



BASEL COMMITTEE ON BANKING SUPERVISION

BANK FOR INTERNATIONAL SETTLEMENTS

Chairman

Via Email: EDComments@ifac.org

Mr Jim Sylph
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Exposure Drafts on Group Audits and The Auditor's Report

Dear Mr Sylph,

The Basel Committee on Banking Supervision welcomes the opportunity to comment on your recent exposure drafts:

- Proposed Revised ISA 600 *"The Work of Related Auditors and Other Auditors in the Audit of Group Financial Statements"* and the proposed new IAPS *"The Audit of Group Financial Statements"*; and
- Proposed Revised ISA 700 *"The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements"*.

The Committee has a strong interest in promoting high quality international standards for audits, and believes that the exposure drafts include many useful proposals.

Please find our detailed comments in the two appendices attached. These comments have been prepared by the Committee's Accounting Task Force, chaired by Prof Arnold Schilder, Executive Director of De Nederlandsche 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), or Donna Bovolaneas at the Basel Committee Secretariat (+41 61 280 9278).

Yours sincerely,

Jaime Caruana

Appendix One

Basel Committee Comments on IAASB Exposure Drafts ISA 600 (Revised) “The Work of Related Auditors and Other Auditors in the Audit of Group Financial Statements”, and IAPS, “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 proposals.

The Committee is pleased to note that the Board intends to expand guidance on the audit of group financial statements by revising the existing ISA 600 and developing a new IAPS. The Committee recognises that auditors are faced with many difficult challenges in the audit of the financial statements of a group and therefore welcomes the Board's initiative to provide updated and expanded guidance on this important subject.

2. General observations

We have identified three areas for which we have general observations.

“Sole responsibility” and “Division of responsibility”

The proposed revised ISA 600 deals with both “sole responsibility” and “division of responsibility.” “Division of responsibility” has been retained as an alternative approach to “sole responsibility.” We believe this to be a key issue in the proposed revised Standard. The Committee's strong preference is for the group auditor to take “sole responsibility” for the audit of the group financial statements unless the group auditor is actually required to adopt the “division of responsibility” approach. The Committee believes that the “Division of Responsibility” section should only be retained for any (rare) cases in which national law or regulation requires the group auditor to divide responsibility for the audit opinion on the group financial statements.

We are unable to see the logic underlying the Board's proposal that auditors in some jurisdictions be allowed to choose which of the two approaches to adopt. We also note

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.

that the guidance in the IAPS deals exclusively with cases in which the group auditor takes sole responsibility and that only very limited guidance on division of responsibility is included in the (draft) revised standard. This appears to reflect a lack of conviction on the part of the Board that the “division of responsibility” approach is ever desirable.

Therefore, we recommend a revision of the first sentence of paragraph 5 of ISA 600 as follows: “Unless national standards enable and national law or regulation requires the group auditor to divide responsibility for the audit opinion on the group financial statements (referred to as “division of responsibility”), the group auditor should take sole responsibility for the audit opinion on the group financial statements.” Corresponding changes would need to be made to the section of ISA 600 dealing with “*division of responsibility*”.

The final sentence of paragraph 35 of ISA 600 directs the group auditor to inform those charged with governance of the group of a decision to divide responsibility. Whenever there is to be a “division of responsibility,” the Committee recommends that the group auditor should obtain written acknowledgement and confirmation from those charged with group governance that they understand that there will be divided responsibility for the audit opinion on the group financial statements (regardless of whether paragraph 5 and related paragraphs of ISA 600 on “division of responsibility” are revised as discussed in the preceding paragraph).

Finally, the Committee is concerned that the proposed wording of the revised standard is such that the two audit models, “sole responsibility” and “division of responsibility” will be permitted to continue indefinitely. Recent corporate scandals underline the importance of a robust group audit model and our comments indicate that the Committee has a strong preference for the “sole responsibility” approach. If, after having reviewed the comments received, the Board decides to retain the “division of responsibility” approach in situations other than where it is required by national law or regulation, we recommend that the Board indicate its preference for the “sole responsibility” approach and its intention to regularly review the benefits and risks of the “division of responsibility” model with a view to its eventual elimination.

Acceptance and Continuance as Group Auditor

The Committee considers the “Acceptance and Continuance as Group Auditor” section and the related guidance in the IAPS to be of major importance. Therefore, as discussed below, we recommend strengthening paragraphs 8 and 9 of the Standard and paragraphs 12 and 13 of the IAPS.

We recommend merging the factors listed in paragraph 10 of the IAPS with the factors enumerated in paragraph 8 of the Standard.

Paragraph 9 of the Standard states that if the group auditor concludes that the group auditor's involvement, including the involvement of related auditors, appears to be insufficient to accept or to continue the engagement, the group auditor considers whether the group auditor is able to resolve the insufficiency by participating appropriately in the work to be performed by the other auditors on the component's financial information. We believe that, depending on the nature of the group auditor's relationship with a “related auditor”, the group auditor may well need to consider participating in the work performed by related auditors on the component's financial

information, as well as work performed by other auditors, and that the Standard should provide guidance to this effect.

To strengthen the guidance in paragraphs 12 and 13 of the IAPS, we recommend moving paragraph 13 ahead of paragraph 12 because the former contains a more general statement than the latter. In addition, both paragraphs should be formulated in a more positive way.

We recommend that (current) paragraph 13 of the IAPS be amended to state that “A group auditor only accepts an engagement to audit group financial statements when the group auditor and related auditors directly perform work on all components that have been identified at the group level as likely to include significant risks of material misstatement of the group financial statements, unless the group auditor will be able to participate appropriately in the work to be performed by the other auditors on the components’ financial information (see paragraph 9 of proposed ISA 600).” We consider it inappropriate to imply that an engagement might sometimes be accepted notwithstanding that other auditors are to audit high risk components and the group auditor will be unable to participate appropriately in their work.

We also recommend that (current) paragraph 12 of the IAPS be reworded as follows: “A group auditor only accepts an engagement to audit group financial statements when the group auditor and related auditors directly perform work on at least 50% of the group assets, liabilities, cash flows, profit or turnover, unless the group auditor will be able to resolve this insufficiency by participating appropriately in the work to be performed by the other auditors on the components’ financial information (see paragraph 9 of proposed ISA 600).” Again, there should be no exceptions to this principle.

Professional Qualifications, Independence, Professional Competence, Resources and Quality Control Process of the Other Auditor

When the group auditor decides to use the work of another auditor, the group auditor should consider the professional qualifications, independence, professional competence and resources of the other auditor, and the quality control process of the other auditor’s firm (paragraph 15 of the Standard). Paragraph 21 of the IAPS states that when the other auditor is not independent or the group auditor is not satisfied with the professional qualifications, professional competence and resources of the other auditor, and with the quality control process of the other auditor’s firm, the group auditor plans to obtain audit evidence relating to the component’s financial information without using the work of the other auditor. The Committee recommends that paragraph 21 of the IAPS be moved from the IAPS to the Standard to strengthen the principle stated in paragraph 15 of the Standard.

We also believe that there is an inappropriate implication in paragraph 17 of the Standard that the group auditor’s consideration of the quality control process of the other auditor’s firm consists simply of seeking a representation that it complies with the firm-level quality control standard (ISQC 1). We believe that the group auditor needs instead to understand what quality control processes the other auditor actually has in place and whether the results of internal or external monitoring indicate a need for improvements to be implemented.

3. ISA 600 (Revised) “The Work of Related Auditors and Other Auditors in the Audit of Group Financial Statements”

Effective date

ISA 600 refers to the proposed ISQC 1 in paragraphs 7, 8 and 17. Although ISQC 1 has now been issued in final form, we note that it does not take effect until June 15, 2005 (i.e., after the proposed effective date of ISA 600). We do not believe the reference to ISQC 1 to be appropriate if ISA 600 is to take effect at an earlier date.

Access to information

We are concerned that the last sentence of paragraph 19, which states that the group auditor does not expect to have greater access than group management to component information and component management, conveys a confusing and inappropriate message. The group auditor should expect to have access to all the information and explanations the group auditor needs to take sole responsibility for the audit opinion on the group financial statements. Where the group auditor does not otherwise have a right to sufficient access, the group auditor should *require* (rather than merely *request*) group management to secure appropriate access for the group auditor.

Paragraph 20 states that when restrictions on the group auditor's access to information and explanations cannot be resolved, the group auditor should consider the impact of this scope limitation on the auditor's report on the group financial statements. We believe that the extent of these unresolved restrictions could be such as to make it inappropriate for the group auditor to continue with the engagement. Therefore, paragraph 20 should acknowledge that the group auditor may need to resign from the appointment in such circumstances. Conforming changes would also be needed for paragraphs 67 and 83 of the IAPS.

Communications

Paragraph 21 states that the group auditor should communicate to the related auditors and other auditors to provide them with the group auditor's requirements. It states that this communication "ordinarily is in the form of a letter of instruction." Paragraph 22 then states that the group auditor should obtain "written communication" regarding these requirements from the related or other auditor. The Standard should mandate that the group auditor's initial communication to the related or other auditors be in writing, especially since the response to this initial communication has to be in writing. This could be accomplished by revising the first (bold lettered) sentence of paragraph 21 to read "The group auditor should provide the related auditors and other auditors the group auditor's requirements in writing."

The final bullet point of paragraph 21 of ISA 600 on the content of the group auditor's letter of instruction applies only to an "other auditor." It addresses the other auditor's acknowledgement of their understanding that the group auditor intends to consider and use their work for the purposes of the audit of the group financial statements. Appendix 2 of the proposed IAPS illustrates examples of matters to be included in the group auditor's letter of instruction. The final bullet under the list of "Required

Acknowledgements and Confirmations" in Appendix 2 is "an acknowledgement that the group auditor intends to consider and use the related auditor's or other auditor's work for purposes of the audit of the group financial statements." Thus, there is an apparent conflict between this bullet in Appendix 2 of the proposed IAPS and the final bullet of paragraph 21 of ISA 600. We recommend that the final bullet of paragraph 21 of ISA 600 be revised to cover both related auditors and other auditors.

Title of Standard

We would note that while the title of ISA 600 points to the work of related auditors and other auditors in a group, the focus is in fact the audit of a group and how the audit work should be organised. Clarification of the title may be advisable.

4. IAPS, "The Audit of Group Financial Statements"

Terms of Engagement

Paragraph 18 of the proposed IAPS states that the group auditor "considers including in the terms of engagement the fact that restrictions on the group's auditor's access" to information, management or other auditors will constitute a scope limitation that may "impact the auditor's report". We recommend that the guidance indicate that the engagement letter *should* state that restrictions on access will constitute a scope limitation. The paragraph could be revised to read (for example) "The group auditor ordinarily includes in the terms of engagement ..." We cannot envision any circumstances in which the group auditor might conclude that such a statement should not be included in the terms of engagement.

Materiality

In several places (paragraphs 30, 54 and 56) the proposed IAPS states or implies that planning materiality thresholds will be different for audits at the component level and audits at the group level and requires the group auditor to assess these differences in determining the scope of the work to be performed. While the proposed guidance is helpful, the Committee looks forward to further exploration and clarification of the relationship between group materiality and component materiality as part of the Board's project to revise ISA 320 "*Audit Materiality*".

The second sentence of paragraph 31 of the proposed IAPS states that the "group auditor also communicates a threshold below which misstatements are regarded as clearly inconsequential and, as a result, need not be communicated to the group auditor." (This concept is also encompassed in the fifth item listed under the corresponding paragraph 22 of ISA 600.) While individual misstatements below some threshold may be individually inconsequential, a component on which a related auditor or other auditor will perform work may have so many individually inconsequential misstatements that they raise questions about the reliability of the component's financial information or internal control system. We believe that the existence of a substantial number of individually inconsequential misstatements is information that the related auditor or other auditor should communicate to the group auditor, and we recommend

that the guidance be modified accordingly. The group auditor should consider such information in assessing whether a material weakness in internal controls is present and, as provided in paragraph 88 of the proposed IAPS, is required to be reported to those charged with group governance.²

Obtaining an Understanding of the Components and the Consolidation

Paragraph 44 of the proposed IAPS, which also refers to ISA 250, "*Consideration of Laws and Regulations*", requires the group auditor to obtain a "general understanding" of the laws and regulations applicable to the parent that may have an impact on the group financial statements. Both paragraph 44 and related paragraphs in ISA 250 would be strengthened by substitution of the term "appropriate" for the term "general". Furthermore, as laws and regulations applicable to other components of the group may have an impact on the group financial statements, the Committee recommends expanding the auditor's responsibility accordingly.

Assessing the Risks of Material Misstatement of the Group Financial Statements

The fifth bullet in paragraph 50 of the proposed IAPS refers to business activities that involve high risk and cites "trading in futures" as an example. Since futures are exchange-traded contracts with standardised terms, a better example would be "trading in over-the-counter derivative contracts."

Paragraph 52 of the proposed IAPS states that the group auditor "ordinarily communicates" to the related auditor or other auditor the results of the group level risk assessment to the extent relevant to the related auditor's or other auditor's work. We recommend that paragraph 52 be revised to indicate that the group auditor's communication to the related auditor or other auditor should be in writing.

The same paragraph also provides that the group auditor ordinarily *requests* the related auditor or other auditor to inform the group auditor if significantly different information comes to the related auditor or other auditor's attention than the information on which the group auditor's risk assessment was based. We believe that this guidance should be revised to state that the group auditor ordinarily *requires* the related auditor or other auditor to so inform the group auditor in writing.

Responding to Assessed Risks: Scoping the Work to be Performed on the Components' Financial Information

The chart on page 35 of the proposed IAPS states in the lower right box (for "remaining components") that "ordinarily no audit or review procedures performed at component level." It then says "see paragraph 61." Paragraph 61 states that "for these components, the group auditor ordinarily performs analytical procedures at group level." We recommend that a statement to this effect be added to the lower right box on page 35. (We note that there is a reference to the performance of analytical procedures at group level in the box above the lower right box on page 35.)

² See also the Committee's comment on ISA 700.33(b) in Appendix 2, which addresses the auditor's responsibility with respect to internal control.

Appendices

Appendices 2 and 3 of the proposed IAPS are listed in the table of contents for the IAPS, but are not referenced anywhere in the text of the proposed IAPS itself. (Appendix 1, which contains definitions, is referenced in paragraph 8 of the proposed IAPS.)

Appendix 2 gives examples of matters to be included in the group auditor's letter of instruction, and Appendix 3 lists examples of related auditor's or other auditor's acknowledgements and confirmations. We note that these two matters are addressed in paragraphs 21 and 22 of ISA 600, in the section labelled "Communications", and suggest that the two Appendices would be more appropriately located in ISA 600 and referenced in paragraphs 21 and 22. Alternatively, if Appendices 2 and 3 remain in the IAPS, they should be referenced in appropriate paragraphs within the IAPS.

Footnote 1 in Appendix 3 states that it is advisable for the group auditor to list the components of the group in the letter of instruction to the related auditor or other auditor. Rather than providing this guidance in the example of the related auditor's or other auditor's acknowledgements and confirmations in Appendix 3, we suggest that this footnote should instead be included in Appendix 2, which provides examples of matters to be included in the letter of instruction itself. Since the names of the components of the group are needed by the related auditor or other auditor for the purpose of assessing independence under the Code of Ethics, this footnote should be located at the end of the third sub-bullet under the first bullet of Appendix 2 on page 44 of the proposed IAPS. In order to make it clear that this relocated footnote relates to independence, it should be expanded to say "When there are several components in the group and their names may not be known to the related auditor or other auditor, it is advisable for the group auditor to list them in the letter of instruction to facilitate the related auditor's or other auditor's assessment of compliance with the independence requirements in the IFAC *Code of Ethics for Professional Accountants*."

Appendix Two

Basel Committee Comments on IAASB Exposure Drafts ISA 700 (Revised) “The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements”; Amendments to ISA 200 “Objective and General Principles Governing an Audit of Financial Statements” and ISA 210 “Terms of Audit Engagements”; and Conforming Amendments to ISA 701 “Modifications to the Independent Auditor’s Report”, ISA 560 “Subsequent Events” and ISA 800 “The Independent Auditor’s Report on Special Purpose Audit Engagements”

1. General comments

The Basel Committee on Banking Supervision³ has a strong interest in high quality and independent audits of banks and has carefully analysed the proposals.

The Committee is pleased to note the efforts for clearer guidance on the form and content of the auditor’s report. We are comfortable with the two-stage approach to the revision of ISA 700 and the proposal to split the extant Standard into two ISAs, a revised ISA 700 when the auditor is able to express an unqualified opinion and no modification of the report is necessary and a new ISA 701, “Modifications to the Independent Auditor’s Report”. However, we would urge the Board to proceed with the project dealing with the new ISA 701 as quickly as possible.

We support in particular the proposals that clarify the auditor’s responsibility to consider the entity’s compliance with specific requirements of the financial reporting framework and the fair presentation of the financial statements as a whole. We fully support the Board’s proposal to impose a general duty on auditors to assess whether compliance with the financial reporting framework, by itself, may provide a misleading financial picture such that additional disclosures, and in extremely rare circumstances a departure from the financial reporting framework, may be warranted in the interest of achieving a true and fair presentation.

³ 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.

Furthermore, we are pleased to see that the exposure draft allows for circumstances in which the financial reporting framework encompasses legal and regulatory requirements and allows the auditor to express an opinion on such requirements (ISA 200.42).

The Committee also supports the introduction of guidance on the auditor's responsibilities with respect to supplementary information included with the financial statements that is not required by the financial reporting framework.

In addition, the Committee supports the direction taken by the Board to expand and update the wording of the auditor's report to enhance understanding of the auditor's role and the auditor's report. In this regard, we are pleased to see that the auditor's report will be explicit about the auditor's responsibility with regard to fraud and error and encourage the Board to retain the report's proposed language referring to financial statements that "are free from material misstatement, whether due to fraud or error" as this relates to the planning and performance of the audit.

In the remainder of the note, we identify areas where we have concerns or recommendations. Our significant comments are summarised below and include the following:

ISA 700

- The auditor's report should clearly identify that management's responsibility is summarized and represents only a component of the overall responsibilities discussed in the management report
- The "Other Reporting Responsibilities" section of the Standard should be clarified to better distinguish it from when legal and regulatory requirements are covered by the auditor's opinion on the financial statements
- The wording of the independent auditor's report should be expanded to be more specific in the introductory paragraph, in the paragraph about management's responsibility and in the paragraph describing the auditor's responsibility
- The "Auditor's Responsibility" section of the Standard and the illustrative auditor's report should refer to the fact that the auditor is expected to communicate any material weaknesses in internal control which come to the auditor's attention to those charged with governance

ISA 200

- As ISA 200 is an umbrella standard and sets out the objective and general principles governing an audit of financial statements, the term "scope of an audit" should be better defined and explained
- Reasonable assurance and materiality are fundamental concepts of the audit opinion and need to be articulated more clearly prior to the issuance of the revised ISA 700
- Financial reporting frameworks that are established through a democratic legislative process should be presumed to be acceptable in addition to those

established by standard-setting bodies. We also recommend that the description of characteristics of suitable criteria offered as guidance to the auditor when considering whether a financial reporting framework is acceptable be reconsidered

ISA 210

- The form and content of the engagement letter should also include the auditor's responsibilities and other reporting responsibilities with respect to legal and regulatory requirements to ensure there is a clear understanding with the client
- Various paragraphs in the section "Agreement on Applicable Financial Reporting Framework" would benefit from further clarification

ISA 701

- As ISA 701 "Modifications to the Independent Auditor's Report" only includes conforming changes and will not be fully revised until 2005, this interim guidance may not be sufficiently clear
- Since the scope paragraph has significantly changed in ISA 700, we recommend that the illustrations in the final ISA 701 be amended to reflect the new wording in the ISA 700 illustrative auditor's report

ISA 800

- Descriptions of management's and auditor's responsibilities in ISA 800 auditor's reports should be aligned with the elements identified for the ISA 700 auditor's report

2. ISA 700 (Revised) "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements"

Management's Responsibility for the Financial Statements

We believe that the auditor's report should clearly identify that management's responsibility is summarized and represents only a component of the overall responsibilities discussed in the management report. We suggest that the final standard include additional wording that acknowledges that internal controls relevant to the financial statements are only one component of the comprehensive system of internal controls required to be maintained by management.

In accordance with IAS 1 and ISA 570, we also recommend that paragraph 25 be extended to include management's responsibility to assess the entity's ability to continue as a going concern and paragraph 33 be extended to state that the description of an

audit in the auditor's report should include evaluating the appropriateness of management's use of the going concern assumption.

We recommend that paragraph 25(c) be revised to read "making accounting estimates, including fair value estimates where relevant, that are reasonable in the circumstances." Adding a reference to fair value would emphasize the importance of management's responsibility in this area.

We note that paragraph 39 contains a provision for the applicable financial reporting framework to encompass legal and regulatory requirements. When this is the case or when the auditor is including a "Report on Other Legal and Regulatory Requirements," we believe that the ISA should require that management's responsibility also include a reference to compliance with the relevant laws and regulations.

Other Reporting Responsibilities

We agree that it is appropriate to distinguish the additional reporting responsibilities in a separate paragraph following the opinion paragraph in the auditor's report. However, where the legal and regulatory requirements are included as part of the applicable financial reporting framework as contemplated by paragraph 39, and there are also other additional legal or regulatory requirements, the Standard does not sufficiently distinguish between such requirements to ensure clear communication of all reporting responsibilities. We understand that paragraphs 40-43 should only apply where the auditor is reporting on matters outside of the financial statements. It would be helpful to include some examples to distinguish between the circumstances described in paragraphs 39 and 40.

We are also unclear as to how the descriptions under Management's Responsibility and Auditor's Responsibility in the auditor's report relate to the Other Legal and Regulatory Requirements section of the report. In some jurisdictions the auditor is required by statute to report on certain matters on an exception basis only (i.e., only if the auditor is not satisfied on the points). It is unclear to us whether it is proposed that the audit report should specifically list all such responsibilities, even if the auditor has nothing to report in relation to them, and if so, whether such an approach is likely to add any value to the report.

Auditor's Responsibility with Respect to Internal Control

Paragraph 33(b) proposes that the auditor be required to state in his report that his consideration of internal control is "not for the purpose of expressing an opinion on the effectiveness of the entity's internal control" (unless there is a specific requirement to report on internal control in the jurisdiction concerned). While factually correct, we consider such a statement in isolation to be potentially misleading. The auditor has a responsibility to communicate material weaknesses in internal control identified in the course of the audit to those charged with governance. In view of the importance of this responsibility, we believe that the audit report should make specific reference to it (contrary to what we understand the Board has previously concluded on this issue). We therefore recommend that the specific segment of paragraph 33(b) referenced above be replaced by the following separate sentence: "The auditor is not required to form and express an opinion as to the effectiveness of the entity's internal control system but is

expected to communicate any material weaknesses in internal control which come to the auditor's attention to those charged with governance". A similar conforming change should be made to the auditor's report.

Furthermore, we suggest adding a further footnote to paragraph 33(b) preceding the existing footnote 5 to indicate that, even though the auditor might not be required to form and express an opinion as to the effectiveness of the entity's internal control system, "external auditors have to obtain an understanding of the internal control system in order to assess the extent to which they can rely on the system in determining the nature, timing and scope of their own procedures".⁴

Auditor's Report

As mentioned in the principle about the introductory paragraph of the auditor's report (paragraph 19), we recommend that the introductory paragraph of the auditor's report specifically mention the period covered by the income statement, statement of changes in equity and cash flow statement (e.g., 'for the period from...to...').

The introductory paragraph of the auditor's report should be revised to also refer to "a summary of significant accounting policies and other explanatory notes" to be in line with paragraph 43 of the proposed amendment to ISA 200.

We recommend that the auditor's report state in the Auditor's Responsibility paragraph that the auditor has determined that the financial reporting framework identified by management is acceptable. We believe that this principle, as mentioned in paragraph 37 of the proposed amendment to ISA 200, should be reflected in ISA 700.

Other Comments on ISA 700

We believe that the section "Elements of the Auditor's Report in an Audit Conducted in Accordance with ISAs" (paragraphs 13 and 14) would benefit from an appropriate introductory principle in bold lettering. This could be achieved by moving the concept described in the last sentence of paragraph 14 to a new paragraph preceding paragraph 13.

We suggest specifying in paragraph 13 that the auditor's address included in the auditor's report be the business or statutory address.

An explanatory paragraph on the importance of auditing management's accounting estimates and a cross reference to ISA 540 "The Audit of Accounting Estimates" should be added following paragraph 33.

The auditor's address referred to in paragraph 50 should also include the country where the auditor practises.

⁴ "Framework for internal control systems in banking organizations" (Basel Committee on Banking Supervision, September 1998)

3. Amendments to ISA 200 “Objective and General Principles Governing an Audit of Financial Statements”

Scope of an Audit

Considering that ISA 200 is an umbrella standard and sets out the objective and general principles governing an audit of financial statements, we believe the term “scope of an audit” should be better defined and explained. Paragraph 10 states “The term scope of an audit refers to the audit procedures deemed appropriate in the circumstances, in the auditor’s judgment, to achieve the objective of the audit.” This statement implies that the scope of the audit is entirely dependent on the auditor’s judgment, and it does not relate the “scope” (i.e., nature, timing and extent of the audit procedures) to the risk assessment and the requirements of the various ISAs.

Therefore, we recommend an amendment to this section so that the “scope” refers to the nature, timing and extent of the audit procedures based on the auditor’s risk assessment and the requirement for the auditor to obtain sufficient appropriate audit evidence. In addition, a restriction on the auditor’s access to information by the entity, another auditor or an expert may be considered a “limitation in scope”; therefore, the concept of the auditor’s free access to all required information should also be included in ISA 200 and the definition of “scope of an audit”. Similarly, corresponding amendments to ISA 700.31 should be considered.

Reasonable Assurance

Paragraph 17 states that an audit in accordance with ISAs is designed to provide the users of the financial statements with “reasonable assurance” that the financial statements taken as a whole are free from material misstatement. In accordance with the definition in the glossary of terms, we have interpreted this to mean “a high, but not absolute, level of assurance”. We do not support the proposed amendment to paragraph 18 to state that “an auditor obtains reasonable but not absolute assurance” since it appears to be an attempt to move away from the concept of a high level of assurance. Reasonable assurance and materiality are both fundamental concepts of the audit opinion; therefore, we would prefer that these concepts be clearly articulated in an appropriate manner prior to the issuance of the revised ISA 200. The proposed amendment to paragraph 18 only serves, in our view, to create additional ambiguity as to what level of assurance an audit report is expected to convey.

We understand that the Board has recently initiated a joint project with national standard setters on reasonable assurance and that a project on materiality is also in progress. We urge the Board to give both projects priority such that the expectation gap with users can be narrowed and clarity provided on these fundamental concepts. We also recommend that the Board seek the views of the Consultative Advisory Group (CAG), at its next meeting, as to how reasonable assurance in the context of an audit should be defined and give proper weight to the CAG’s views when contemplating changes to current guidance. Therefore, until this project on reasonable assurance is completed, we recommend that the Board retain the existing language of paragraph 18, which states that “an auditor cannot obtain absolute assurance”, and not adopt the proposed language.

Applicable Financial Reporting Framework

It should be made clear that national financial reporting frameworks that have been approved in a democratic process by a legislature (Parliament or Government), which is the case in some countries, qualify as an acceptable financial reporting framework under ISA 200. In this regard, the first sentence of paragraph 41 states “Financial reporting frameworks...are presumed to be acceptable for general purpose financial statements ... provided the standard setting organisations follow an established process *involving deliberation and exposure of proposals for comment to a wide range of stakeholders.*” We recommend that the italicised part of the sentence be deleted to avoid the possibility of some recognised national frameworks being deemed to be unacceptable.

Similarly, we also recommend that the description of characteristics of suitable criteria offered as guidance to the auditor when considering whether the financial reporting framework is acceptable (paragraph 44) be reconsidered. We are concerned that the frameworks established by some leading national standard-setting bodies or by certain national laws may not fully meet all the stated criteria.

Other Comments on ISA 200

We particularly welcome the final sentence of paragraph 8 stating that “an auditor who does not apply the guidance included in a relevant IAPS needs to be prepared to explain how the basic principles and essential procedures in the Standard addressed by the IAPS have been complied with.” Given the importance of IAPSs 1004 and 1006 to banking supervisors, we strongly support the spirit of this provision but consider that it could be expressed more clearly (e.g., that there is a rebuttable presumption that applying the guidance in the IAPS is necessary to achieve compliance with the Standard).

Paragraph 35 appears inconsistent with the wording in ISA 700, paragraph 25. It is missing a reference to management's responsibility “for the preparation and fair presentation of the financial statements”.

We recommend that the last bullet point in paragraph 35 be revised to read “Making accounting estimates, including fair value estimates where relevant, that are reasonable in the circumstances.” Adding a reference to fair value would emphasize the importance of management's responsibility in this area. See also our comment on ISA 700.25(c).

Paragraph 47 of ISA 200 cross-references ISA 700, but ISA 700 deals primarily with unqualified opinions. Paragraph 48 refers to ISA 800 on special purpose audit engagements. However, there is no reference to ISA 701 on modifications to the independent auditor's report in these paragraphs. We recommend that a cross-reference to ISA 701 be added to paragraph 47.

4. Amendments to ISA 210 “Terms of Audit Engagements”

Audit Engagement Letters: Principal Contents

This section of ISA 210 has not been fully amended in line with ISA 700. The form and content of the engagement letter should also include the auditor’s responsibilities and other reporting responsibilities with respect to legal and regulatory requirements to ensure there is a clear understanding with the client.

Paragraphs 6-8 include lists of items that are not mandatory as the preambles include the discretionary words “generally include” (paragraph 6), “may also wish to include” (paragraph 7) and “could be made” (paragraph 8). We recommend that the Standard distinguish between what should be included in all engagement letters (i.e., where the item is required) and what is discretionary. In addition to the items mentioned in paragraph 6, we believe that audit engagement letters should include a reference to:

- The auditor’s responsibilities
- The other legal and regulatory requirements
- Arrangements concerning the involvement of other auditors and experts (particularly actuaries)

The engagement letter should not imply that the identification of the financial reporting framework is the auditor’s responsibility. We recommend that the third bullet point in paragraph 6 be amended to include the words “identified by management”.

Agreement on Applicable Financial Reporting Framework

We recommend that paragraph 16 be amended to include a reference to frameworks established by legislation and regulations by revising the introductory clause to read “not established by an authorized or recognized international or national standards setting organization or by national laws or regulations”.

We recommend that paragraph 17 be reconsidered as we do not believe that the auditor should seek to undertake a comparison of the type described. The intended meaning of the term “significant differences” is unclear and open to a variety of interpretations. We also note that the paragraph refers to assessing whether the framework is “suitable” whereas the requirement under ISA 200 is to assess whether it is “acceptable”.

We believe that paragraph 18 should include the alternative of changing the audit engagement to a special purpose audit engagement and reporting under ISA 800 when the auditor has identified that the financial reporting framework is not acceptable for general purpose financial statements. We would also point out that the terms “acceptable” and “suitable” are used interchangeably as if these terms are synonymous.

Other Comments on ISA 210

We recommend that paragraph 19 be amended to state that an updated engagement letter should be sent and signed annually. This is particularly important for listed entities, banks and other regulated financial institutions as well as for high risk audits generally. It

may also be mandated for other entities by national standard setters or regulation. Conforming changes would also be required to the text of paragraph 20.

In addition, we recommend amending paragraphs 2 and 26 to state (in bold lettering) that the terms of engagement should be agreed in writing.

5. Conforming Amendments to ISA 701 “Modifications to the Independent Auditor’s Report”

We understand that ISA 701 “Modifications to the Independent Auditor’s Report” will not be fully revised until 2005, but we question whether the proposed interim guidance provided is sufficiently clear.

Since the scope paragraph of the auditor’s report has significantly changed in ISA 700, we recommend that the illustrations in the final ISA 701 be amended to reflect the new wording in the auditor’s report and to show how the concluding sentence of the auditor’s responsibility section of the auditor’s report, “We believe that the audit evidence that we have obtained is sufficient and appropriate to provide a reasonable basis for our opinion on the financial statements”, should be amended when the issuance of a modified auditor’s report is appropriate (e.g., for a scope limitation).

6. Conforming Amendments to ISA 800 “The Independent Auditor’s Report on Special Purpose Audit Engagements”

We believe that the elements of ISA 800 auditor’s reports should be aligned with the elements identified for ISA 700. More specifically, the descriptions of management’s and the auditor’s responsibilities should be the same as the respective descriptions in ISA 700, where applicable. Similarly, the examples in the Appendices to ISA 800 should reflect these conforming changes.