the coverage of financial statements, its components and other subject matters in the ISAs. The Working Group was concerned that the ISAs did not cover historical financial information other than financial statements or components of financial statements, for example, historical financial information about a transaction or expenditure prepared in accordance with the requirements of a contract.
- The Working Group suggested that the Task Force consider developing a diagram that clarifies the link between the applicable financial reporting framework, the other historical financial information, and the text and examples in proposed ISA 701.

### PROPOSED ISA 800

- The requirements and guidance on the form of opinion. The Working Group was of the view that there is a need for flexibility in the form of opinion. Extant ISA 800 provides for an opinion on “consistency,” whereas proposed ISA 800 requires an opinion on “appropriate summarization.” In many jurisdictions, law or regulation requires the former.
- The requirements and guidance on criteria. The Working Group was of the view that additional guidance is necessary and that such guidance should be developed with reference to the International Framework for Assurance Engagements.

Ms. Prinsloo confirmed that the matters highlighted by the Working Group have been included in the summary of significant comments, which will be considered by the IAASB at its March 2006 meeting.

The Working Group noted that the use of telephone conferences proved to be an effective and efficient way of discussing matters related to the project.

### **The Audit of Group Financial Statements (Agenda Item G)**

Mr. Hansen introduced the agenda item. The IAASB approved the issue of the exposure draft of proposed ISA 600 (Revised), “The Audit of Group Financial Statements” in March 2005. The comment period closed on July 31, 2005, and a total of forty-four comment letters were received. The IAASB will consider a summary of significant comments, the Task Force’s recommendations, and a revised and redrafted proposed ISA at its December 2005 meeting. The revised and redrafted proposed ISA was based on the comments received, and reflects the application of the new clarity drafting conventions.

Generally, Representatives were supportive of the Task Force’s recommendation to eliminate the distinction between related and unrelated auditors, the distinction between

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components that are not significant in the aggregate and the remaining components, and the redraft of the proposed ISA based on the clarity drafting conventions.

Representatives commented as follows:

- Ms. Sucher was of the view that the summary of significant comments did not clearly explain the reasons for the Task Force’s recommendations.
- Some Representatives were of the view that it was not clear whether the term “group auditor” refers to an individual and/or the audit firm, or who would be regarded as members of the engagement team and as other auditors.
- Mr. Roussey was concerned that the proposed ISA uses accounting terms differently from their use in the International Financial Reporting Standards (IFRSs). For example, the term “consolidation” in the proposed ISA includes accounting for associated companies by the equity method. This is not the case in IFRSs.
- Mr. Rabin noted that the term “commonality” used in the context of the group auditor’s understanding of other auditors, is not a commonly-used term and may be difficult to translate – “equivalence” might be better.
- Referring to the identification of significant components based on their individual financial significance to the group, Mr. Popham suggested that the example in the application material designating financially significant components, which contained what was in his view a rather low percentage applied to a chosen benchmark, be deleted.
- Some Representatives were of the view that the requirements and guidance on access to information did not provide sufficient guidance on the “other means” by which the group auditor could obtain the necessary audit evidence. However, they did agree that, should the group auditor not be able to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level, he or she should not accept/continue the engagement or consider the effect on the auditor’s report, as required by the proposed ISA.
- Some Representatives suggested that the proposed ISA require the other auditor to provide the group auditor with access to relevant parts of his or her audit documentation if not prohibited by law or regulation.
- Mr. Roussey suggested that the proposed ISA provide for rotation of the audit of components that are not significant.
- Mr. Popham suggested that the matters required to be included in the other auditor’s memorandum or report of work performed are too onerous in the case where a group auditor relies on a statutory audit of the financial statements of a component that is not individually significant.
- Mr. Roussey suggested that the guidance be expanded to refer to the use of work performed by internal auditors, or that – at a minimum – a cross reference to ISA 610, “Considering the Work of Internal Audit” be included.

### **Materiality (Agenda Item H)**

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Ms. Esdon introduced the agenda item. The IAASB approved the issue of the Exposure Draft of proposed ISA 320 (Revised), “Materiality in the Identification and Evaluation of Misstatements” in December 2004. The comment period closed on April 30, 2005, and a total of forty-eight comment letters were received. At the October 2005 meeting, the IAASB discussed the overall comments received on exposure and some of the significant comments and the Task Force’s related recommendations.

To enhance the clarity and flow of the requirements and guidance, the IAASB agreed to address materiality and misstatements in separate ISAs, i.e., ISA 320 (Revised), “Materiality in Planning and Performing an Audit” and ISA XXX, “Evaluation of Misstatements Identified During the Audit.” The IAASB will consider the proposed ISAs at its December 2005 meeting.

Representatives commented as follows:

### PROPOSED ISA ON MATERIALITY

- Some Representatives questioned the need to describe materiality in the context of an audit. They were of the view that the definition in IAS 1, “Presentation of Financial Statements” should be used. It was noted, however, that the proposed description is in line with the IAS 1 definition. It was suggested that the proposed description be moved to precede paragraph 8 of proposed ISA 320.
- Some Representatives were of the view that proposed ISA 320 (Revised) should include reference to materiality determined by management of an entity and how it affects the auditor’s determination of materiality. Ms. Singh was of the view that the auditor should not determine materiality, but that he or she should use management’s materiality. Mr. Popham added that the determination of materiality is a matter for the auditor but that some recognition of management responsibility for the correctness of the financial statements is important. Ms. Esdon noted that the IAASB will consider a paper containing the Task Force’s recommendation regarding management’s materiality. The Task Force is of the view that, although not explicitly stated, ISA 315, “Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement” sufficiently addresses the auditor’s understanding of management’s materiality. (The IAASB paper can be accessed at: <http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0040&ViewCat=0448>. Click on “Agenda Item 6-E – Materiality – Management’s Materiality.”)
- Mr. Morris was of the view that proposed ISA 320 (Revised) should not include examples of percentages that could be applied to chosen benchmarks. Mr. Popham was of the view that, when redrafted based on the clarity drafting conventions, examples of percentages, if any, should be in the application material.

### PROPOSED ISA ON MISSTATEMENTS

- Mr. Popham referred to the reference in the definition of misstatement to disclosures that, in the auditor’s judgment, is otherwise necessary for the fair presentation of the financial statements. He noted that this assumes the auditor is expressing an opinion on the fair presentation of the financial statements, which may not be the case. Mr. Sekiguchi shared this view, referring to possible practical confusion due to the

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ambiguity of this definition.

- With regard to prior period uncorrected misstatements, Mr. Popham was of the view that the proposed ISA should provide for a fourth category of misstatements, i.e., misstatements as a result of the improper application of an accounting policy that may become material in the future.

### **Accounting Estimates (Agenda Item I)**

Mr. Ashton explained that the objective of this session was to obtain the views of CAG on how the IAASB Estimates Task Force has responded to the main issues raised by respondents to the Exposure Draft of proposed ISA 540 (Revised), “Auditing Accounting Estimates and Related Disclosures (Other than Those Involving Fair Value Measurements and Disclosures).”

He reported that the comment period closed on April 30, 2005. A total of 40 comment letters were received. The IAASB discussed the Task Force’s recommendations in response to the comments received at its October 2005 meeting. He noted that the IAASB was broadly in support of the recommended dispositions, but had suggested additional areas where the proposed ISA could be enhanced to be more responsive to the comments. He referred CAG to the draft minutes of the October 2005 IAASB meeting for a summary of the views and recommendations of the IAASB.

### AUDITOR-DEVELOPED RANGE OF REASONABLE OUTCOMES

Mr. Gutterman reported that some actuaries that were consulted on the wording of the proposed ISA noted that the term “range of reasonable outcomes” is technically incorrect and, from their perspective, incomprehensible. He suggested that the auditor focus on whether the estimate is reasonable, rather than the outcomes *per se*.

Mr. Popham was of the view that it is imperative for the auditor to consider whether disclosure of the uncertainty associated with the measurement of an estimate is adequate. He noted that the requirements and guidance on significant uncertainties in paragraph 80 of the proposed ISA, which restrict disclosure of uncertainty to that required by the financial reporting framework, are inconsistent with the proposed conforming amendments to paragraph 31 to ISA 570, “Going Concern” (noted in the Exposure Draft of proposed ISA 705, “Modifications to the Audit Opinion in the Independent Auditor’s Report” and proposed ISA 706, “Emphasis of Matter Paragraphs and Other Matters Paragraphs”), which requires clear disclosure of significant uncertainties to the extent necessary for the financial statements not to be misleading.

Mr. Rabine noted that the expectation of the public is often that the outcome of an estimate will not be materially different from the estimate as audited. He was therefore of the view that an audit model that focuses on a range of reasonable outcomes as a basis on which to evaluate the estimate would be ineffective in responding to the public’s expectations.

Mr. Gutterman shared the concerns of the IAASB, as recorded in the draft minutes of the October 2005 IAASB meeting, over the use of the phrase “as likely as not” in describing the process of narrowing the range of reasonable outcomes.

### POINT ESTIMATES AND TREATMENT OF DIFFERENCES AS MISSTATEMENTS;

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Mr. Gutterman was concerned about the notion that an auditor is capable of developing a point estimate that is more reliable than that of management. Greater emphasis should be placed on the auditor's use of ranges in general, an approach that would be more consistent with practice.

Mr. Gutterman was also concerned that the guidance on the circumstances in which the auditor determines that a misstatement exists seems to imply that the identification and measurement of misstatements depends on the approach taken by the auditor in auditing the estimate and on the ability of the auditor to develop either a point estimate or a range. He suggested that the Task Force clarify the cases where the auditor is likely to arrive at either a point estimate or a range, including those circumstances where the financial reporting framework specifies that a particular point within a range is to be used as the point estimate.

### INDICATORS OF POSSIBLE MANAGEMENT BIAS

Mr. Rabine was of the view that it is unclear to what extent, if any, the auditor is expected to communicate indicators of possible management bias to management or those charged with governance. Mr. Ashton explained that the proposed revised ISA does not restrict the auditor from communicating identified indicators of possible management bias. Communication is required in ISA 240, "The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements," when the auditor suspects fraudulent financial reporting, and in proposed ISA XXX, "Evaluation of Misstatements Identified During the Audit," when the auditor concludes that the financial statements are materially misstated as a result of the auditor's consideration of such indicators in aggregate and in relation to other qualitative factors.

Messrs. Gislason and Gutterman noted that there is a broad spectrum of different forms of bias. It was suggested that emphasis should be placed on intentional bias.

### CONSIDERATIONS IN THE AUDIT OF SMALL ENTITIES

Mr. Gislason noted that the IFAC SMP Committee appreciates the consideration given by the Task Force in responding to its concerns about the need for additional guidance explaining how the requirements of the proposed revised ISA are to be applied in the audit of SMEs. He suggested that further consideration be given to guidance dealing with those situations where the estimation uncertainty associated with an estimate is so large in relation to the financial statements that it may affect the use of the going concern assumption. This is particularly important in relation to SMEs as management may not have the appropriate expertise to recognize or evaluate the implications of estimation uncertainty.

Mr. Gutterman noted that it is the risks associated with an estimate that are critical, rather than the size of the entity. For example, a small entity trading in derivatives poses greater audit risk than a larger entity that undertakes only simple, routine transactions throughout the year.

### RELATIONSHIP OF PROPOSED ISA 540 (REVISED) AND ISA 545

Mr. Ashton reported that the Task Force and IAASB will be considering options to clarify

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the relationship between proposed ISA 540 (Revised) and ISA 545, “Auditing Fair Value Measurements and Disclosures.” He noted that one option under consideration is to establish proposed ISA 540 (Revised) as an umbrella standard, and ISA 545 as a supplement thereto, dealing specifically with those additional procedures required to respond to the risks associated with fair value measurements. The advantage of this approach is that it effectively extends the provisions of proposed ISA 540 (Revised), including the risk based approach adopted therein, to the audit of fair values, while avoiding unnecessary repetition, and clarifying the link between the two ISAs.

Mr. Gutterman noted that the CAG Working Group on Accounting Estimates supports the Task Force in exploring the proposed direction. He noted that Mr. Pickeur would encourage the IAASB to consider addressing the revision of IAPS 1012, “Auditing Derivative Financial Instruments” as part of the process of updating ISA 545.

Ms. Sucher commented that the proposed approach seemed to be a pragmatic solution.

### **Communications with Those Charged with Governance (Agenda Item J)**

Mr. Sylph reported that the Exposure Draft of proposed ISA 260 (Revised), “Communications with Those Charged with Governance” was issued in March 2005. The comment period closed on July 31, 2005. A total of thirty-four comment letters were received. He explained that the purpose of the session is to obtain the views of CAG on how the Task Force has responded to the main issues raised by respondents to the Exposure Draft, and on any other matters that should be considered by the IAASB.

#### THE USE OF THE TERM “SIGNIFICANT” IN DETERMINING MATTERS TO COMMUNICATE TO THOSE CHARGED WITH GOVERNANCE

Ms. Koski-Grafer supported the suggested initiative to promote common terminology and, if possible, to find one word to replace the many synonyms that are presently used, noting that this could help to simplify the ISAs and increase understanding.

Mr. Lamoureux was unclear as to how the term “significant” relates to “material.” Mr. Roussey shared the concern, noting that he would interpret a matter that is “significant” to be of lower importance than a matter that is “material.” Mr. Rabine suggested that the term “significant,” if used in the ISA, be defined in the Glossary of Terms.

#### REQUIRED COMMUNICATIONS

The CAG was generally supportive of the proposal for the ISA to require auditors to communicate matters to those charged with governance, even if such matters have already been communicated by management.

#### GUIDANCE PERTAINING TO SMES

Mr. Popham was of the view that several of the requirements are important in the context of SMEs, but that their importance is lost when they are presented with the other requirements. He suggested that the Task Force consider further those requirements that are essential to be communicated even when those charged with governance are also involved in managing the entity.

He also noted that the paragraph pertaining to the audit of group financial statements omits

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the fact that the parent is often charged with governance responsibilities for wholly-owned subsidiaries. He was of the view that reference to such circumstances was necessary to avoid unnecessary boilerplate reporting to the boards of wholly owned subsidiaries.

### APPENDIX OF OTHER ISAS

Mr. Roussey was of the view that a list of the requirements in other ISAs to communicate to those charged with governance is helpful from an SMP perspective. He did not, however, see it as essential that the list be included as an appendix to the ISA. He suggested that the IAASB provide the list on the IAASB website or in the proposed ISA Guide under consideration by the IFAC SMP Committee.

### OTHER MATTERS

Mr. Sylph explained that the IAASB does not intend to issue the final ISA 260 (Revised) until it has been redrafted in accordance with the clarity drafting conventions. This will delay issue of the revised ISA by approximately one year. He asked CAG whether this raised any concern. CAG did not raise any specific issues. Mr. Popham supported the proposed clarity implementation approach as it avoids unnecessary duplication in translation. However, this should not be seen as permitting a shorter implementation period. Mr. Rabine indicated that the European Commission is primarily interested in the clarified ISAs.

Mr. Pickeur noted that the comment letter submitted by the Basel Committee on Banking Supervision expressed concern over the proposal that the auditor's written communications to those charged with governance should not be disclosed to others, or quoted or referred to, without the auditor's prior written consent. He noted that the need to seek consent may possibly delay timely communication of relevant issues to appropriate authorities. He observed that this was not addressed in the Issues Paper to be discussed with the IAASB. Messrs. Edwards and Gielen shared this concern. Mr. Sylph noted that this matter will be raised with the IAASB at its December 2005 meeting. The IAASB's response will be reported at the next CAG meeting.

Mr. Popham expressed concern over the guidance that local laws preventing the auditor from communicating certain matters with those charged with governance, or others, within the entity may constitute a scope limitation that results in a modification of the auditor's opinion. He suggested that the guidance be amended to explain that the auditor reports illegal activities, for example, unless prohibited by national laws or regulations.

Mr. Gielen noted that Mr. Hegarty expressed concern at the last CAG meeting that the proposed revised ISA may not be governance-framework neutral. He was of the view that the proposed revised ISA does not adequately address the differences that exist amongst jurisdictions. He noted that an assumption underlying the ISAs generally has been the separation of "management" and "those charged with governance," a hallmark of U.S. publicly traded corporations in particular. There are, however, developing economies and non-U.S. systems where this assumption does not hold. Mr. Gielen referred to the role of shareholders as those charged with governance, the presence of controlling shareholders, and the definition of "listed entity." He agreed to submit the specifics of his concerns to IAASB Staff in writing.

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### **Modifications to the Audit Opinion, and Emphasis of Matters and Other Matters Paragraphs (Agenda Item K)**

Mr. Hansen explained that the objective of this session is to obtain the views of CAG on the significant comments received from respondents to the Exposure Drafts of proposed ISAs 705 and 706. The comment period closed on July 31, 2005. A total of forty comment letters were received. It is expected that the IAASB will consider the significant comments and the Task Force's recommendations at its March 2006 meeting.

#### MULTIPLE UNCERTAINTIES LEADING TO A DISCLAIMER

Mr. Roussey agreed with the Task Force's recommendation that it is the inability to obtain sufficient appropriate audit evidence that should be used as the basis for determining whether to disclaim an opinion, rather than the cumulative nature and possible effect of uncertainties. He noted, however, that it may be appropriate to include in the auditor's report a discussion of whether the qualification arose as a result of both the lack of sufficient appropriate audit evidence as well as the possible effects of the uncertainty, consistent with the practice observed in the U.S. at one point in relation to its savings and loans industry.

#### USE OF THE TERMS "SIGNIFICANT UNCERTAINTY" VS. "MATERIAL UNCERTAINTY"

Mr. Damant noted that the IASB views a figure as either material or not, and that there is no other relevant level. He noted that the Task Force's proposal establishes a "significant" matter as one that is of greater importance than a "material" matter. The question is whether there is adequate justification for a level beyond materiality. He was of the view that there is, given that the auditor needs a basis for determining whether an emphasis of matter paragraph is necessary and the type of opinion to be provided. Mr. Hansen noted that Mr. Damant's view was consistent with that of the Task Force, and that it is essential that there is a clear articulation and common understanding of the two levels.

Mr. Rabine was of the view that "significance" is a combination of the materiality of an item and the likelihood of the outcomes associated with the uncertainty. He suggested that the Task Force consider whether both of these elements should feature in the definition of "significant uncertainty."

Mr. Karim was of the view that materiality should be the threshold for purposes of determining whether or not the opinion should be modified, as this is the basis upon which the auditor judges whether or not users' decisions would be affected. He did not believe that clarity is achieved if auditors can interpret these matters differently. Mr. Hansen explained that using "material uncertainty" as a threshold may result in a proliferation of emphasis of matter paragraphs within certain industries, thereby diluting the effectiveness of such paragraphs.

Mr. Roussey expressed concern over using the term "significant uncertainty" in the auditor's report because of the disconnect that arises when management refers to "material uncertainty" in the notes to the financial statements when disclosing matters pertaining to the use of the going concern assumption. He suggested that the Task Force consider further the issues that may arise as a result of this possible inconsistency. Mr. Lamoureux and Ms Singh shared this view. It was suggested that, as an alternative, the term "significant

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uncertainty” should not be featured in the emphasis of matter paragraph in the auditor’s report. Rather, the emphasis of matter paragraphs should simply explain that there is an uncertainty that is material and which may affect the use of the going concern assumption. CAG generally supported this view, and suggested that while “significance” could be discussed in the proposed ISA, it should not manifest itself in the wording of the auditor’s report.

### MEANING OF, AND CRITERIA FOR DETERMINING, “PERVASIVENESS”

Messrs. Popham and Gutterman expressed concern over the phrase “quantifiable maximum potential misstatement” in the proposed definition of “pervasiveness.” Mr. Popham questioned whether it is in the public interest to permit auditors not to opine on a set of financial statements where one figure is in question but the rest of the financial statements is capable of being reported on. Mr. Gutterman viewed the phrase as possibly being meaningless to many, in particular those in the insurance industry, where it is the “probable misstatement” that is more relevant.

Ms. Sucher noted that the definition is difficult to understand, particularly because of the combined use of negatives therein.

CAG asked the Task Force to consider further the proposed definition.

### DISAGREEMENT WITH MANAGEMENT ABOUT DISCLOSURES AND WHETHER TO PROVIDE THE OMITTED DISCLOSURES IN THE BASIS FOR MODIFIED OPINION PARAGRAPH

Mr. Popham noted that there are two serious issues with requiring the auditor to provide omitted disclosures. First, the omission of the information in the financial statements results in a situation where management is making no assertions about such information. The auditor is therefore left in the position of making the assertion that the information is complete and accurate, which may not be possible if management has not provided all relevant information to the auditor. Second, there is a question of the auditor’s independence, irrespective of whether the auditor is satisfied that the information is reliable, complete and accurate. He believed that a general statement referring to the nature of the omitted information, and not the specific details or facts, is all that is appropriate. Further, this is all that is needed to make enforcement authorities aware of the need to consider further action. Messrs. Gislason and Morris shared this view, noting that the auditor is placed in a precarious situation in relation to information that management is not willing to report in the financial statements.

Mr. Roussey was of the view that the auditor should be required to disclose all of the information that is required by the financial reporting framework, where it is available and management has omitted it. Ms. Sucher had a similar view, noting that there is little difference between disclosing the quantifiable effect of a matter and other specific details.

### CRITERIA FOR EMPHASIS OF MATTER

Mr. Popham expressed concern over the proposal to establish criteria for when the auditor must include an emphasis of matter paragraph in the auditor’s report. He was of the view that the auditor should not be prohibited from including an emphasis of matter paragraph if the criteria were not met. Auditors should be permitted the flexibility to emphasize a

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matter if, in the auditor's judgment, it is appropriate to do so. In addition, he was concerned that, in closely regulated environments, auditors may choose to err on the conservative side when uncertain as to whether to include an emphasis of matter paragraph. This could lead to a proliferation of such paragraphs. Ms. Singh had a similar view, noting that a proliferation of such paragraphs may lead to the perception by some that they constitute a semi-qualified audit opinion.

Ms. Koski-Grafer was of the view that a wider range of circumstances might warrant an emphasis of matter paragraph. She also noted that the combination of the requirements pertaining to emphasis of matter paragraphs and other matter paragraphs seems to encourage greater disclosures by the auditor.

Mr. Gielen supported the direction of the Task Force in seeking to define better the circumstances when the auditor should include an emphasis of matter paragraph. He noted that in some countries it is not uncommon to see such paragraphs in every set of financial statements, with the reverse true in other countries; this inconsistency results in confusion from an international point of view.

### **Material Weaknesses in Internal Control (Agenda Item L)**

Mr. Ashton reported that the IAASB, in October 2005, approved a project proposal to develop guidance on the material weaknesses in internal control in relation to financial reporting. The output of the project will mainly clarify wording in existing ISAs, rather than a new ISA as originally noted in the project proposal. Mr. Ashton noted that this topic is being addressed in various jurisdictions, sometimes in different ways. CAG was asked for its views on the project proposal.

Mr. Rabine reported that the European Commission can support at this stage the approach proposed in the project proposal. He noted that different jurisdictions, however, have different views on this subject, and that it may be necessary to clarify whether an audit of internal control is a by-product of the external audit of the financial statements or a matter of a separate engagement. He also noted that the auditor's consideration of statements by management about the description of internal controls in other documents containing the audited financial statements will be particularly important in the European Union as a result of the requirements of the 4<sup>th</sup> and 7<sup>th</sup> Directives, which require at least consistency checks on such information. Mr. Ashton noted that this will be considered, but that it needs to be recognized that the issue is more prevalent in certain jurisdictions in relation to listed entities, whereas this project addresses audits conducted in accordance with ISAs, which are also applicable to the audit of all entities.

Mr. Popham was of the view that an ISA dealing with definitions may be misunderstood, and that it would be preferable to incorporate the definitions in the existing ISAs rather than to write a new one.

Mr. Cassel supported the two stage process noted in the project proposal, whereby the first step is to focus on enhancing the definitions. Mr. Cassel noted that it may be useful for the Task Force to explore the relationship between the responsibilities for internal control over financial reporting and the auditor's responsibilities with respect to laws and regulations.

Mr. Sekiguchi noted that difficulties have been experienced in translating terms such as "significant deficiency" and "material weakness," and the necessity of considering such

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difficulties when deliberating the standard.

Ms. Blomme suggested that the Task Force consider consulting stakeholders outside the auditing profession, such as business leaders and investors – an approach adopted by FEE when it considered the issue of reporting on internal control.

### **IFAC SMP Committee: Request for Proposal to Develop ISA Guide (Agenda Item M)**

Mr. Gislason highlighted the main objectives of the IFAC SMP Committee's request for proposals for the development of an ISA guide. He explained that the proposed guide is intended to focus on the application of ISAs in the audit of SMEs, along with relevant practice aids. It is not intended to replace ISAs. He noted that the development of the guide would not impact the scope or timing of the IAASB Clarity Project.

Mr. Damant inquired of Messrs. Kellas and Sylph whether they are comfortable with the level of involvement by the IAASB or IAASB Staff in ensuring the quality and consistency of the guide in relation to the ISAs. Mr. Sylph reported that the extent of IAASB or IAASB Staff involvement, if any, has not yet been determined. He noted that IFAC will be seeking to understand practices followed by national standard setters in dealing with similar publications produced at the national level. It will also consider the suggestions for quality control process by those who tender proposals. The issue of IAASB or IAASB Staff involvement will be determined before any contract is signed.

### **Improving the Clarity of IAASB Pronouncements (Agenda Item N)**

Mr. Kellas explained that the objective of this session is to obtain the views of CAG on certain aspects of the Exposure Drafts on Improving the Clarity of IAASB Pronouncements issued in October 2005, specifically: (1) the application of the IAASB's clarity drafting conventions and related matters; (2) the proposed implementation approach and timetable; and (3) other matters of consequence or importance that the IAASB should consider.

#### OBJECTIVES

Mr. Kellas referred CAG to the objectives stated in the four ISA Exposure Drafts and asked for views thereon, specifically the precise form that they should take, and how best to use them to convey the underlying purpose of the ISA.

Mr. Damant noted that this element of the IAASB Clarity Project is extremely important. It is essential for Member Organizations to comment thereon in responding to the Exposure Drafts. He noted that, in his view, the IAASB has adopted a practical approach in addressing the need for a comprehensive set of "core principles" in auditing literature.

Mr. Carchrae was of the view that the coherence and consistency of the objectives as a whole are particularly important. He suggested that objectives for all of the ISAs be developed so that they could be evaluated as a whole and in relation to the objective of an audit. Mr. Popham had a similar view. He noted that doing so may help flesh out the purpose and exact form of the objectives; that is, whether objectives should be specific and linked to the requirements, or broader in nature and more reflective of the purpose of the ISA.

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Mr. Kellas noted that the next step of the Task Force is to explore objectives for the remaining ISAs for this purpose. It has not yet been decided, however, whether they will be developed for purposes of separate consultation, or as an internal exercise only.

Mr. Rabine indicated that the European Commission strongly supports setting mandatory objectives. However, some concern has been expressed over the provision that limits the auditor's responsibilities to those objectives in ISAs that are "relevant in the circumstances." He suggested that the IAASB further explain and provide guidance on what is meant by "relevant in the circumstances" to assist in consistent interpretation and application. Mr. Kellas indicated that the IAASB is aware of the need to clarify this matter.

Mr. Karim was of the view that the objectives should be expressed in the form of the relevant element of the *audit process*, rather than in terms of an expectation of *the auditor*. He notes that the style adopted creates a disconnect between the ISAs and ISA 200, the latter of which refers to the objective of an audit. Objectives that focus on the *audit process* would help to clarify precisely what the audit process should be, and what that process is intended to achieve. Messrs. Kellas and Sylph noted in response that the form proposed is consistent with the general convention of using the phrase *the auditor* in the ISAs, the intention of which is to emphasize the individual accountability and responsibility of the auditor, towards the principal goal of driving auditor performance. Messrs. Edwards and Cassel and Ms. Koski-Grafer did not see a need to change the wording. Mr. Cassel noted that the focus on *the auditor* in the objectives maintains the necessary link between the ISAs and the IFAC Code of Ethics for Professional Accountants.

Ms. Koski-Grafer asked whether the IAASB had developed objectives for the redrafted ISAs on a "bottom-up" or "top-down" basis – that is, were the objectives created only from the previous content of the ISAs or were they created based on what would be the full expectation for the subject area of each ISA. Mr. Kellas responded that it was some of both, but more of the former.

Ms. Koski-Grafer noted that IOSCO had found it difficult to consider the adequacy of some objectives without knowing the objectives of the other ISAs, and asked if the IAASB had identified objectives for the total package of ISAs, or planned to do so as part of its work in redrafting the ISAs. Mr. Kellas responded that Staff had done some preliminary work in this area, but that it has not yet been considered by the IAASB.

### GUIDELINES FOR REQUIREMENTS

Mr. Popham observed that in the supplements to the Exposure Draft there is generally explanation of why a present tense sentence was not made into a requirement, but little in the case when one was. He noted that he continues to have reservations about the increase in the number of requirements and the consequences it may have on the audit. Mr. Kellas noted that comments on the treatment of the sentences in the present tense as either requirements or application guidance would be particularly helpful when Member Organizations are responding to the Exposure Drafts.

Mr. Edwards inquired whether the guideline that states that a requirement is specified when the requirement would be applicable to "virtually all engagements" limits the ability of the IAASB to specify a requirement to address a unique circumstance that may be

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particularly important to, for example, a significant sector of the global economy or as a result of an emerging issue. Mr. Kellas explained that they are intended to be guidelines only, and that there is no intent for them to preclude the IAASB from doing what is appropriate in the circumstances.

Messrs. Pickeur and Damant suggested that the IAASB consider documenting the guidelines in some permanent form, for example, on the IAASB website, or within the Preface.

### DEPARTURE CONDITION

Mr. Rabine was of the view that the use of the wording “relevant circumstances” and “exceptional circumstances” in the departure condition leaves room for interpretation, possibly resulting in more departures than expected by the IAASB. He suggested that the IAASB explain further when a departure is, and is not, permitted. Mr. Kellas noted that the wording of the departure condition clearly explains that a departure is intended only in relation to those requirements that call for the performance of a specific procedure, and that procedures would be ineffective in the circumstances. He also noted that the departure condition does not allow an auditor to disregard a requirement; rather, it requires the auditor to justify why a requirement may not be effective in the circumstance, and for the auditor to perform alternative procedures necessary to achieve the purpose of the requirement that is being departed from, of all which is required to be documented.

Messrs. Rabine, Pickeur and Edwards were of the view that it would help clarify the applicability of the requirements if the IAASB were to provide additional guidance explaining what is meant by, and the difference between, “relevant requirements,” “relevant ISAs” and “relevant objectives.”

### WHETHER IT IS NECESSARY TO REPEAT REQUIREMENTS AT RELEVANT POINTS WITHIN THE APPLICATION MATERIAL

Mr. Edwards was of the view that the cross-referencing provided should allow reasonably competent professionals to navigate the standards easily. He therefore did not see a need to repeat the requirements within the application material for purposes of context and reference.

Mr. Gislason also did not see a need for repetition, and noted that he does not view the separation between the requirements and application material as resulting in difficulties from an SMP perspective. On the contrary, he believed that repeating the requirements within the application material creates the risk that some may read the application material section only, overlooking both the requirements section and, more concerning, the objectives section. Ms. Sucher had a similar view.

Mr. Morris was of the view that the key determinant will be the views of practitioners; that is, whether they view it as assisting or hindering their use of the ISAs in practice. Ms. De Beer had a similar view. Mr. Diomeda was of the view that the issue of presentation is less important than the question of the relevance and applicability of the requirements and guidance to the audit of SMEs.

Mr. Rabine did not take a position on the issue. He observed, however, that if the requirements were to be repeated in the application material, then any explanatory material

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in the requirements section would need to be removed to avoid the perception that there is a hierarchy within the application material.

Mr. Roussey suggested that the IAASB explore an electronic version of the ISAs that allows for printing of both styles to assist those that prefer one format to the other.

Mr. Carchrae questioned whether the application material as presented is comprehensible in and of itself, and capable of being read on a stand-alone basis. Mr. Kellas noted that the application material is intended to provide guidance on the requirement, and not to be read like a book. Mr. Pickeur supported this view.

Ms. Koski-Grafer asked what would be the downside of repeating requirements, if doing so would address the concerns of those who felt that it was needed to make the standards more understandable.

### USE OF THE TERM “SHALL”

CAG did not raise any concerns with the proposed use of the term “shall.” Mr. Rabine indicated that the European Commission fully supports its use, and believes strongly that it helps improve the enforceability of the ISAs and facilitates legislative and regulatory matters related to the adoption of the ISAs.

### PRESENTATION OF APPLICATION MATERIAL PERTAINING TO SMES

CAG did not raise any concerns with the proposed presentation of application material pertaining to SMEs, i.e., highlighting considerations specific to SMEs through the use of specific sub-headings within the application material. Messrs. Ashmalash, Gislason, Gathinji and Popham expressed support for the treatment, noting that the addition of another layer of referencing to the structure of the ISAs would be undesirable.

Mr. Diomeda was of the view that the main issue for SMEs is whether the requirements and guidance are applicable to engagements for entities of all sizes, particularly SMEs. He noted the importance of professional judgment, and asked how much scope the auditor had for judgment in determining a requirement not to be relevant (and therefore requiring no action) as against not appropriate and therefore requiring an alternative procedure to be followed, with related documentation requirements. As an alternative to this “flexible use” of professional judgment, he suggested a distinction between requirements that are applicable to entities of all sizes, and additional requirements that are applicable to larger entities. In response, Mr. Popham noted that the question of different requirements for different sizes of engagements was discussed at the previous meeting, and that there was consensus that the philosophy that “an audit is an audit” should prevail. He was of the view that the main issue is whether the ISAs explain adequately in the application material that the work effort in meeting the requirements will be different depending on the size and complexity of an entity, and the ways in which they may be met efficiently and effectively in an audit of an SME.

### APPLICATION OF CLARITY DRAFTING CONVENTIONS TO ISA 240

Ms. Esdon led CAG through the process of applying the clarity drafting conventions to, and the main sections of, the proposed redrafted ISA 240.

Mr. Pickeur questioned whether the relationship between the objective and the

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requirements could be enhanced further by some form of cross-referencing between the requirements and the relevant aspect of the objective. Ms. Esdon noted that the Task Force will consider this, but that it may be difficult since more than one requirement may pertain to more than one aspect of the objective. Further, it will depend on the final form of the objectives.

Mr. Carchrae inquired about the basis for determining whether explanatory material should be in the requirements section or in the application material section. Mr. Kellas explained that it depended on whether a competent auditor could understand the requirements on their own, or whether some additional explanation of the requirements was needed for a competent auditor to be able to understand the requirements on a “stand-alone” basis. He noted that the explanatory material is restricted to explaining what a requirement means, and in some cases is “definitional,” as opposed to describing how to apply it.

Mr. Popham was unclear why there are documentation requirements in light of ISA 230 (Revised). His understanding was that ISA 230 (Revised) results in the documentation of the performance of each requirement in an ISA to demonstrate compliance. If this is the case, then it is unnecessary to specify documentation requirements in individual ISAs. Mr. Kellas explained that ISA 230 (Revised) does not require the documentation of the performance of every requirement, but rather establishes the general principle that the documentation should be able to demonstrate compliance with the ISAs. The specification in individual ISAs of matters to be documented is intended to reinforce this general principle to particularly important aspects of the audit. Mr. Popham noted that others, including regulatory agencies, may not interpret ISA 230 (Revised) in this manner, and may presume that if a procedure has not been documented, then it has not been done. He suggested that the IAASB clarify further the documentation requirements under ISA 230 (Revised).

Mr. Popham expressed concern that the second element of the proposed objective in proposed ISA 240 (Redrafted) is too open-ended, and that it is inconsistent with his understanding of the responsibilities of the auditor with respect to fraud. His concern was that auditors may over-compensate by performing extensive additional procedures in seeking to ensure that the objective has been achieved. He suggested that, in the special case of fraud, the objective be specified in terms of performing the procedures specified in the ISA. Ms. Koski-Grafer disagreed with this view. She was of the view that the objective encourages the auditor to step back and consider whether enough has been done in response to the risk of fraud.

Ms. Koski-Grafer noted that it will be important from an enforcement point of view to understand whether, and to what extent, auditors are expected to comply with the procedures and actions specified in the application material. Mr. Kellas explained that there is an obligation on the auditor to consider the entire text of the Standards, and that the application material is intended to provide guidance on the requirements; whether the auditor performs the procedures in the application material, however, is a matter of professional judgment based on the engagement circumstances.

### IMPLEMENTATION

Mr. Kellas reported that the proposed implementation timetable for the clarification of the “older” ISAs in the period 2008-2011 has received some criticism. He noted that the

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IAASB will be considering ways in which to accelerate the timetable, including whether it is necessary to revise all of those ISAs, or whether some, or all, require clarification only.

CAG was of the general view that that the timetable should be accelerated. Mr. Rabine noted that completion of the IAASB Clarity Project on a timely basis is critical to the adoption of ISAs in the European Union, and that 2011 is too long in terms of allowing the European Commission to set a manageable adoption schedule for ISAs. Mr. Edwards supported the idea of dealing with the older ISAs earlier than 2011, for example, somewhere in 2008, by only redrafting the older ISAs.

Mr. Sylph asked whether there would be any disagreement with redrafting the older ISAs for clarity purposes only. Mr. Damant asked Representatives to obtain the views of their Member Organizations on this question, and to include them in their comment letters on the Exposure Draft.

### OTHER MATTERS

Mr. Edwards asked whether the IAASB has considered if, and when, a revision of IAPS 1004, “The Relationship Between Banking Supervisors and Banks’ External Auditors,” and IAPS 1006, “Audits of the Financial Statements of Banks,” might be undertaken, as recommended as a future priority project by the Basel Committee on Banking Supervision. He noted that the Basel Committee would be willing to provide resources for the project. Mr. Kellas noted that the IAASB is aware of the request, and that revision of those IAPSs depends on resources and the direction the IAASB may take in clarifying the authority, status and future role of IAPSs. He reported that the major firms have been asked about resources to assist with this project, if undertaken.

Ms. De Beer encouraged the IAASB to bear in mind the effect that that the redrafting of the ISAs may have on those countries that have just adopted, or are in the process of adopting, the ISAs, when setting effective dates.

Mr. Brown asked Member Organizations to consider, when responding to the Exposure Draft, whether the objective of the project to improve the clarity of Standards, and thereby the quality of audits, is being met. He also asked Member Organizations to consider whether there are additional ways in which the clarity of Standards and quality of audits could be further enhanced.

### **External Confirmations (Agenda Item O)**

Mr. Kellas reported that the IAASB Steering Committee approved for recommendation to the IAASB a project proposal to revise ISA 505, “External Confirmations,” and Part C: Procedures Regarding Litigation and Claims of ISA 501, “Audit Evidence – Additional Considerations for Specific Items.” He noted that the proposal was put forward principally in response to the European Commission’s request for the IAASB to revise the ISA to require confirmations with banks and legal advisors. He also noted that the U.S. Auditing Standards Board recommended improvements to its standard to the U.S. PCAOB. He explained that the objective of the session is to obtain Representatives’ views on whether there is a need to change the extent of the auditor’s obligation to obtain external confirmations, and the appropriateness of doing so in an international context.

Mr. Sylph reported that IAASB Staff is in the process of surveying certain national

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standard setters about their practices, including whether they have formal agreements with the banking and legal communities. He noted that there is anecdotal evidence that recent U.S. regulation has reduced the willingness of some entities to respond to trade confirmation requests.

Representatives expressed support for the IAASB to undertake the proposed project.

Mr. Popham noted that an effective confirmation process requires professional bodies in each country to reach an acceptable understanding in terms of the protocol to be followed. Doing so, however, will be a significant challenge.

Mr. Morris agreed with this point, and reported that past efforts to reach an agreement between the accounting profession and the banking industry in the U.S. on the form and content of confirmations was a significant challenge. He suggested that it may only be practical to reach agreement if the request for confirmation provides the information to be confirmed by the responding entity; that is, reaching an agreement internationally to respond to open-ended confirmation requests is unlikely to be possible.

Mr. Carchrae was of the view that the scope of the project should not be restricted to the question of whether to mandate the use of confirmations, but should also address the issue of reliability of confirmations as audit evidence, and the potential for over-reliance. Messrs. Edwards and Morris and Ms. Koski-Grafer shared this view. Ms. Koski-Grafer suggested that the Standard include guidance on what the auditor should do in the case of non-responses, or where evidence suggests that a confirmation may not be reliable. Mr. Morris noted that an issue related to confirmations is the ability to obtain information that is in fact relevant to the auditor's decision making process. Auditors should apply greater skepticism in evaluating confirmations, and should understand the evidentiary value that confirmations provide.

Ms. Sucher noted that the main issue is whether confirmations provide sufficient appropriate audit evidence. There is little point in mandating the use of confirmations if they are not effective in obtaining such evidence.

Mr. Edwards reported that the Basel Committee on Banking Supervision supports the project, and that it is willing to encourage banks and auditors thereof to seek ways to enhance the quality and effectiveness of the confirmation process. He noted that careful consideration is necessary to address the issue of mandating confirmations, particularly in light of the fact that acceptable arrangements would need to be determined at national levels

Mr. Lamoureux was of the view that there is a role for regulators to support this project by implementing penalties for issuing false or incorrect confirmations, or for not responding to confirmations requests.

Mr. Sekiguchi asked whether the IAASB intends to consider whether changes in technology may affect the reliability of confirmations, and the alternative procedures that may be available.

### **Using the Work of an Expert (Agenda Item P)**

Mr. Ferlings introduced the agenda item. The IAASB approved a project proposal to revise ISA 620, "Using the Work of an Expert" in December 2004. The IAASB will consider an

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Issues Paper and draft outline of the proposed revised ISA in December 2005.

Representatives commented as follows:

- It was suggested that the proposed ISA provide guidance on the circumstances in which an expert should be used by the auditor. Mr. Ferlings explained that the auditor's decision is based on the results of his or her risk assessment, which should include an assessment of the professional competence of the engagement team.
- It was suggested that the proposed ISA provide guidance on how the auditor should satisfy himself or herself of the professional qualifications and competence of the expert, of the quality of the experts' work, and that sufficient appropriate audit evidence has been obtained.
- It was asked that the following matter(s) be clarified in the proposed revised ISA:
  - The application of a risk based approach to the use of the work of an expert – as proposed in the issues paper.
  - The use of an expert employed by the auditor's firm and when to apply ISA 220, "Quality Control for Audits of Historical Financial Information," instead of the proposed revised ISA. Mr. Gutterman was of the view that a "bright line" may not exist. Mr. Popham asked about the difference between building an engagement team with the "right specialists" and building an engagement team and then deciding on which experts to use. Some argued that an expert under the direct supervision of the auditor could be considered part of the engagement team. Mr. Popham asked whether an expert employed by the firm but consulted by the engagement team should be treated differently from an expert employed by the firm and who is part of the engagement team. Mr. Roussey was of the view that, if the auditor's firm has "vetted" the expert employed by the firm, the auditor should not also have to do it, while Mr. Gutterman was of the view that the engagement team should determine whether the expert has the appropriate expertise.
  - Whether the auditor can accept an engagement where a significant part of the audit evidence will be obtained through experts.
- Mr. Gutterman did not think that it was necessary to distinguish types of expert in the scope of the proposed revised ISA. Mr. Sekiguchi noted that in some jurisdictions, law, regulation or the code of ethics requires the auditor to be an expert in accounting and taxation.

### **Acceptability of the Financial Reporting Framework (Agenda Item Q)**

Mr. Damant postponed CAG discussion of the agenda item on the acceptability of the financial reporting framework to the next CAG meeting. He asked those Representatives who have not yet obtained the views of their organizations on this subject to do so in preparing for the next meeting.

### **Public Meetings (Agenda Item R)**

Mr. Damant reported that the next CAG meeting will be a public meeting, whereby the agenda material will be accessible by the public, and at which public observers will be able to attend. He indicated that a press release announcing this will be issued within the next

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few weeks.

With respect to the proposed guidelines for observers, CAG agreed to the proposed change to delete reference to private session of CAG in the document, and to delete the reference to the provision of teleconference facilities. Mr. Edwards suggested that it may be useful to explain that some restrictions may be imposed on observers when CAG meetings are held at a private facility.

### **Closing**

Messrs. Damant and Kellas thanked the Representatives for their valuable input, and Mr. Damant closed the meeting.

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### Appendix

#### Membership of CAG Working Groups

Group Audits:	Hegarty, Popham, Roussey
SME/SMP Drafting:	Asmelash, Diomeda, Hegarty,
Modifications / EOM:	Lamoureux, Sucher
Related Parties:	Cassel, Roussey
Auditing Accounting Estimates:	Gutterman, Pickeur, Sucher
Materiality:	Blomme, Morris
Communications with Those Charged with Governance:	Diomeda, Popham
Use of Experts:	Gutterman, Morris, Roussey
Management Representations:	Morris, Peyret, Popham
Special Reports:	Blomme, Gielen, Lamoureux, Singh
<i>Working groups established at or subsequent to December 2005 CAG meeting:</i>	
External Confirmations	De Beer, Gielen, Morris
Material Weaknesses in Internal Control	Blomme, Morris, Peyret

In the case of the projects on clarity and international convergence, the CAG as a whole acts as working group.