



BASEL COMMITTEE ON BANKING SUPERVISION

BANK FOR INTERNATIONAL SETTLEMENTS

Chairman

VIA ELECTRONIC MAIL:

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IAASB exposure draft ISA 200 (revised and redrafted), overall objective of the independent auditor, and the conduct of an audit in accordance with international standards on auditing

Dear Mr Sylph

The Basel Committee on Banking Supervision (the Committee) welcomes the opportunity to comment on your recent exposure draft. The Committee has a strong interest in high quality and independent audits of banks and has carefully analysed the proposal 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 efforts of the International Auditing and Assurance Standards Board (IAASB) in clarifying the auditing standard to enhance auditor performance in an audit of financial statements and improve the clarity of the language within the standard to more clearly describe the responsibilities of the auditor. While this proposed International Standard on Auditing (ISA) provides a description of the objectives of both the audit and the auditor, it appears to be heavily weighted toward describing what an audit is not designed to provide and, at times, the tone appears defensive. Additionally, some of the requirements could be more clearly written and the ISA could be enhanced with added definitions. We have provided more detailed comments and proposed changes to wording in the attached appendix. 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 Sylvie 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 large initial 'N' and a stylized, flowing script.

Nout Wellink



Appendix

Basel Committee comments on IAASB exposure draft ISA 200 (revised and redrafted), overall objective of the independent auditor, and the conduct of an audit in accordance with international standards on auditing

1. Introduction

The Basel Committee on Banking Supervision¹ (the Committee) has a strong interest in high quality and independent audits of banks and has carefully analysed the proposed redrafted International Standard on Auditing (ISA) pertaining to the overall objectives of an audit and an independent auditor. The remainder of this appendix highlights certain issues, questions and suggestions for the Board's consideration.

While this proposed International Standard on Auditing (ISA) provides a description of the objectives of both the audit and the auditor, it appears to be heavily weighted toward describing what an audit is not designed to provide, contains numerous references to professional judgement that may not always be appropriate, and includes a lengthy description of limitations of an audit. Ultimately, these inclusions and wording choices create a defensive tone and could be perceived as diminishing the value of an independent auditor and an audit in accordance with international auditing standards. Additionally, some of the requirements could be more clearly written, the ISA could be enhanced with added definitions and some parts of the ISA are not internally consistent.

2. Observations related to specific paragraphs

We have the following observations and suggestions related to specific paragraphs within the ISA:

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.

Overall objective of the independent auditor (paragraphs 4-6)²

If the *purpose* of an audit was clearly and specifically described, the clarity of the overall objective of the independent auditor, which is currently in paragraph 5, would be enhanced. For example, some of the concepts within paragraph 9, which describe characteristics/attributes of an audit, could be included within a separate section that could be part of the introduction to the ISA. Alternatively, paragraph 9 could replace paragraph 4 and provide an introduction to paragraph 5.

Paragraph 5 deals with the overall objective of the independent auditor. However, this paragraph contains multiple concepts within one sentence and could be easily misunderstood. Additional concepts within the paragraph could be included in additional sentences. We believe that the overall objective of the independent auditor is expressing an opinion on the financial statements and we believe that paragraph 5 should take this as a starting point.

An audit of financial statements, and related concepts (paragraphs 9-13)

The IAASB should consider eliminating this section and blending the guidance within these paragraphs into the Overall Objectives, Definitions, and Application and Other Explanatory Materials (AM), as appropriate. For example, the *concepts* within paragraph 13 could be renamed *terms* and be moved to the Definitions section with clear definitions added.

If the IAASB decides to move concepts from this section into the Definitions section, they should consider referring to the 'concepts' as 'terms,' when appropriate, because the term 'concepts' is currently used within the ISA in slightly different ways. Also, the IAASB should ensure that definitions within this ISA are consistent with the Glossary. For example, paragraphs 10-12 include characteristics of the term 'reasonable assurance,' which are different from the characteristics of this term in paragraph 16(h) within the Definitions section.

If the IAASB decides to move guidance from this section into other sections, the IAASB should ensure that the concept of 'reasonable assurance' remains prominent, as this concept is key to fulfilling the overall objective of an independent auditor. For example, paragraphs 10-12 could be a subsection of the Overall Objective of the Independent Auditor section, or could be covered in a separate section on the purpose of an audit.

The IAASB should revisit paragraphs 13, 18, A26, A27 and A42, which relate to 'professional scepticism' to ensure the text is internally consistent, both in substance and in tone.

Auditor independence (paragraphs 14-15)

Since the link between the Code of Ethics and this ISA is made in paragraph 17, the IAASB should consider moving paragraph 14 into the Application Material (AM).

Definitions (paragraph 16)

In addition to expanding this section to include some of the terms within paragraphs 9-13, some of the terms from the AM section could be included, particularly when the AM refers to

² The IAASB should revisit the three subtitles in this section (ie, Preparation of the Financial Statements; An Audit of Financial Statements, and Related Concepts; and Auditor Independence) and consider how these subtitles fit together with the overall objectives.

terms that are not defined in paragraph 16. For example, the term ‘professional scepticism’ from paragraphs A26 and A27 could be defined in paragraph 16, used where appropriate within the ISA, and expanded upon within the AM. Other examples of terms that could be defined, which are discussed further below, include the terms ‘professional judgment’ and ‘audit’.

Requirements (paragraphs 17-29)

Paragraphs 20 and A43, which outline the role of the ISAs, appear to be inconsistent. The IAASB should revisit these paragraphs and modify them as appropriate.

In paragraph 21, the second sentence is not necessary and should be dropped.

While paragraph 23 sets the relationship between the objectives and the requirements, it is not a requirement, as there is no ‘shall’. The IAASB should consider including the two sentences in paragraph 23 as introductory sentences for paragraph 24. Alternatively, these sentences could be included in the AM.

In the first sentence of paragraph 24, the IAASB should consider substituting the term ‘judge’ with the clearer term ‘evaluate.’

We are concerned about the message conveyed by the last two sentences of paragraph 24. These sentences appear to minimise the auditor’s responsibility by implying that the need to judge whether other audit procedures should be performed can be dismissed simply by complying with the requirements of the ISAs. However, it is likely that in many of the more complex or specialist audits (eg for banks) the application of the requirements of the relevant ISAs on their own may not be sufficient to achieve the objectives of these ISAs. We suggest the IAASB consider one of the following approaches to reduce possible misinterpretation of this paragraph: 1) delete the last two sentences of paragraph 24, 2) revise the last two sentences and reverse their order to read “Because the ISAs cannot anticipate all circumstances that may arise, the proper application of the requirements of the ISAs in and of themselves may not provide a sufficient basis for the auditor’s achievement of the objectives”.

In the first sentence of paragraph 25, the IAASB should change the term ‘consider’ to the more appropriate term ‘evaluate.’

Application and other explanatory material – an audit of financial statements, and related concepts (paragraphs A9-A39)

Audit risk – detection risk (paragraphs A18-A19)

Paragraph A19 places undue importance on the ‘inherent limitations of an audit.’ The IAASB should consider including the content of this paragraph within discussions of the term ‘reasonable assurance.’

Professional judgment (paragraphs A24-A25)

The IAASB should consider including a definition of the term ‘professional judgement’ in the Definitions section. In this section, the IAASB could include descriptions of how professional judgment should be used in completing the audit objectives.

In paragraph A25, the first sentence places undue emphasis on professional judgment as a personality characteristic. Training and experience provide the foundation for professional

judgment and these elements are currently described in the second sentence. Therefore, we suggest that the first sentence be deleted. Further, the Committee believes that well-trained and experienced auditors should, generally, come to similar conclusions in the same circumstances. In particular, consistent conclusions should be reached when issues or circumstances are material. This paragraph, as currently written, gives the impression that disparate judgments are common. The IAASB should revisit this paragraph to ensure it portrays the appropriate tone and characteristics of the term ‘professional judgment.’

The AM currently refers to three levels of professional judgment (ie judgment, professional judgment, and reasonable professional judgment). We suggest the ISA should focus consistently on ‘reasonable professional judgment.’

Inherent limitations of an audit (paragraphs A28-A31)

The second bullet in paragraph A29 mentions ‘the effectiveness of internal control’ as an example within parentheses. This concept warrants a more complete explanation than this brief mention. In some jurisdictions, an auditor may be required to report on the effectiveness of internal control in addition to conducting an audit in accordance with ISAs and this could be noted in the AM.

Instead of describing the inherent limitations of an audit, paragraph A29 lists areas not covered by an audit. To minimize the expectation gap associated with audits, it may be important to include this information in the ISA. However, this topic may need to be further developed and may be better placed elsewhere. For example, if the IAASB adds a definition of an ‘audit’ to the Definitions section (see previous comment on possible modifications to paragraph 9), this paragraph could be included as AM for that definition.

In paragraph A30, the IAASB mentions that the AM contains eight paragraphs describing inherent limitations of an audit. The Committee wonders whether this emphasis on audit limitations could foster perceptions that minimise the value of audits and independent auditors.

The last sentence in paragraph A31 is too strong. We suggest replacing the phrase ‘cannot be overcome’ with ‘cannot be completely overcome,’ as the auditor should make some attempt to mitigate limitations.

The overall tone of paragraph A32 is inappropriate. For example, the terms ‘highly likely’ and ‘however skilled’ infer that when professional judgment is used in making estimates, the results are generally unreliable.

Within paragraph A32, there is a reference to fair value estimates, which gives the impression that estimates based on fair values are an inherent limitation of the audit. At a minimum, the text should clarify that this may be the case when fair value estimates are based on models or with entity specific assumptions. Even then, the reasonableness of the assumptions still could be audited. Additionally, the third sentence implies that fair value estimates are subject to significant subjective and potentially unreliable inputs. Since some fair value estimates are based on highly observable market inputs, the IAASB should consider revising the reference from “fair value” to “fair values based on models.”

Furthermore, one could question whether paragraphs A32 and A33 should be included in the section “inherent limitations of an audit” as these paragraphs deal with inherent risk.

The overall tone of paragraph A38 is inappropriate because it overemphasises the concepts of speed and cost. One solution may be to move the last sentence to a more prominent position or to use the concept within the last sentence as a starting point.