

EUROPEAN COMMISSION

Internal Market and Services DG

FREE MOVEMENT OF CAPITAL, COMPANY LAW AND CORPORATE GOVERNANCE
Director

Brussels, 15.11.07 00004366
MARKT/2007/16192

Mr Jim Sylph
Technical Director
International Auditing and
Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York,
NY 10 017 – USA

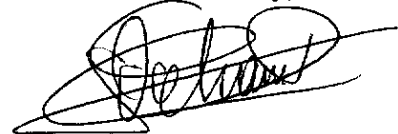
**Subject: Comment on the Exposure Draft of Proposed ISA 510 (Redrafted) –
*Initial Engagements – Opening Balances***

Dear Mr Sylph,

1. We appreciate the opportunity to comment on the IAASB proposal for a redrafted International Standard on Auditing on Initial Engagements – Opening Balances.
2. Proposed ISA 510 (Redrafted) intends to clarify the auditor's responsibilities relating to opening balances when conducting an initial audit engagement. We have the following major concerns with this exposure draft:
 - The current draft contains a number of audit requirements which are relevant for both initial and recurring audits. For instance, requirements in paragraph 5 a) and b) consisting in verifying the opening balances also apply in the case of a recurring audit. Paragraph 5 c) (i) mandating reviewing the predecessor auditor's work paper should also apply in the case of the rotation within a firm. We would find it confusing, from the clarity point of view, if certain requirements applicable to recurring audits were to be found only in ISA 510. Whilst we see no objections to have both types of requirements in ISA 510, we invite the IAASB to identify comprehensively which audit requirements of ISA 510 applicable to initial engagements are also applicable to recurring audit engagements, and to ensure that the latter appears also elsewhere in ISAs applicable to recurring audits, such as e.g. ISA 710 on comparatives.
 - We support deleting any reference in ISA 510 to "split opinions", i.e. the ability to report separately on e.g. the balance sheet and a cash flow statement. This stands for paragraphs A7(c) as well as for the Appendix in ISA 510. As you know, many Member States do not allow for such type of opinion. It should be exclusively up to ISA 705 to address the issue of 'split opinion', in order to devise a workable solution centrally.

- Moreover, the Appendix creates confusion because it seeks to address numerous issues ("split opinion", statement of responsibilities, sub-headings, ...) which do not belong to ISA 510. We also doubt that the consequences of misstated opening balances on the audit opinion are of such relevance as to justify an Appendix. We therefore support deleting the Appendix. In exchange for this, more guidance may be included in the application material.
 - The current draft is not clear and consistent enough when addressing the situations where an auditor is not able to obtain sufficient appropriate audit evidence, as compared to situations where material misstatements have been identified. ISA 510 should spell out in a clearer and more consistent way how to address this from the standpoint of communication with those charged with governance and the audit report. We provide with further details and drafting suggestions in points 4. and 7. (see Annex).
3. I would like to emphasise that this comment letter cannot pre-empt any future official position of the European Commission. In particular, our position on the above ISA, and the objectives therein, may be modified depending on the outcome of the future revision of other ISA's in the frame of the Clarity Project.
 4. The comments in this letter have taken account of the views expressed within the European Group of Auditors' Oversight Bodies (EGAOB), and/or within the 'ISA Sub-group' of the EGAOB. The ISA Sub-group is comprised of participants from European organisations including audit regulators, standard setters on auditing, professional bodies, and companies. Those comments may not necessarily reflect in all circumstances unanimous views of the members of the EGAOB and/or of the participants to the EGAOB ISA Sub-group.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Pierre Delsaux', written in a cursive style with a large loop at the end.

Pierre Delsaux

Cc: Jürgen Tiedje, European Commission, Members of the EGAOB.

GENERAL COMMENTS

Responsibilities of the Auditor in Auditing Opening Balances when conducting an initial audit engagement

1. We understand from the scope of ISA 510 and the new definition of the predecessor auditor that this standard deals with the auditor's responsibilities relating to opening balances when conducting an initial audit engagement. However, the current draft of ISA 510 contains requirements which are relevant also under other circumstances. For instance, para. 5a, 6 and 7 are applicable also for recurring audit engagements, whereas para. 5c(i) is relevant in case of a change in partner within the same audit firm.

As part of the Clarity Project IAASB needs to ensure that those audit requirements, which are also applicable for recurring audits or in case of a change in partner within the same audit firm, should be clearly addressed also in other ISAs (e.g. in ISA 710).

2. In order to sharpen the focus of (proposed) ISA 510 on specific requirements of initial audit engagement, we suggest the following improvements:

-Para. 5c(i) requires the incoming auditor to review his predecessor's working papers. Related guidance in paragraph A2 indicates that his appreciation of the evidence thus obtained is influenced by the professional competence and independence of the predecessor auditor. In order to clarify how to apply this, the IAASB may wish to make use for this situation of an adapted "sliding scale" as the one developed for the assessment of a component auditor's by a group auditor in ISA 600.

- Para. 5 c(ii) and 5c(iii) require the auditor to conduct specific audit procedures so as to obtain audit evidence regarding the opening balances. However the guidance in para. A1-A5 provides essentially with a few examples and contains only limited indications as to what those audit procedures might be. Further narrative and descriptive guidance should be developed in order to underpin, from a best practice point of view, how to best implement the requirements mentioned of para. 5c. Furthermore, the link between the individual sub-paragraphs of para. 5 and the related application material in para. A1-A5 should be stated more clearly by the use of split cross-references (e.g. it seems that para. A2 is for para. 5c(i), para. A4 and A5 are – except for the last sentence in each case which is for para. 5c(iii) – for para. 5c(ii), etc.).

- Para. 8 requires the auditor to re-consider his assessment of the audit risks in the event a predecessor auditor's report was modified. We believe the same type of assessment should be performed in case the prior period's financial statements were not audited at all. We therefore suggest renaming the heading of para. 8 into "Unaudited prior period's financial statements / Modification to the opinion in the Predecessor Auditor's Report", and adding the following sentence in para. 8: "If the prior period's financial statements were not audited, the auditor shall consider the effect of this matter as part of the auditor's risk assessment in the current period."

3. The phrasing in para. 5c): "Performing one or more of the following, as is necessary in the circumstances:" could be misunderstood by the auditor as requiring him to

assess the necessity of performing one or more of the procedures mentioned, but in the end possibly performing none of the procedures. For clarification purposes we propose to replace "as is necessary in" by "depending on".

4. We understand that para. 6 requires the auditor to communicate material misstatements in the opening balances to the appropriate level of management and those charged with governance, if he concludes that, based on the audit evidence obtained, such misstatements exist. We believe that the auditor should also communicate to management and those charged with governance in case he is unable to obtain sufficient appropriate audit evidence. Therefore, we suggest the following amendment in para. 6: "If the auditor concludes that such a misstatement exists, or if the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall communicate ...".
5. We invite the IAASB to re-examine whether it is necessary to require the auditor in paragraph 6 to inform the predecessor auditor about misstatements detected in the opening balances. We are ready to support such a requirement insofar there is a clear benefit in the public interest, but we fail to see how this contributes noticeably to the achievement of the defined objectives of the ISA.

Responsibilities of the Auditor regarding Audit Conclusions and Reporting

6. As mentioned in the cover letter, we do not support the reference to "split opinions" in para. A7(c), since such issues belong to ISA 705. Therefore, we propose removing such a reference. Furthermore, we believe any guidance on modification of audit opinions should be addressed in ISA 705. Therefore, we suggest clarifying para. A7 by deleting options (a) – (c) and amending the last sentence of para. A7 in the following way: "... to the opinion in the auditor's report foreseen by ISA 705". For the same reasons, we also support removing entirely the Appendix.
7. The requirements of para. 9, 10 and 11 are not consistent in the way they refer to (proposed) ISA 705. For instance, paragraph 9 does not refer to ISA 705, whereas para. 10 and 11 do. Paragraph 10 repeats ISA 705 whereas paras. 9 and 11 do not. In addition, some requirements are not neutral: paragraphs 10 and 11 sort of "preempt" the type of opinion an auditor might express under ISA 705, by not mentioning a disclaimer of opinion as a possible outcome. We invite the IAASB to consider redrafting these paragraphs altogether so as to ensure a consistent and neutral approach towards ISA 705.

REQUEST FOR SPECIFIC COMMENTS

Objectives to be achieved by the auditor

8. The objective refers to the application of accounting policies. The IAASB may consider expanding the scope so as to also refer to the way accounting policies have been adequately disclosed in the financial statements, as this is a cornerstone of almost every accounting framework.