

**DATE:** January 2018

**TO:** External Reporting Board  
New Zealand Auditing and Assurance Standards Board (NZAuASB)  
Australian Auditing and Assurance Standards Board (AUASB)  
Chartered Accountants Australia and New Zealand (CA ANZ)

**FROM:** Lyn Provost, IAASB member  
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**SUBJECT:** Report on IAASB Dec 2017 Meeting

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### **Introduction**

1. This report provides an overview of the International Auditing and Assurance Standards Board (IAASB) meeting held in New York on 11-15 December 2017.
2. The full meeting papers can be accessed [here](#).

### **ISA 540**

As noted in our report on the October meeting, a first read of the proposed redrafted standard was planned for the December meeting, including consideration of the remainder of the issues arising from comment letters and the new and revised application material. We were not surprised to hear that the timeline has changed and that the aim is now for a full read of the standard at the March meeting, and approval at the June meeting. Key stakeholder outreach is planned before and after the March meeting.

Key points discussed were scalability, the term reasonable, professional scepticism and the approach to the application material.

#### *Scalability*

There was overall agreement and support for the Task Force's changes, especially regarding the removal of the low/not low threshold, and the introduction of scalability in various ways. The drafting and overall approach is now much clearer, but we consider scalability is still a work in progress, and that there is still room for improvement to rewrite in plain English.

Overall suggestions for improvement include better alignment of the description of the spectrum of risk and work effort with ISA 315 and ISA 330, and examples to demonstrate scalability.

#### *The term reasonable*

There was still concerns raised by some members about the use of the term reasonable rather than adequate (as used in the accounting standards) in respect of

evaluating disclosures, and the need to consider consistency throughout the standards. The Task Force Chair agreed to consider it further and whether it needed to be explained better.

#### *Professional scepticism*

There was general support for the way professional scepticism has been addressed in the updated draft. However, some members asked for clarification of some of the words used. The Task Force Chair noted that further work needs to be done, including how to consider management bias. The Task Force will be liaising further with the Professional Scepticism Working Group. It is worth noting here that Lyn has agreed to be the Chair of the Professional Scepticism Working Group in the absence of the current Chair while he is undergoing medical treatment. She looks forward to being involved in this important topic.

#### *Approach to the application material*

The Board received a presentation on the analysis of the responses received, which clearly was a huge task. We were impressed with the amount of work and the systematic process used in analysing responses to the application material, but found ourselves still drowning in the detail. It was interesting to note that 3 paragraphs in the standard accounted for 2/3 of the application material. A lot of the material is also educational in style. It was also interesting to note that some respondents asked for more guidance and examples. We wonder if it is a case of wanting appropriate guidance, not necessarily more.

The Board was overall supportive of the process used by the Task Force, but noted that the proof would be in the writing, recognising the different views, making it simpler and shorter.

We volunteered to work through the application material and provided the Task Force just before XMAS with a summary of what we believe could be deleted, and what we considered to be more educational in style. We look forward to seeing the updated draft at the March meeting.

#### *First read of standard*

Revised requirements were presented to the Board after the first reading of the standard, which received much support. The Task Force is not expecting significant changes to the requirements going forward, but some changes are possible as the Task Force progresses the application material. The Task Force agreed that further work is also needed to clarify the auditor's procedures when management has not appropriately understood and addressed estimation uncertainty.

Lyn raised the question of due diligence and the potential of re-exposing the standard, given the significant changes to the draft. The Chair noted the procedure is first to approve the standard, and then to consider whether re-exposure is needed. Our view is contrary to that of the Task Force at this time that changes made is a restructure of the standard rather than fundamental changes to the standard itself.

## ISA 315 (Revised)

The Task Force Chair provided an update on the project, noting feedback received from the SMP committee has been positive about the overall direction but that it still has concerns around scalability and application for SMPs.

This was the first read of the full standard. There was broad support for the general direction of the proposed changes, but the overall feedback was that the flow of the standard is complex, and that more consideration should be given to scalability. The Board agreed that scalability should be presented through the requirements and application material in context of the auditor's consideration of risk thereby eliminating the need for "considerations for smaller entities."

Other key comments were as follows.

- There was support for the incorporation the spectrum of risk concept in the standard but further consideration is needed about how it can be explained earlier in the standard. Also, the spectrum of inherent risk and the relationship to the spectrum of risk of material misstatement needs to be clarified.
- There was support for the proposed changes to definitions but further consideration needed of controls definition, specifically how to include the concept of informal policies. There was also some concern about the use of 'reasonable possibility' when defining relevant assertions as it may not clarify the threshold.
- There was a good discussion about whether to include fraud risk in the Qualitative inherent risk factors (QIRFs), with most of the members continuing to support that. However, further consideration is needed about the interaction of the 'susceptibility to fraud' QIRF with ISA 240<sup>1</sup> and the fraud risk factors, and about quantitative aspects in areas where QIRFs are used.
- More consideration is needed about the description of the 'business model' in obtaining and understanding of the entity.
- There is an urgent need to consider including data analytics in the risk assessment procedures.
- Some concerns were raised about how to operationalise some of the concepts in the risk assessment, and that the spectrum of risk needs to be explained better.
- Further clarification is needed about what controls are 'relevant to the audit', including when the auditor needs to evaluate the design and determine the effectiveness of controls.

The Board will consider a second read of the full standard at the March meeting, and the targeted approval date of the ED is June 2018.

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<sup>1</sup> ISA 240, *The Auditor's Responsibility Relating to Fraud in an Audit of Financial Statements*

## Quality Control (at the engagement level) ISA 220

At the June 2017 meeting the Board asked the Task Force to go back to the drawing board, and to consider what the problem is with ISA 220 that needs to be fixed. Overall the Board was very supportive and complimentary of the comprehensive changes that had been made to the standard since the June meeting. Feedback included:

- There is a need to consider the use of 'sufficient' and 'appropriate' throughout the standard, how the actions in ISA 220 contribute to audit quality and how the concept of policies and procedures links to the concept of 'response' at the firm level in proposed ISQC1.
- Overall support for the proposals in respect of the objective that clarify that the engagement partner(EP) is responsible and accountable for audit quality, but to reconsider to whom the requirements of the ISA should be directed (i.e. the auditor, EP or the engagement team).
- More clarity is needed on the concept of 'manage and achieve' quality. The Board agreed that quality is more than just compliance with the standard, and that the Task Force need to consider if the objective implies a compliance activity. However, the Board cautioned to be careful and to be clear about what beyond compliance means.
- Consider whether the definitions of network and engagement team remain appropriate, including IESBA considerations.
- Consider whether situations where the signing partner is different from the engagement partner should be addressed within this standard or elsewhere.
- Overall support for the direction on leadership responsibility, but to clarify what managing and achieving quality means. Also, consider elevating related select application material.
- Clarify what the EP is expected to do to be satisfied that the firms policies and procedures on ethical requirements have been followed.
- Think about whether to include concepts of commercial considerations, long association, auditor rotation and how they relate to acceptance and continuance decisions.
- Consider whether additional actions are needed when the EP is not comfortable with the firm's acceptance and continuance of a client.
- Think about how best to emphasise the importance that engagement team members have the time available to perform the engagement, and the appropriate nature of resources.
- Clarify what actions can be delegated in the performance of the engagement
- Overall support for the stand back provision in the standard but to consider whether it should be a conforming amendment to ISA 700<sup>2</sup>.

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<sup>2</sup> ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

The Board will do a full first read of the standard at the June meeting.

### **Quality Control (Firm level) ISQC1**

Following feedback at the June meeting on how the scalability of the standard could be improved, and various outreach undertaken, the Quality Control Task Force (QCTF) reorganised the standard with a simpler and clearer structure, and introduced a new section in the introduction clarifying upfront how the standard may be applied by different firms.

The overall feedback from the SMP Committee and the Board is that the standard is scalable, but that new ways should be explored to emphasise scalability. For example, to explore development of accompanying guidance to be issued with the ED that addresses how the standard applies to a spectrum of firms. Field testing should be conducted to see how operable the standard is, and if it can be applied by a sole practitioner.

Further key feedback included:

#### *Deficiencies, major deficiencies, introduction, objective, definitions*

- Clarify concepts of deficiency and major deficiency, as well as shortcomings.
- Develop a framework to evaluate results of monitoring and other information to determine if there are deficiencies or a major deficiency.
- Clarify what happens when a major deficiency exists, and what is communicated to firm leadership and others.
- Reduce the introductory paragraphs.
- Better clarify the objective of the system versus the objective of the firm.
- Various proposed enhancements to definitions.

#### *Components*

- Overall support for the 8 components, but to clarify the interrelationships between the components.
- Consider reorganising governance and leadership, and the appropriate prominence of components.
- Rephrase the component objectives as objective statements.
- On balance, support for the structure of each component.
- Quality management process - reconsider threshold for quality risks – not practical and may result in too many risks being identified. Differentiate between the identification of the risks and assessment of their severity.
- Governance and leadership- include explicit reference to public interest, and clarify who are relevant stakeholders.
- Information and communication - more emphasis on two-way communication.
- Support for appointing individual responsible for independence, and not to broaden to have a chief ethics person. Balance the emphasis on various aspects of relevant ethical requirements.
- Acceptance and continuance – address circumstances when the firm does not have a choice in acceptance and continuance, for example in some public sectors.
- Resources – refine financial resource and technology resource, and enhance so that there is a forward-looking focus.

- Engagement performance – retain engagement quality control review in this component, but improve the link to the component objective.
- Monitoring and remediation – clarify how the objective of the standard to obtain reasonable assurance relates to monitoring and remediation. Consider if there should be an annual stand back. Improve emphasis on undertaking root cause analysis on engagements that went well.

#### *Networks and Third-Party Service Providers*

- Support for overall direction, but need to do more on professional scepticism.
- Include requirements for third party service providers, maybe in resources component.
- Address security issues in relation to use of third party service providers.

#### **EER Project**

At the October meeting the Board considered and unanimously approved the project proposal to develop new non-authoritative guidance to address the Ten Key Challenges, identified by the IAASB, which arise in the performance of assurance engagements over EER in applying ISAE 3000 (Revised)<sup>3</sup>.

The Board received an update on the Task Force discussions since the October meeting, including

- which of the Ten Key challenges identified by the IAASB will be addressed in Phase 1 of the project;
- planned research agenda;
- detailed project plan and timing of meetings; and
- draft call for nominations to a Project Advisory Panel (this was finalised and released in January – applications close on 2 February)

A proposal on the Form and structure of the guidance will be presented to the Board at the March 2018 meeting. It is likely to be organised by reference to either the Key Challenges or to the requirements in ISAE 3000.

The key challenges to be tackled first are:

- Evaluating suitability of criteria
- Materiality
- Building assertions
- Maturity in governance and internal control
- Narrative and future oriented information.

To project has been very effectively visually depicted as an 'EER Assurance house':

- The roof is communicating effectively in the audit report.
- The pillars are the key challenges.
- The foundation consists of determining the scope of an EER engagement, exercising professional scepticism and professional judgement, and obtaining the competence necessary to perform the engagement.

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<sup>3</sup> International Standard on Assurance Engagements ISAE 3000 (Revised), *Assurance Engagements other than Audits or Reviews of Historical Financial Information*

The planned research agenda includes research on:

- EER frameworks
- Assurance standards and guidance
- Assurance reports and EER reports
- What do users want

Members all highlighted they were very satisfied with the structural elements of the project, with compliments on the progress.

### **Professional scepticism**

The Board discussed the Professional Scepticism Subgroup's conclusions and recommendations related to different "mindset" concepts of professional scepticism, and the use of words in the ISAs in this respect.

The Board broadly agreed that the current concept of the attitude of professional scepticism involving a "questioning mind" in the definition of professional scepticism continues to be appropriate and it is therefore in the public interest that it be retained, rather than being replaced by other concepts suggested by some respondents to the ITC, such as "doubting mindset" or "challenging mind(set)".

The Board further agreed that the definition could potentially be more precise, and discussed what the next steps could be. The PIOB member noted the importance of working jointly with IESBA to get a common understanding so it can consistently feed into other standards development. The IAASB Professional Scepticism Subgroup will liaise as needed with the Professional Scepticism Joint Working Group.

### **Data Analytics Update**

The Board received an update on the activities of the Data Analytics Working Group(DAWG), which included a feedback statement and video on the feedback received on the ITC. No additional information was provided to that received at the October meeting. The DAWG is planning to continue conference calls and dialogue and further outreach activities. It is also working on developing case studies of use of Data Analytics for the ISA 315 Task Force.

### **Group Audit Update**

The Board received a presentation about the interconnections between ISA 600<sup>4</sup> and other ongoing projects, and how the Task Force is monitoring the activities of the other task forces, providing input and considering implications of changes in the other standards on ISA 600.

### **Next meeting**

The next meeting will be held 12-16 March 2018 in Amsterdam.

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<sup>4</sup> ISA 600 *Special Considerations – Audits of Group Financial Statements( Including the Work of Component Auditors)*