



BASEL COMMITTEE ON BANKING SUPERVISION

BANK FOR INTERNATIONAL SETTLEMENTS

Chairman

VIA ELECTRONIC MAIL:
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**IAASB exposure draft ISA 600 (revised and redrafted),
The audit of group financial statements**

Dear Mr Sylph

The Basel Committee on Banking Supervision (the Committee) welcomes the opportunity to comment on your recent exposure draft on 'The audit of group financial statements'. The Committee has a strong interest in high quality and independent audits of banks and has carefully analysed the revised and redrafted proposals pertaining to the audit of group financial statements.

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 have been approved by the 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), Marc Pickeur, who chairs the Audit Subgroup of the Accounting Task Force (+32 2 220 5253), or Linda Ditchkus at the Basel Committee Secretariat (+41 61 280 8007).

Yours sincerely,

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Appendix

Basel Committee comments on IAASB exposure draft ISA 600 (revised and redrafted), The audit of group financial statements

1. Introduction

The Basel Committee on Banking Supervision¹ has a strong interest in high quality and independent audits of banks and has carefully analysed the revised and redrafted proposals pertaining to the audit of group financial statements. While the remainder of this appendix highlights certain issues, questions and suggestions for the Board's consideration, the Committee wishes to express its broad support for the approach taken in this revised draft.

The Committee appreciated the publication of the explanatory memorandum to the exposure draft, which provides the background to the development of the ISA and the rationale for the key decisions.

Our comments in Section 2 refer to the request for specific comments contained in paragraph 33 of the explanatory memorandum.

2. The revised and redrafted exposure draft

Specific comment on the proposal to eliminate the distinction between related and unrelated auditors (see paragraph 33(a) of the explanatory memorandum to the exposure draft)

The Committee supports the elimination of the distinction between related and unrelated auditors. Therefore we agree with the proposal, and the effect that it has on the procedures that the group auditor performs in relation to the work of other auditors. We have no specific comments on the proposed new definitions.

Specific comments on the approach taken by the IAASB to enhance the quality of group audits (see paragraph 33(b) of the explanatory memorandum to the exposure draft)

We recognise that the new ISA is written from the perspective of the group auditor. As a consequence, what is expected of the other auditor is an implied corollary to expectations of the group auditor. As we indicated in our previous comment letter, dated 29 July 2005 on the

¹ 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.

March 2005 Exposure Draft, this approach may not be sufficient to ensure that other auditors understand their roles, responsibilities, and other issues specific to their roles. Additionally, the ISA could be enhanced by explicitly requiring the other auditor to cooperate with the group auditor. We recommend adding such a requirement (ie consistent with the requirements in the existing ISA 600, paragraph 15) to the revised and redrafted Standard.

Responding to assessed risks – components that are not individually significant

We understand from paragraphs 24 and 25 and the illustrative diagram in paragraph A27 that the group auditor decides on the extent of work to be performed on components that are not individually significant when the work performed on significant components will not reduce audit risk for the group financial statements to an acceptably low level. Additionally, the auditor will only perform analytical procedures for components that are individually not significant and that are not selected for the performance of other audit procedures. We are concerned that some components may not be audited for a long period of time as the last sentence of paragraph A28 does not require, but only allows, the auditor to vary the selection of components. We recommend changing the verb “may” in the last sentence of paragraph A28 to the verb “shall”. The sentence then becomes “The group auditor shall vary the selection of components and work to be performed on their financial information over a period of time”. Since this sentence would then become a requirement, it should be moved to paragraph 25.

Communication with the other auditors

Paragraph 38 describes the content of the group auditor’s communication about the work to be performed by the other auditors. In order for other auditors to be aware of non-compliance with laws and regulations that occurred at the group level and may affect financial reporting decisions on the component level, we believe that the group auditor should communicate such group-level non-compliance in addition to communicating about non-compliance applicable to components. Therefore we suggest modifying the last sentence of paragraph 38(c) by dropping the words “applicable to the component”.

Compliance with applicable laws and regulations is, particularly for banks, very important. We recommend that the other auditor communicate in his or her memorandum or report of work, as described in paragraph 39, any identified non-compliance with laws and regulations that could materially affect the group financial statements. This could be achieved by adding, in paragraph 39, this requirement to the list of matters relevant to the group auditor’s conclusion with regard to the group audit.

Evaluating the sufficiency and appropriateness of audit evidence obtained

As described in the explanatory memorandum, the IAASB has revised the requirements to base the group auditor’s decision whether to review relevant parts of another auditor’s documentation on his or her evaluation of the other auditor’s memorandum or report of work performed (paragraph 41). The Board has also concluded that the nature, timing and extent of the group auditor’s involvement in the other auditor’s work are affected by the significance of the component, identified significant risks and the group auditor’s understanding of the other auditor (paragraph 26). This paragraph contains the requirement for the group auditor to evaluate the other auditor’s memorandum or report of work performed. This requirement is similar to the requirement introduced in paragraph 41. The two requirements may be seen as duplicative. However, it could be that the requirements contained in paragraph 26 refer to the involvement of the group auditor in the work performed by the other auditor *during* the audit and an evaluation *during* the audit of what is considered necessary while the requirement introduced in paragraph 41 is the evaluation of the other auditor’s report of work that the group auditor performs *at the end* of the audit. If this is the intention of the Board the wording of both paragraphs 26 and 41 should make this difference in timing clearer.

Communication with group management and those charged with governance of the group

Paragraph 47 requires the group auditor, who believes or suspects that group or component management may be involved in fraud, to communicate this to those charged with governance of the group. We recommend complementing this required communication with a requirement for the group auditor to communicate with those charged with governance of the group when the group auditor believes or suspects that employees who have significant roles in internal controls may be involved in fraud or that others may be involved in fraud that results in material misstatements in the financial statements. We believe this addition to paragraph 47 is justified by referring to the requirement of ISA 240.95, “The auditor’s responsibility to consider fraud in an audit of financial statements”.

Documentation

Although we are aware that most of the documentation requirements in previous versions of ISA 600 have been removed and replaced with a reference to ISA 230 (Revised), “Audit Documentation”, we strongly believe that this section could be made more robust by adding documentation requirements specific to group audits, in particular the requirements contained in paragraphs 30 through 34 (consolidation process), and the matters referred to in paragraph A2 (obtaining an understanding at the acceptance or continuance stage) and paragraphs A4 and A5 (identifying significant components).

Specific comment on the appropriateness of the objective to be achieved by the auditor (see paragraph 33(c)(i) of the explanatory memorandum to the exposure draft)

Paragraph 4 contains the statement that the group auditor alone is responsible for the audit opinion on the group financial statements. The Committee believes that this important statement should be included in the objective of the ISA. By doing so, the ISA should also make clearer the sole responsibility of the group auditor. Therefore, we recommend modifying the introductory sentence of paragraph 6. This could be done as follows: “In relation to this ISA, the objective of the auditor is to determine whether the auditor is able to act as the group auditor, and to obtain sufficient appropriate audit evidence to express an opinion on whether the financial statements are properly prepared in all material respects, in accordance with an applicable financial reporting framework”.

Specific comments on the appropriateness and consistency of the guidelines identified by the IAASB for determining whether a requirement should be specified (see paragraph 33(c)(ii) of the explanatory memorandum to the exposure draft)

The Committee appreciates the fact that the Board made available a ‘mapping document’ that demonstrates how the material in the March 2005 Exposure Draft has been reflected in this Exposure Draft.

The mapping document indicates that paragraph 26 of the March 2005 Exposure Draft is not retained as a requirement in the new Exposure Draft but is now application material (paragraph A11) because the requirement was not considered an essential step in an engagement to audit group financial statements. Paragraph 26 would have required a group auditor to state in the terms of the engagement that restrictions imposed after the acceptance of the engagement on (a) the group auditor’s access to component information or to those charged with governance, component management or other auditors, or (b) on the work to be performed on component financial information constituted scope limitations. We believe that making such a statement is an essential step in a group audit, and we disagree with the explanation in the ‘mapping document’. Therefore we recommend that paragraph A11 of the Exposure Draft be restored to a requirement.

Paragraphs 98 and 102 of the March 2005 Exposure Draft are not retained as requirements in the present Exposure Draft. The mapping document states that “Based on respondents’ request that the IAASB reconsider the number and appropriateness of the proposed requirements, the IAASB has concluded that (these requirements) could be viewed as application material”. The Committee strongly believes that the Board’s consideration is inappropriate: whether or not a “should” requirement or a statement written in the present tense becomes a requirement in the “clarified” version of the Standard should be based solely on the guidelines identified by the IAASB in this respect, not on respondents’ desire to reduce the number of requirements imposed on a group auditor. Accordingly, we believe the moment is right to reiterate the comment made in our comment letter dated 27 February 2006 on the Exposure Draft on “Improving the clarity of IAASB standards”: *“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”* (see Appendix to our comment letter, section 3, question 3).

Based on the IAASB’s own guidelines in this respect, we firmly believe that paragraphs 98 and 102 of the March 2005 Exposure Draft should be retained as requirements in the present draft although these paragraphs could be less detailed and could be drafted at a more appropriate level or included in other requirements.