Staff Note to IAASB

Due to a technical problem on transmission, the following comment letter on the exposure draft of proposed ISA 501 (Redrafted) was not addressed by the Task Force when developing the Summary of Significant Comments and Task Force Recommendations in Agenda Item 4-A. The IAASB is asked to read and consider it in conjunction with Agenda Item 4-A.

EUROPEAN COMMISSION
Internal Market and Services DG
FREE MOVEMENT OF CAPITAL, COMPANY LAW AND CORPORATE GOVERNANCE
Director

Brussels,
MARKT/2008/4634

Mr Jim Sylph
Technical Director
International Auditing and Assurance Standards Board
Edcomments@ifac.org

Subject: Comment on the Exposure Draft of Proposed ISA 501 (Redrafted) – AUDIT EVIDENCE REGARDING SPECIFIC FINANCIAL STATEMENT ACCOUNT BALANCES AND DISCLOSURES

Dear Mr Sylph,

1. We appreciate the opportunity to comment on the IAASB proposal for a redrafted International Standard on certain audit evidence.

2. We understand that this standard, which we find quite specific compared to other ISAs, was drafted before ISA 315 and the 'modern' audit risk model. We nevertheless appreciate that the current exposure results from a redrafting and see the content of this standard as overall valuable. We suggest a number of improvements in the Annex.

3. We 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 Commission européenne, B-1049 Bruxelles / Europese Commissie, B-1049 Brussel - Belgium. Telephone: (32-2) 299 11 11
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 (DG MARKT), EGAOB.
ANNEX – COMMENTS ON INTERNATIONAL STANDARD ON AUDITING 501

OTHER GENERAL COMMENTS

1. Whilst the scope of the standard is quite clear, paragraph 1 is by far not as clear. We suggest avoiding "certain assertions and related considerations for specific financial statements account balances and disclosures" and focus instead on the obtaining of audit evidence regarding the existence and condition of inventories, the completeness of litigation and claims, and the presentation and disclosure of segment information. In addition, this paragraph may be used to further clarify how ISA 501 fits in with ISA 315 and ISA 330, as one may see this ISA, entitled "audit evidence...", as a complement to ISA 500 rather than "guidance additional to that contained in ISA 330".

2. The construct of paragraph 8 is not robust enough since the auditor is invited to either (a) 'request' confirmation or to (b) 'obtain' audit evidence by other means on inventory under custody of a third party. We understand that an auditor may therefore request information under (a) and, in case no sufficient appropriate audit evidence is obtained, 'consider' (A15) performing other procedures under (b), thus possibly leaving the auditor with no evidence supporting the existence of inventories held by third parties. We support revising the construct of paragraph 8(a) possibly by requiring the auditor to obtain sufficient appropriate evidence by means of direct confirmation, and by elevating paragraph A14 into this paragraph. As a result, the auditor would be free to perform (a) and/or (b) with a view to obtain sufficient appropriate audit evidence and a clearer connection would be made with ISA 505.

3. Section 'Litigation and Claims' is much oriented towards getting audit evidence by means of direct confirmation from, or by meeting with, the external legal counsel. As such, we question whether the entire section and application material would not be better placed in ISA 505.

4. A requirement in ISA 501 that the auditor shall obtain management's consent before seeking direct confirmation from, or meeting with the legal counsel(s) is certainly missing. Such requirement, either in ISA 210 or ISA 501 (e.g. in 10(a)), would considerably improve the understanding and consistency of paragraphs 10 and 11.

5. We believe that the construct of paragraph 11 is not faithful to paragraph 37 of extant ISA 501. We understand that according to extant ISA 501 both situations where management does not permit communication with a legal counsel, and/or legal counsel refuses to respond, justify a modified opinion unless evidence can be obtained by other means. The construct and meaning of paragraph 11 would be considerably improved if it followed the same reasoning i.e. :

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1 Paragraph 1 of ED ISA 501
i. consider whether the auditor is unable to obtain evidence from the external legal counsel (either due to management's or legal counsel's refusal); and

ii. consider whether the auditor is unable to obtain evidence by applying alternative audit procedures; and

iii. draw the consequences of (i) and/or (ii) on the auditor's report. In addition, due to possible constraints beyond legal counsel's will (i.e. legal privilege, safe harbour, professional standard, etc.), the legal counsel might not be able to respond appropriately to the auditor. There should however be no automaticity between such refusal and a modified audit opinion. We support instead a requirement for the auditor "to consider modifying the audit report…".

REQUEST FOR SPECIFIC COMMENTS

Comments on the Application of the Clarity Drafting Conventions

6. The word "condition" appears many times\(^2\) to qualify the appraisal of inventories by the auditor. We invite the IAASB to clarify which assertions (e.g. valuation) it is referring to when using the word 'condition'. In addition, since audit evidence is generally obtained on assertions, paragraph 3(a) should refer to the relevant assertion(s) instead of 'condition'.

7. We believe that reference in paragraph A11 to 'threats to safety' is sufficient as a reason for limiting attendance at an inventory. Reference to threats to 'well-being' seems superfluous.

Other matters (audit of smaller entities, public sector entities, developing nations, translations)

8. No comments.

\(^2\) Paragraphs 3(a), 4, 7, 8(a), 8(b), A2, A12 and A13.