



BASEL COMMITTEE ON BANKING SUPERVISION

BANK FOR INTERNATIONAL SETTLEMENTS

Chairman

**VIA ELECTRONIC MAIL:
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**IAASB exposure drafts of redrafted International Standards on Auditing:
ISA 230, Audit documentation; ISA 560, Subsequent events; ISA 610, The
auditor's consideration of the internal audit function; and ISA 720, The
auditor's responsibility in relation to other information in documents
containing audited financial statements**

Dear Mr Sylph

The Basel Committee on Banking Supervision (the Committee) welcomes the opportunity to comment on your recent exposure drafts. The Committee has a strong interest in high quality and independent audits of banks and has carefully analysed the redrafted proposals captioned above. The Committee appreciated the publication of the supplemental mapping information, which provided explanations for decisions regarding requirements and application materials and changes to the proposed text.

We appreciate the diligence of the International Auditing and Assurance Standards Board (IAASB) in revising and redrafting the auditing standards to improve the clarity of the language within the standards to more clearly describe the responsibilities of the independent auditor. While most of the comments included in the attached appendixes are primarily technical recommendations, we strongly feel that *ISA 610 (redrafted), The auditor's consideration of the internal audit function* warrants a thorough review, revision and re-exposure. Should the IAASB decide against doing so, the IAASB should, at a minimum, add a definition of 'internal audit function' to the standard, which it currently lacks, and address the auditor's obligations with respect to an outsourced internal audit function.

Please find our detailed comments in the attached appendixes. These comments have been prepared by the Committee's Accounting Task Force, chaired by Ms Sylvie Mathérat, Director of the Commission Bancaire in France, 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 Ms Mathérat (+33 1 4292 6579), 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,

A handwritten signature in blue ink, appearing to read 'Nout Wellink', with a stylized flourish at the end.

Nout Wellink



Appendix One

Basel Committee comments on IAASB exposure draft ISA 230 (redrafted), Audit documentation

1. Responses to the IAASB's questions

1) Is the objective to be achieved by the auditor, stated in the proposed redrafted ISA, appropriate?

In general, the Committee believes that the objective should be more outcome oriented. In this case, as shown in the title, the Committee believes the term 'audit documentation' or the word 'document' is a key to the application of this standard and should be reflected in the objective. Therefore, the Committee suggests that the objective could be reworded as follows (the new words are in bold only to more easily see the suggested change):

'The objective of the auditor is to have a sufficient and appropriate record of the basis for the auditor's report, and evidence that **documents that** the audit was performed in accordance with ISAs and applicable legal and regulatory requirements.'

2) Have the criteria identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and the use of professional judgment by auditors?

The Committee suggests changing the introductory sentence of paragraph 7 in order to establish a link with the redrafted ISA's objective of requiring the audit documentation to be sufficient and appropriate. The Committee believes that such a clarification would also emphasise the *sufficiency* of the audit documentation as stated in the objective. To clarify this requirement, the text could be changed as follows:

'The auditor shall prepare audit documentation **that is sufficient** to enable an experienced auditor, having no previous connection with the audit, to understand.'

Paragraph 12 deals with the completion of the assembly of the final audit file on a timely basis after the date of the auditor's report. In the interest of further clarity and improvement to the extant ISA, the Committee proposes to emphasise in the requirement section that the assembly of the final audit file should be restricted to an *administrative process* that does not involve the performance of new audit procedures or the drawing of new conclusions. Therefore, the Committee recommends rewording paragraph 12 as follows, consistent with its comment provided to the IAASB in March 2005 relating to paragraphs 18 and 19 of ISA 230 (Revised), Audit Documentation:

'The auditor shall complete **the administrative process** of assembling the final audit file on a timely basis after the date of the auditor's report.'

Paragraph 14 refers to the modification of existing audit documentation and the addition of new audit documentation after the assembly of the final audit file has been completed. The Committee believes that this requirement does not include in its current form enough information about the circumstances in which the auditor could find it necessary to modify or add audit documentation. Therefore, the Committee recommends adding application material to this requirement.

The Committee also believes that, as a sound quality control procedure, audit documentation should be reviewed whenever it is modified or added after the assembly of the audit file has been completed. Therefore, the Committee suggests that the phrase '(where applicable)' in paragraph 14(a) should be deleted.

3) Do you agree with the changes described above as being helpful to the clarity of the redrafted ISA, including whether considerations in the audit of small entities have been dealt with appropriately?

No comment.

2. Additional specific comments

As written, the second sentence in paragraph A1 of the application material, which refers to paragraph 6 regarding timely preparation of audit documentation, primarily seems to be a repetition of the first sentence. The Committee believes it is undesirable for the auditor to prepare documentation subsequent to the time that the work is performed and that the auditor should avoid such a practice as much as possible. To emphasise this and make the second sentence more of a corollary of the first sentence, the Committee recommends revising the second sentence in paragraph A1 as follows:

'Documentation prepared subsequent to the time the audit work is performed is likely to be less accurate than documentation prepared on a timely basis.'

The Standard provides guidance in paragraph A7 to clarify that it is unnecessary for the auditor to document separately compliance with matters for which compliance is 'self-evident' within the audit file. Paragraph A7 then provides a number of examples to illustrate this point. However, the second and third examples use the expression 'some evidence,' which seems contradictory to 'self-evident' and implies that additional documentation of compliance is necessary. Therefore, the Committee suggests the IAASB reconsider whether these are appropriate examples or, alternatively, modify the wording of the examples.

Also, the Committee believes that the concepts 'some evidence' and 'self-evident' may pose a potential translation issue when this redrafted ISA is translated from English into other languages. Therefore, the Committee believes that there is a need for clarification.

With respect to paragraph A9 (documentation of significant matters), the Committee believes that the expression 'that provides an understanding' in the second sentence is unnecessary and therefore should be deleted.

According to paragraph A11, auditors may prepare a summary of significant matters identified during an audit with a description of how these matters were addressed. Banking supervisors have a special interest in the existence of such summary memoranda and we believe they should always be prepared for large and complex audits of entities of public interest. Therefore, we recommend that the IAASB require preparation of a summary completion memorandum for public interest entities.



Appendix Two

Basel Committee comments on IAASB exposure draft ISA 560 (redrafted), Subsequent events

Responses to the IAASB's questions

1) Is the objective to be achieved by the auditor stated in the proposed redrafted ISA appropriate?

The Committee believes that the ISA's objective should be to identify as well as appropriately reflect events occurring between the date of the financial statements and the date of the auditor's report. As such, the objective in paragraph 4(a) should be revised to read as follows:

'(a) Obtain sufficient appropriate audit evidence about whether events occurring between the date of the financial statements and the date of the auditor's report that materially affect the financial statements are identified and appropriately reflected in those financial statements, and'

This recommended revision also creates a clear linkage between this objective and the requirement in paragraph 6.

2) Have the criteria identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and the use of professional judgement by auditors?

For reasons of clarity, the second sentence of paragraph 7 should contain another "shall" so that it reads as follows:

'Such audit procedures shall take into account the auditor's risk assessment and shall include the following:'

The requirement in paragraph 8 lacks a description of the consequences that should result from the auditor's findings concerning the accounting and disclosure for events that materially affect the financial statements. In contrast, paragraph 12 gives detailed descriptions of the actions required from the auditor in another case. The Committee believes that the clarity of the redrafted ISA would be enhanced by the addition to paragraph 8 of descriptions of the actions an auditor should take if subsequent events that materially affect the financial statements are not properly accounted for nor adequately disclosed in the financial statements.

Paragraphs 11 and 17 both contain unduly lengthy first sentences. These sentences make the paragraphs difficult to read and to translate. A simplified sentence structure would enhance clarity and aid in translation. Suggested wording to clarify the first sentence of each paragraph follows:

‘11. The financial reporting framework may allow management to restrict the amendment of the financial statements to the effects of the subsequent event(s) causing that amendment and may permit those responsible for approving the financial statements to restrict their approval to that amendment. In such a situation, the auditor is permitted to restrict the audit procedures on subsequent events required in paragraph 6 regarding the amended financial statements to that amendment.’

‘17. Management may decide not to take the necessary steps to ensure that anyone in receipt of the previously issued financial statements together with the auditor’s report thereon is informed of the situation and not to amend the financial statements in circumstances where the auditor believes they need amendment. In such a situation, the auditor shall notify management and those charged with governance that the auditor will take action to prevent future reliance on the auditor’s report.’

- 3) Do you agree with the changes described above as being necessary to the clarity of the redrafted ISA, including whether considerations in the audit of small entities and public sector entities have been dealt with appropriately? In particular, do you have any comments on the public sector issue requiring additional consideration described in the section on the considerations in the audits of small entities and public sector entities above?**

No comment.

- 4) Do you agree with the IAASB’s proposed treatment of the issue in relation to the application of the proposed redrafted ISA 560 to securities offering documents as noted above?**

No comment

- 5) Do you agree with the IAASB’s treatment of the restriction of subsequent events procedures and dual dating of the auditor’s report for amended financial statements?**

No comment.



Appendix Three

Basel Committee comments on IAASB exposure draft ISA 610 (redrafted), The auditor's consideration of the internal audit function

1. General comment

The Committee strongly feels that *ISA 610 (redrafted), The auditor's consideration of the internal audit function* warrants a thorough review, revision, and re-exposure to bring it in line with the current state of the art of internal audit functions. This is particularly important given the increased reliance that auditors place on the work of internal auditors. We also refer to our publications in this area:

- Internal audit in banks and the supervisor's relationship with auditors (August 2001) and
- Internal audit in banks and the supervisor's relationship with auditors: A survey (August 2002)

Should the IAASB decide against reviewing, revising, and re-exposing this ISA or decide to first address issues related to clarity and later address the need to update the standard, the IAASB should, at a minimum, add a definition of 'internal audit function' to the standard, which it currently lacks, and address the auditor's obligations with respect to an outsourced internal audit function.

Presented below are the Committee's responses to the IAASB's questions for ISA 610. In addition, the Committee also found it necessary to make additional comments on this ISA that were not requested by the IAASB.

Given the Committee's extensive concerns with the redrafting of this ISA, and its belief that this ISA is in need of being updated, the Committee recommends that the IAASB redraft, update and re-expose this ISA.

2. Responses to the IAASB's questions

1) Is the objective to be achieved by the auditor, stated in the proposed redrafted ISA, appropriate?

The objective in the redrafted ISA is written in such a way as to reference or reflect all the ISA 610 requirements in the aggregate. The Committee does not believe it is necessary for the ISA's objective to be written in this manner. Instead, the Committee believes that the more important considerations are that the ISA's objective be outcome-oriented and that all the requirements of the ISA are relevant to its objective.

In this case, the Committee believes that the desired outcome is for the external auditor to obtain an understanding of the internal audit function so that the external auditor can determine the extent to which the work of internal audit can be effectively used to modify or reduce the nature, timing and extent of audit procedures that the external auditor would otherwise need to carry out. The Committee recommends that the IAASB modify the ISA's objective to be more reflective of this desired outcome.

2) Have the criteria identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and the use of professional judgment by auditors?

The Committee believes that the manner in which the IAASB has reorganised and developed the redrafted ISA's requirements, when compared to the requirements in the extant ISA, has not contributed to an improvement in the clarity of the ISA in many areas. The Committee suggests that the following changes would provide greater clarity and consistency.

Paragraph 13(a) of extant ISA 610 incorporates the concept of 'independence' within 'organisational status', which is one of several criteria the auditor considers when obtaining an understanding and performing an assessment of the internal audit function. Paragraph 7 of the redrafted ISA makes the importance of the 'independence' concept less transparent in relation to organisational status. The Committee's best practices paper entitled *Internal audit in banks and the supervisor's relationship with auditors (2001)*, also highlights independence as a fundamental principle for an effective internal audit function. As a result, the Committee believes that an assessment of the degree of internal audit independence should be explicitly part of the requirements of paragraph 7. Thus, the second sentence of this paragraph should be revised by inserting the following (the new words are in bold): "the organisational status **and degree of independence** of the internal audit function".

In the interests of further clarity and improvement to the standard, the Committee also proposes the following adjustments be made to the ISA's requirements:

- Add an additional criterion to paragraph 9 to also require the auditor to evaluate the effectiveness of the two-way communications between the external auditor and the internal audit function.
- Add the word "audit" into paragraph 10 so as to have it say "the external auditor shall perform audit procedures". In redrafting ISA 610, the word "audit" was dropped from the extant ISA text without justification.
- Adjust the second sentence of paragraph 11 to say "shall evaluate and document whether:" Paragraph 19 of the extant ISA included a documentation requirement, which was dropped in the clarified ISA. While ISA 230 covers audit documentation, the Committee believes that documentation with respect to the evaluation of specific work performed by the internal audit function is a matter of such importance that auditor documentation requirements should also continue to exist within redrafted ISA 610. In this regard, paragraph 1 of proposed redrafted ISA 230 acknowledges the need for subject matter-specific documentation requirements and guidance in other ISAs.

3. Additional specific comments

The ISA no longer includes a definition of “internal audit function”. The Committee believes that the IAASB should add a definition of this term and suggests that the Institute of Internal Auditors’ (IIA) definition be used. The Committee’s 2001 best practices paper on internal audit in banks also uses this IIA definition of internal audit:

‘Internal Auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.’

Paragraphs A1 and A2 should consider the situation where an entity has outsourced its internal audit function.

In addition, paragraph A2 should highlight the importance of reviewing an appropriately approved Audit Charter, where one exists, to obtain knowledge of the organisational status and scope of the internal audit function.



Appendix Four

Basel Committee comments on IAASB exposure draft ISA 720 (redrafted), The auditor's responsibility in relation to other information in documents containing audited financial statements

1. Responses to the IAASB's questions

1) Is the objective to be achieved by the auditor, stated in the proposed redrafted ISA, appropriate?

As currently written, paragraph 4 states that 'the objective of the auditor is to avoid being associated with other information that may undermine the credibility of the audited financial statements'. The Committee believes that the objective should be more direct and should focus on the outcome of the audit work. The Committee suggests that the objective include the following wording:

'to ensure that no other information is provided with the audited financial statements that undermines the credibility of the audited financial statements'

2) Have the criteria identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and the use of professional judgment by auditors?

The Committee suggests refining the definition of 'other information' in paragraph 5. The concepts 'on the same terms' and 'at the same time' may need some further explanation to add clarity and ensure that translations of this redrafted ISA convey the appropriate intended meaning. In addition, the Application and Other Explanatory Material should take into account the fact that financial and regulatory reporting have evolved since the ISA was originally issued. In this respect, paragraph A2, whose content has not been changed, should include the example of regulatory disclosures, ie disclosures made to satisfy regulatory requirements.

The revised ISA defines 'inconsistency' and describes the possible consequences of a 'material inconsistency' in paragraph 5(b). To improve the clarity of the revised ISA, the Committee believes that the ISA should provide a definition of 'material inconsistency' as this term is often used throughout the document. In the same vein, the Committee believes that the removal of the word "material", which appears as a modifier of the term 'misstatements of fact' in extant ISA 720, may be inappropriate. The new wording is unclear as to whether the Board intended to incorporate a threshold for the auditor's required actions with respect to 'misstatements of fact' in paragraphs 11 through 13 of the revised ISA or whether these requirements apply to all misstatements regardless of how trivial and unrelated to matters appearing in the audited financial statements they may be.

Because the word 'material' no longer modifies the term 'misstatements of fact', the requirement in paragraph 12 for the auditor to request that management consult with a qualified third party will apply to every apparent misstatement of fact that remains unresolved after the misstatements have been discussed with management regardless of the significance of the misstatement. While management may choose not consult with a qualified third party concerning those apparent misstatements of fact that are insignificant, it should be incumbent on the auditor to apply judgement in determining which apparent misstatements of fact warrant third party consultation by management. Restoring the word 'material' as a modifier of 'misstatements of fact' would alleviate this concern about paragraph 12.

The Committee believes that the second sentence of paragraph 7, which addresses situations when "other information" is not obtained prior to the date of the auditor's report, is not sufficiently clear as to the subsequent actions the auditor is required to take after reading this information. Although paragraph 7 creates the presumption that "other information" should be provided and read before the date of the auditor's report, we recognize that this will not always be the case. The clarity of redrafted ISA 720 would be enhanced by explicitly linking the second sentence of paragraph 7 to the requirement in paragraph 14. This could be accomplished by adding a phrase such as "and follow the requirement in paragraph 14" at the end of paragraph 7. Alternatively, the requirement embodied in the second sentence of paragraph 7 could be incorporated into paragraph 14, which is the initial paragraph in the section of the redrafted ISA entitled "Availability of Other Information After the Date of the Auditor's Report".

2. Additional specific comment

The Committee believes that the second sentence of paragraph A7 should be reworded in a manner similar to paragraph A9 of redrafted ISA 560, which refers to management's responsibility under the terms of engagement. We also recommend a conforming amendment to ISA 210, Terms of Audit Engagements as to an agreement with the entity that the entity will provide the other information in a timely manner.