



EUROPEAN COMMISSION

Internal Market and Services DG

**FREE MOVEMENT OF CAPITAL, COMPANY LAW AND CORPORATE GOVERNANCE
Director**

22.10.07 00004072

Brussels,
MARKT/2007/14987

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 ISA 200 (Revised and Redrafted) – Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing

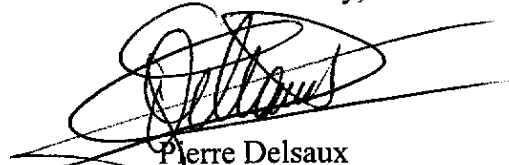
Dear Mr Sylph,

1. We appreciate the opportunity to comment on the IAASB proposal for this key standard.
2. Overall, important questions remain open:
 - Management responsibilities: we have commented on management's responsibilities in ISA 580, both on substance and from the perspective of consistency throughout the ISAs. Having regard to paragraphs 7 and 8 of this exposure draft, we appreciate the improvements made so far on how ISA apprehend management's responsibilities. We would like to encourage the IAASB to develop principles based solutions throughout the ISAs. Such solutions should include only the essential preconditions, and allow ISAs to perfectly fit in any legal and regulatory environment. In addition, there should not be too much emphasis in management's responsibility compared to the tasks of an auditor.
 - Inherent limitations: the limitations inherent to an audit deserve being addressed in ISA 200. However, lengthy application material combined with ambiguity how inherent limitations fit in the audit model, convey an imbalanced view on professional duties versus limitations. We invite the IAASB to consider shortening paragraphs A28 to A40 relating to inherent limitations so that the key elements remain. We also invite the IAASB to address centrally and comprehensively in SOA 200 the inherent limitations, including those specific to other ISAs. We are strongly opposed to the view of A30 that 'Other ISAs may provide further explanation of limitations that are of particular relevance to their

subject matter'. On the contrary, we continue to support that all inherent limitations should be centralised in ISA 200 so as to avoid confusion with respect to the authority of such statements. We invite the IAASB also change A19 putting professional mistakes and inherent limitations on equal footing. Paragraph A29, which in our opinion addresses scope limitations rather than inherent limitations, should be deleted. We also refer in the Annex to the ambiguous use of the future tense in para. A37 and A39.

- Professional judgement represents another key aspect of this standard, and we understand the difficulty of promoting sound and consistent professional judgement out of a standard. However, paragraph A25 tends to fall short of these goals. It states that professional judgement may differ – even significantly – between experienced auditors, and that consistency and reasonableness of judgement could be ascertained in any circumstance insofar any other experienced auditor(s) would concur with the views of the auditor. From the perspective of external quality assurance as foreseen by Directive 2006/43/EC on Statutory Audit, such statements might result in the inability for public oversight systems to challenge professional judgements made. We cannot subscribe to this and support therefore deleting paragraph A25. In addition, we support developing a definition of professional judgement and believe that the first sentence of paragraph A24 constitutes a first basis to build such definition.
 - Conditions for withdrawal: The withdrawal from an engagement is often prohibited for auditors under laws and regulations. Statutory auditors should be given the possibility to always fulfil the objectives, even in the cases where he or she would have to modify the audit opinion or disclaim an opinion.
3. I would like to emphasise that this comment letter cannot pre-empt any future official position of the European Commission.
 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,



Pierre Delsaux

Cc: Jürgen Tiedje (European Commission), Members of the European Group of Auditors' Oversight Bodies and of the Audit Regulatory Committee.

GENERAL COMMENTS

Objectives

1. The dual structure and drafting of the Overall objectives, i.e. one objective for the audit (paragraph 4.), and one for the auditor (paragraph 5.) entails a number of issues, as follows:
 - paragraphs 4 and 5 seem inconsistent. Paragraph 4 states that the objective of an audit is to enable the auditor to express an opinion, whatever that opinion might be (i.e. modified or not). We read paragraph 5 as considering that the objective will be met only when the auditor has obtained reasonable assurance on the financial statements as a whole, i.e. when the audit opinion is unmodified. ISA 200 should however enable any statutory auditor to fulfil the overall objective(s) of ISA 200 in all types of circumstances, including in the cases of qualified opinion or disclaimer. Beyond this inconsistency, para. 5 leaves in addition in a 'grey zone' audit engagements where no reasonable assurance could be reached on the financial statements as a whole. This is not acceptable for statutory audits in the EU as the public interest will often prohibit withdrawal of a statutory auditor, even in the case of a possible modified opinion.
 - The way paragraph 6 is drafted ("the objective of an audit cannot be fulfilled unless the auditor achieves the objective of the auditor") leaves room for possible misleading interpretations such as: that the auditor might reach the objective of paragraph 5 whilst not reaching that of paragraph 4; or that the auditor who decides to modify or disclaim an opinion would not be able to reach the objective stated in paragraph 4. Paragraph 6 also seeks to address those cases where the auditor has to prepare a modified opinion. Since a modified opinion seems to not represent one possible way of fulfilling the overall objectives, paragraph 6 addresses at the same time the withdrawal of the auditor from the engagement, and puts both options on equal footing. We do not subscribe to this view: whilst a withdrawal might represent an easily accessible option in the case of contractual audits, this ability is often restricted by law in the case of statutory audits, depending on the jurisdiction. In addition, a withdrawal from an audit under EU law is of greater magnitude in terms of consequences than a modified opinion¹.
 - There are a number of footnotes, attaching to the Objectives, which convey important assertions.
 - Finally, paragraph 9 reminds that the purposes of an audit include "expressing an opinion designed to enhance the degree of confidence of intended users in the financial statements". Some confusion may arise between paragraphs 4 and 9, due to the differences in wording and scope. The word 'purpose' is also used in paragraph 7, and whereas it seems very close to the word 'objective', there is no explanations thereon.

¹ Directive 2006/43/EC requires in Art. that "Member States shall ensure that the audited entity and the statutory auditor or audit firm inform the authority or authorities responsible for public oversight concerning the dismissal or resignation of the statutory auditor or audit firm during the term of appointment and give an adequate explanation of the reasons therefore."

2. We believe that reference to intended users, as stated in para. 9 of this draft and para. 7 of the Framework² is valuable and should remain in the body of this ISA. We provide suggestions in point 18 of this Annex regarding the footnotes.
3. We strongly support to prepare further explanations on the audit model through paragraphs 9 to 13. We believe this section is key for implementation of ISA 200 as well as other ISAs. In this respect, the IAASB may consider specifying in paragraph 12 the connection between the concept of inherent limitations of an audit and the reasonable assurance required by the objective. In addition, each of the concepts listed in paragraph 13 would deserve further essential guidance. For instance, the last sentence of A9³ would fit in perfectly well as essential guidance to the concept of materiality. Finally, the second bullet point of paragraph 11 ("Obtain audit evidence whether the risks have given rise to material misstatements ...") seems inconsistent with the objective of obtaining evidence that there are NO ("are free from") material misstatements. Paragraph 11 would gain clarity by being aligned with the objective.
4. Reference to the IFAC Code of Ethics in paragraph 14 is an issue in the light of the possible adoption of ISA in the EU. We believe there is no need to specify in the Requirements by which Code the auditor should abide, since: either the auditor operates in a jurisdiction where national requirements are already more restrictive, and the requirement is useless; or the auditor operates in an environment with no or a less stringent codes, and the auditor is referred to the Application Material to determine which code(s) shall apply. We therefore suggest moving to the Application material attaching to para. 14 the part reading: the Codes "comprise Part A and B that are more restrictive." Paragraph 14 could for instance read: "The auditor is subject to independence and other ethical requirements as provided by the relevant Codes."

Definitions

5. The definition of **misstatement** in 16(g) is unnecessarily long. We fail to see the value of determining at this stage the possible sources of misstatements. The paragraph could end after "error or fraud". The remaining text may be placed within the application and other explanatory material.
6. Audit risk (16(c)), Detection Risk (16(d)), and Risk of Material Misstatement (16(i)) are interconnected. The sentence in paragraph A10 indicating that the audit risk is a function of the risks of material misstatements and detection risk would greatly clarify the ISA if it were included in 16(c).

² The International Framework for Assurance Engagements states that an "Assurance engagement" means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.

³ "The concept of materiality is used both in planning and performing the audit, and in evaluating the effect of identified misstatements on the financial statements and the related auditor's report, as discussed further in [proposed] ISA 320 (Revised and Redrafted), "Materiality in Planning and Performing an Audit" and [proposed] ISA 450 (Redrafted), "Evaluation of Misstatements Identified during the Audit," respectively"

7. We believe that the word "assertions" should be defined, as this word appears in e.g. para. 16, A11, A12, A14, A15, A18 and A20, possibly explaining also how classes of transactions and account balances relate to the assertions.

Requirements

8. The purpose of paragraph 19 is unclear: it starts with 'in order to obtain reasonable assurance' whereas it has not yet been stated that the auditor shall undertake the procedures necessary to obtain reasonable assurance. A requirement should specify this.
9. The word "ordinarily" is too vague to be used in the body of the requirements (paragraphs 14, 16(e), 24), in the course of a clarifying exercise. It may in addition cause problems for translations. We invite the IAASB to reflect on other possible words, such as "in other than exceptional circumstances", or "in most cases".
10. Paragraph 24 delivers an unclear message when it states first that the auditor should assess as to whether sufficient appropriate audit evidence has been obtained and later that: 'the proper application of the requirements will ordinarily provide a sufficient basis for the auditor's achievement of the objectives'. This is partly due to the use of the word 'ordinarily' (see above). But also, this statement may be seen as downplaying the support for a principles based approach, thus discouraging the use of professional judgement in determining for each engagement whether the overall objective was fulfilled. We therefore suggest to further underpin, preferably in the body of paragraph 24, that the auditor should always step back at the end of an engagement and use professional judgement to assess whether the overall objective was fulfilled.

For the sake of consistency, the IAASB might consider moving the last sentence of paragraph 25 to a specific sub-section on Documentation within the Requirements section, as has been done for a number of clarified ISAs. We also encourage the IAASB to modify paragraph 25 in the context of our comments on withdrawal in point 2 of this Annex.

11. Paragraph 26 contains no requirements. Its content would carry much more weight and be much clearer if positioned at the end of paragraph 27 (or paragraph 5).
12. Paragraph 28 is unclear. We understand that an auditor may depart from a relevant requirement if in the specific circumstances of the audit, a relevant requirement would appear ineffective. However the ISA falls short of explaining how the auditor can determine that a requirement is at the same time relevant and ineffective.
13. Paragraph 21 and 29 seem very close. The IAASB might consider merging these paragraphs.

Application Material

14. The assertions in para. A2: "management is responsible for identifying..., management is also responsible for preparing and presenting the financial statements, etc." give the impression that there are more responsibilities for management than those stated in para. 8. This would create conflicts with national laws. We also fail to see the point of repeating paragraph 8 in the final part of para. A2 – however with different words or concepts. We therefore support the deletion of A2.

15. Although we do not intend making the statutory auditor a forensic auditor, the statement that 'an audit rarely involves authentication' in § A27 goes too far. An auditor should detect, for example, a bank confirmation that has been falsified, when there are visible signs thereof on the bank confirmation. We therefore invite the IAASB to amend A27 from the angle of constant alertness, and consistency with the revisions of ISA 500 and ISA 505.
16. In A34, we doubt that the wording "absence of legal powers of search – *which in themselves have limitations* – ... " adds anything. We suggest deleting the words shown in italic here.
17. Paragraph A58 provides an example of departure from an objective. It states that not fulfilling the objectives of, for example, ISA 220 (Quality Control) or ISA 230 (Documentation) does not automatically lead to the conclusion that reasonable assurance has not been obtained. The examples chosen, and possibly even the entire content of the paragraph, are not helpful. Audit quality does depend on quality control and documentation. We suggest to at least delete the sentence "This is the case, for example, with the ISAs that deal with quality control and documentation". In addition, the last sentence could read: "There would, however, be a higher and non negligible risk that this would not be the case" since one might read that not fulfilling certain types of Objectives entail few or no consequences. Alternatively, the IAASB may consider deleting paragraph A58.

Other issues

18. The ISAs should in general avoid footnotes containing narrative material, especially in the body of objectives and requirements. We invite the IAASB to clarify its drafting policies regarding the footnotes, and to apply these consistently. In the context of this ISA:
 - footnote 1: will disappear in the final version, in our understanding
 - footnote 2: should belong to the Application Material
 - footnote 3: should be included in the body of para. 5
 - footnote 4: should be deleted or included in the body of para 7.
 - footnote 5: should be included in the body of 16(c)
 - footnote 6: is not acceptable. Since it contains essential elements, it should be in the body of the text. In addition, there is considerable confusion as to what constitutes a single financial statement and which examples of a single financial statement refer to a separate part of financial statements. We suggest this information to be placed within section Application and Other Explanatory material.
 - footnote 7: should be included in the body of A2
 - footnote 8: will disappear in the final version, in our understanding
 - footnote 9: should be included in the body of A13
 - footnote 10: should be deleted

REQUEST FOR SPECIFIC COMMENTS

Special considerations in the audit of SMEs

19. None

Special considerations in the audit of Public Sector Entities

20. None

Developing Nations

21. None

Translation issues

22. The words "premises", "premised" (para 7 and 8) pose problem for some EU languages (see also comment Letter ISA 580). We would support the use of an alternative wording, such as "based on the assumption that".
23. We consider that in the last sentence of para. A26 the word 'inappropriate' should be used instead of 'faulty'.
24. Paragraphs A37 and A39 use verbs in the future tense to describe potential situations where material misstatements may not have been detected by the auditor. We suggest redrafting these paragraphs since for non native speakers, the use of such tense might give rise to the perception that in any case, there will be undetected material misstatements:
- A37: "*Because of the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements will not be detected*"
 - A39: "*a material misstatement will fail to be detected*"