



BASEL COMMITTEE ON BANKING SUPERVISION

BANK FOR INTERNATIONAL SETTLEMENTS

Chairman

VIA e-mail: [EDComments@ifac.org](mailto:EDComments@ifac.org)

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**Exposure draft on 'Improving the Clarity of IAASB Standards'**

Dear Mr Sylph

The Basel Committee on Banking Supervision welcomes the opportunity to comment on your recent exposure draft on 'Improving the Clarity of IAASB Standards'.

The Committee has a strong interest in promoting international standards for auditing that are understandable, clear and capable of consistent application, and believes that this exposure draft includes many useful proposals.

Please find our detailed comments in the attached appendix. These comments have been prepared by the Committee's Accounting Task Force, chaired by Prof Arnold Schilder, Executive Director of the Netherlands Bank, and approved by the Basel Committee. The Committee trusts that you will find its comments useful and constructive.

If you have any questions regarding our comments, please feel free to contact Prof Schilder (+31 20 524 3360), Mr. Marc Pickeur, who chairs the Audit Subgroup of the Accounting Task Force (+32 2 220 5253), or Mr Steven Friedman at the Basel Committee Secretariat (+41 61 280 8096).

Yours sincerely,

Jaime Caruana



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## **Basel Committee Comments on IAASB Exposure Draft on ‘Improving the Clarity of IAASB Standards’:**

**“Proposed Amendments to the Preface to the International Standards on  
Quality Control, Auditing, Assurance and Related Services”,**

**“Proposed ISA 240 (Redrafted), The Auditor’s Responsibility to Consider  
Fraud in an Audit of Financial Statements”,**

**“Proposed ISA 300 (Redrafted), Planning an Audit of Financial  
Statements”,**

**“Proposed ISA 315 (Redrafted), Understanding the Entity and Its  
Environment and Assessing the Risks of Material Misstatement”, and**

**“Proposed ISA 330 (Redrafted), The Auditor’s Procedures in Response to  
Assessed Risks”.**

### **1. Introduction**

The Basel Committee on Banking Supervision<sup>1</sup> has a strong interest in high quality and independent audits of banks, and international standards for auditing that are understandable, clear and capable of consistent application can serve as an important foundation of such audits.

Section two of this Appendix contains our general observations on the IAASB’s proposals. Our comments in section three refer to selected questions raised in the Explanatory Memorandum accompanying the proposals.

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<sup>1</sup> The Basel Committee on Banking Supervision is a committee of banking supervisory authorities, which was established by the central bank Governors of the Group of Ten countries in 1975. It consists of senior representatives of bank supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States. It usually meets at the Bank for International Settlements in Basel, where its permanent Secretariat is located.



## 2. General observations

The Committee believes that the redrafted Standards demonstrate that the Board's approach for improving the clarity of its Standards is in general appropriate.

The Committee recognizes that the Board will consider, as explained on page 9 of the Explanatory Memorandum, whether the content (in particular, the objectives and requirements) of the redrafted ISAs is consistent, complete and free of overlap. This aspect of the Clarity Project is important and the Board should consider setting up a formal mechanism that ensures the consistency of the objectives and requirements of these and all subsequently redrafted Standards and monitors how the clarified ISAs interrelate.

The Board should also consider making a formal statement recognizing that it may be appropriate to revisit the Standards when the Clarity Project is finalized in order to assess the completeness and internal consistencies of the objectives and the requirements. This approach is an alternative to exposing, at one time, a complete package of all ISAs, redrafted for clarity, for which significant support was expressed by respondents.

The Committee appreciates the fact that the Board made available for each ISA Exposure Draft a 'mapping document' that demonstrates how the material in the existing ISAs has been reflected in the ISA Exposure Drafts. These documents have proven to be very helpful and the Committee encourages the Board to publish similar documents for the other Standards that will be redrafted in the context of the Clarity Project.

## 3. The Exposure Drafts (ED)

### Restructuring Aspect of the New Drafting Convention

1. ***In the light of the separation of requirements and application material, as presented in the four ISA Exposure Drafts, do you believe there is a need to repeat the requirements at relevant points within the application material to enhance context and reference, as discussed on page 10?***

We believe that the approach taken in the four ISA Exposure Drafts is appropriate and that there is no need to repeat the requirements at the relevant points within the application material. Paragraph 18 of the proposed amendments to the Preface to the International Standards on Quality Control, Auditing, Assurance and Related Services clearly indicates that the professional accountant is required to consider the entire text of a Standard in carrying out work on an engagement. This important requirement should remain in the final version of the Preface.

### Application of the New Drafting Conventions to the Four ISA Exposure Drafts

2. ***Are the objectives to be achieved by the auditor, stated at the beginning of the proposed ISAs, appropriate?***

While the Committee supports the new approach of including objectives to the Standards, it has two observations about the drafting of the objectives.



The Committee is in favour of objectives that represent overall principles that identify what the auditor is trying to achieve and apply to the various situations that the auditor might encounter. The Committee believes that the Board in drafting objectives should not only reiterate wording from the existing ISAs (or be inspired by wording therein) but should formulate objectives in the clarified ISAs that are 'over and above' what is stated in the requirements.<sup>2</sup> The Committee recognizes that this approach goes further than clarifying existing ISAs. However, the approach we advocate would fit perfectly with paragraph 19 of the Preface, which emphasizes the principles-based nature of the ISAs.

Furthermore, the Committee recommends that the IAASB develop criteria that will be used to determine the objectives of its redrafted ISAs and include these criteria in the Preface. These criteria may be different depending on the type of ISA. For example ISA 200 (Objectives and General Principles Governing an Audit of Financial Statements), which concerns the entire audit process, would have very different criteria for establishing objectives than the much more specific ISA 505 (External Confirmations).

**3. *Have the guidelines identified by the IAASB for determining whether a requirement should be specified, as set out on page 6, been applied appropriately and consistently, such that the resulting requirements are at a level that promotes consistency in performance and the use of professional judgment by auditors?***

The Committee has a general concern about the placement of the criteria that the Board uses to determine the audit requirements. These criteria are explained on page 6 of the Explanatory Memorandum, in particular the seventh (bulleted) paragraph of the section 'Clarifying Professional Requirements'. As these criteria are important, the Committee recommends including them in the Preface to the International Standards.

Subject to our comments hereafter, we believe that the guidelines for determining whether a requirement should be specified have been applied appropriately and consistently.

The requirements sections of the clarified ISAs contain paragraphs either without a 'shall' statement or where the 'shall' requirement is embedded in more general explanation.<sup>3</sup> The status of this explanatory material may cause confusion in the mind of the reader. In addition, the Committee has questions as to the status of the explanatory material under the heading 'Requirements', specifically, whether this material imposes any additional requirements on the auditor.

In case the Board prefers to keep some explanatory material in the Requirements section of the clarified Standards, this material should at least be in paragraphs separate from the requirements.

We note that the clarified ISA 240 has an elaborate introductory section, while the opposite is true for the clarified ISA 300. We would recommend that some additional explanatory text be

<sup>2</sup> We note that the wording of the objectives stated at the beginning of the proposed ISAs is taken from the existing ISAs. For example the wording of the objective of the clarified ISA 315 (paragraph 3) is taken almost literally from paragraph 2 of the existing ISA. The wording of the objective of the clarified ISA 330 (paragraph 3) is inspired by, among others, paragraphs 1, 3, 4 and 7 of the existing ISA.

<sup>3</sup> Examples are ISA 315.5 and ISA 240.15 respectively.



added to the introduction to ISA 300, in particular in relation to the importance of planning an audit (see for example paragraphs A1-A2 of the Application Material).

**4. *Has the application material been edited in a way that makes it clearer?***

In general, we believe that the approach taken by the Board increases clarity. However, we note an inconsistent approach in some cases as to what is or is not included in the application material or requirements, without adequate explanation of why this is the case. An example is ISA 330.5 and ISA 240.21-22. Both deal with responses to address the risks of material misstatement. ISA 330.5 is a one sentence paragraph (including a reference to Application Material) and ISA 240.21-22 are two lengthy paragraphs (including references to Application Material). Although the approach could be justified by the topic of ISA 240 (fraud), we believe that a more consistent approach would be appropriate.

**5. *Has an appropriate balance been achieved between eliminating duplicative material and retaining some repetition in the proposed ISAs to help users understand a particular ISA or how the ISAs interrelate?***

The last part of the question, as to whether the approach taken helps users understand how ISAs interrelate, is difficult to assess without having seen all clarified Standards (see also our general observations in section two of this Appendix).

**8. *Do you foresee any potential translation issues?***

Please see the response to question 10.

## **Implementation Approach**

**9. *Do you agree with the proposed implementation approach, including priorities and timetable, as discussed on pages 8 and 9 and as set out in Appendix 1?***

In general, we agree with the proposed implementation approach, except for some aspects of the timetable. We share the opinion expressed by several members of the Consultative Advisory Group during its 30 November – 1 December 2005 meeting that the estimated time period in Table IV of Appendix 1 of the Explanatory Memorandum should be shortened by two years so that the Clarity Project will be finalized before the end of 2009.

At the same meeting, it was proposed that it would be useful to separate the list of ISAs in Table IV into one list of ISAs to revise and another list of ISAs to clarify. We support this approach. We believe that the following Standards should be revised: ISA 250 (consideration of laws), ISA 505 (external confirmations), ISA 545 (auditing fair values) and ISA 570 (going concern).

Finally, we recommend prioritizing the list of ISAs that need to be revised and we confirm our view that ISA 545 (auditing fair values) should be in the first wave of ISAs for revision (see also our previous comments on IAASB priorities).

In previous comment letters, we have noted the need to revise IAPS 1004 and IAPS 1006 to bring these Practice Statements into line with new developments in supervisory practices (IAPS 1004) and with developments in internal control (IAPS 1006). We stand ready to



examine with you how this can be achieved, particularly as IAPS 1004 is a joint document of the IAASB and the Basel Committee. In this context, we recommend that the Board publicly state its intentions as to the possible future role of Practice Statements (see last page of the Explanatory Memorandum).

## **Proposed Amendments to the Preface**

### **10. *Do you have any comments on the necessary changes to the Preface to reflect the new drafting conventions?***

Paragraph 19 of the proposed amendments to the Preface states that 'The professional accountant must achieve the objective stated at the beginning of each Standard that is relevant in the circumstances of the engagement'. We understand that 'relevant in the circumstances of the engagement' refers to the Standard itself and not to the objectives stated in the Standard. It may be useful to clarify this as it is not appropriate for an auditor not to achieve all of the objectives of a relevant Standard. In other words it should be clear that a departure from the objectives is not allowed.

A similar comment as made in the preceding paragraph can also be made for paragraph 21 of the proposed amendments to the Preface regarding requirements. It should be made clear that 'relevant' in the first sentence of the paragraph relates to the Standard and not to the requirements.

Paragraph 20 of the Preface explains that the expression 'shall consider' means that 'the consideration of the procedure or action is required, while carrying out the procedure or action is not'. We are not convinced that this explanation will provide clarity to auditors. It seems that the expression 'shall consider' is used in different ways in the ISAs and this may also cause confusion about the necessary documentation requirements, e.g. if there is a departure from a 'shall consider' requirement.

In some places, 'shall consider' means using judgement when there are alternative courses of action, and the auditor needs to reflect on what to do or what not to do. The result is an action or the absence of an action. An example can be found in paragraph ISA 240.26.

In other places, 'shall consider' is used in the sense of 'assessing' and there would be audit results from the consideration itself. The action is the 'shall consider' itself; there is no choice of actions. An example can be found in paragraph ISA 240.29.

The Board should ensure that the expression 'shall consider' has only one meaning, not two different meanings. In addition, as the expression 'shall consider' is used in different ways, it may pose a potential translation issue if the expression is not used in a consistent manner throughout the ISAs.