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February 29, 2008

Mr. James M. Sylph
Executive Director, Professional Standards
International Auditing and Assurance Standards Board
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, NY 10017

Email address: Edcomments@ifac.org

Re: Proposed Redrafted International Standard on Auditing 510 "Initial Audit Engagements – Opening Balances"

Dear Mr. Sylph:

The International Organization of Securities Commissions (IOSCO) Standing Committee No. 1 on Multinational Disclosure and Accounting (SC 1) appreciates the opportunity to comment on the Exposure Draft of proposed redrafted international standard on auditing ISA 510, *Initial Audit Engagements – Opening Balances* (the ED). As an international organization of securities regulators representing the public interest, IOSCO is committed to enhancing the integrity of international markets through promotion of high quality accounting, auditing, and professional standards.

Members of SC 1 seek to further IOSCO's mission through thoughtful consideration of accounting, auditing and disclosure concerns, and pursuit of improved global financial reporting. As we review proposed auditing standards, our concerns focus on whether the standards are sufficient in scope and adequately cover all relevant aspects of the area of audit being addressed, whether the standards are clear and understandable, and whether the standards are written in such a way as to be enforceable.

Our comments in this letter reflect those matters on which we have achieved a consensus among the members of SC 1; however, they are not intended to include all comments that might be provided by individual members on behalf of their respective jurisdictions.

Scope of the ISA

We would like to express concerns regarding the stated scope of ISA 510 in this Exposure Draft on two fronts:

(1) As now written, it is unclear if the scope has been narrowed from the former (extant) ISA 510 to exclude coverage for successor partners rotating onto an engagement within an audit firm, or

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whether the addition of new wording "from a different audit firm" is clarifying what had been the previous intent of the standard, and

(2) The scope does not provide coverage of audit objectives and requirements for the full range of opening balance conditions that arise whenever audits are begun, leaving a gap in the body of ISAs unless coverage exists elsewhere (which we do not believe to be the case).

As we read the redrafted ISA and considered the subject of opening balances, we noted that four different conditions can exist where opening balances need some action in an audit:

1. The entity has never been audited before (or has not been audited in recent periods)

2. The entity was audited in the prior year by another audit firm

3. The entity was audited in the prior year by another engagement partner in the current auditor's audit firm, and now there is a new engagement partner

4. The entity was audited in the prior year by the same engagement partner as the one who will do the current year audit

It appears that the scope of this ISA as now drafted includes only conditions 1 and 2 above. However, some of the procedures described in the redrafted ISA 510 are also important steps in recurring audits, and we can find no coverage of these matters in other ISAs. For example, even in conditions 3 and 4, there are audit procedures that must be done on opening balances, such as determining whether the prior period's closing balances have been correctly brought forward to the current period, as well as other procedures appropriate in the circumstances.

The apparent gaps in coverage that result have prompted us to ask "why is there only an ISA on opening balances for initial engagements?" and "wouldn't it be useful to discuss the auditing of opening balances for both initial and recurring audits in ISA 510?" While such action would then modify the project for this ISA to be a revision and improvement project as well as a clarity redrafting project, it may be that such additional coverage could be added relatively easily and thereby provide enhanced guidance to auditors.

IOSCO SC 1 members understand that the Board decided to revise ISA 510 only to the extent of redrafting the standard into the new Clarity project format in this standards project. However, we note that the Board has made some changes that would go beyond a simple redrafting. We therefore recommend that the Board reconsider the scope of the standard and the nature of the ISA 510 project to address the gaps we have noted above. We acknowledge that ISA 710, *Comparatives*, addresses some procedures in cases where comparative balances are included in the financial statements.

Should the IAASB chose to retain the scope as is, we believe it would be advisable for the IAASB to ensure that additional necessary opening balance auditing requirements for the uncovered conditions are included in another ISA as soon as possible.

Definition of Predecessor Auditor - Paragraph 4

Paragraph 4 (c) of the Exposure Draft defines "predecessor auditor" as "The auditor from a different audit firm, who was previously the auditor for an entity, and who has been replaced by an incoming auditor."

The words "from a different audit firm" do not appear in the existing IFAC Standards Glossary of Terms, and the existing Glossary further defines "auditor" as "The Engagement Partner", although in the next sentence it notes that "The term auditor is used to describe either the engagement partner or the audit firm." This ambiguity has given rise to different views among our members as to whether ISA 510 as now written has changed to whom the standard applies and specifically, has now scoped out new engagement partners in an audit engagement partner rotation.

Definition of Incoming Auditor - Paragraph 4

Paragraph 4 defines "predecessor auditor" but does not define "incoming auditor". We recommend that "incoming auditor" be included in the definitions, with a definition consistent with that currently included in the Glossary of Terms. That definition reads: "The auditor of the financial statements of the current period, where either the financial statements of the prior period have been audited by another auditor (in this case the incoming auditor also known as a successor auditor), or the audit is an initial audit engagement."

Audit procedures on opening balances

It appears that the effort to come up with a common set of objectives and a single statement of required or possible audit procedures for two different kinds of opening balance situations has obscured the fact that certain procedures are required for different situations. When an entity has never been audited before, the standard should include specific requirements and guidance pertaining to that condition. For example paragraph 5 c) iii) - the performance of specific audit procedures on opening balances - should be mandatory in all audits when the opening balances have never been audited before. As ISA 510 has been redrafted, the performance of specific audit procedures on opening balances is not required because it is only one of three choices in a list preceded by a statement that the auditor should "perform one or more of the following, as is necessary in the circumstances." We believe this statement in the redrafted ISA needs revision.

In the case where an entity's prior period closing balances have been audited by another audit firm, the standard should require the auditor to consider the professional competence and independence of the predecessor auditor as well as determine whether to apply one or more of the procedures listed in paragraph 5 (c). We think this is an important evaluation for a new auditor to make and that the implied requirement in paragraph 6 of the extant ISA 510 is more clear than the proposed language in paragraph A2 of the redrafted ISA.

We believe an additional procedure is warranted in paragraph 5. In our view, the standard should explicitly require that, if the prior period's financial statements had been audited, the incoming auditor should obtain and review the most recent audited financial statements and the predecessor's audit report thereon. As we believe this should be done in all relevant instances, we would not include this procedures among the "one or more" procedures listed under the proposed paragraph 5(c). As such, we recommend that a new paragraph 5(a) be inserted as drafted below.

> "(a) If the prior period financial statements have been audited, review the most recent audited financial statements and the predecessor auditor's report thereon;"

Interrelationship between various standards

We observe that the requirements specific to an initial audit engagement are outlined in at least two other ISA standards: ISA 300 (Redrafted), *Planning an Audit of Financial Statements*, and ISA 710, *Comparative Information*. However, only ISA 710 is referred to in this ISA. We believe that the auditor would be more readily able to identify all guidance related to the topic of initial audit engagements if either a) ISA 510 incorporated all relevant guidance currently included in other standards or b) ISA 510 included a reference to all other ISA guidance specific to initial audit engagements. (We refer to the appendix of proposed ISA 230 (Redrafted), *Audit Documentation*, as an example of an effective means of implementing alternative b.) As currently drafted, this ISA employs neither of these approaches. At a minimum, the scope should be clarified to indicate that additional responsibilities of the incoming auditor are outlined in ISA 710 and ISA 300.

Thank you for the opportunity to comment on this ED. If you have any questions or need additional information regarding this comment letter, you may contact me or Susan Koski-Grafer at 202-551-5300, or any member of the IOSCO Standing Committee No. 1 Auditing Subcommittee.

Sincerely,

Julie A. Erhardt

Julie A. Erhardt
Chair
IOSCO Standing Committee No. 1

Appendix A: Reponses to Request for Specific Comments in the Exposure Draft

1. **Are the objectives to be achieved by the auditor, stated in the proposed redrafted ISA, appropriate?**

   We believe that the objective to be achieved by the auditor as stated in the proposed redrafted ISA is largely appropriate. However, we believe the objective in paragraph 3(b) would be clearer if modified to read as shown below, and furthermore would then be consistent with the language used in the related requirement:

   "(b) Appropriate accounting policies <u>reflected in the opening balances</u> have been consistently applied <u>during the current period</u>, or changes thereto have been accounted for properly."

2. **Have the criteria identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and the use of professional judgment by auditors?**

   We generally believe that the criteria identified by the IAASB for determining whether a requirement should be specified have been applied appropriately and consistently. Our specific comments on the requirements of the ISA are provided in Appendix B to this letter.

Appendix B: Additional Comments

<u>Requirements (paragraphs 5-12)</u>

- When the auditor becomes aware of misstatements in opening balances that could materially affect the current period's financial statements, paragraph 6 states that the auditor should 1) communicate the misstatement to the company and 2) "subject to obtaining management's authorization, inform the predecessor auditor, if any." In addition to communicating the misstatement to the relevant parties, we believe that the auditor is also required to evaluate the effect of the misstatement on the current period financial statements in accordance with proposed ISA 450 (Revised and Redrafted). Accordingly, we propose the following modification to paragraph 6:

  "If the auditor concludes that such a misstatement exists, the auditor shall communicate the misstatement to the appropriate level of management and those charged with governance <u>and evaluate the effect of the misstatement</u> in accordance with [proposed] ISA 450 (Revised and Redrafted), "Evaluation of Misstatements Identified during the Audit<u>.</u>~~,~~" ~~and s~~ <u>S</u>ubject to …".

  Additionally, the standard should be clarified to outline the actions that the auditor is required to take if management does not allow the auditor to inform the predecessor auditor. We therefore recommend that the following requirement be added to ISA 510:

  "<u>If management refuses to authorise the auditor to inform the predecessor auditor, the auditor shall evaluate the implications on the current engagement.</u>

- We note that paragraph 7 simply restates the objective stated in paragraph 3(b). As mentioned earlier we recommend that the objective in 3(b) be revised to make it clearer, in which case paragraph 7 as proposed would be appropriate.
- Paragraph 11 describes the situations related to consistency of accounting policies in which an auditor is required to issue a qualified or adverse opinion under proposed ISA 705 (Revised and Redrafted). In addition to the two situations identified, we believe it is possible that other circumstances could arise in which the auditor might need to disclaim an opinion under ISA 705 – for example, if inadequate financial records or limitations imposed by the client preclude the auditor from obtaining sufficient appropriate audit evidence about the consistent application of accounting principles in the current period's financial statements (paragraphs 9 or A7 in ISA 510 as drafted only address opening balances and not consistency of accounting policies), and the auditor judges the effects to be material and pervasive. We therefore believe that paragraph 11 should be modified as follows:

  "… (b)…presented and disclosed<u>; or</u>

  <u>(c) inadequate financial records or limitations imposed by the client preclude the auditor from obtaining sufficient appropriate audit evidence about whether the accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements</u>

  the auditor shall express a qualified opinion or an adverse opinion or <u>disclaim an</u> opinion as appropriate in accordance with [proposed] ISA 705 (Revised and Redrafted)."

Types of opinion in case of inability to obtain sufficient appropriate audit evidence (paragraph 9)

In par. 9 of proposed ISA 510, the auditor is only requested "to consider the effect" on the his opinion of the inability to obtain sufficient appropriate audit evidence regarding the opening balances, without any mention of what type of opinion should be expressed in the auditor's report in these circumstances.

We believe that, in order to give a clear indication on what type of opinion has to be expressed by the auditor when sufficient appropriate audit evidence are not obtained on the correctness of opening balances, par. 9 should be restated as follow:

> "If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with ISA 705".

Application and Other Explanatory Material (paragraphs A1 – A8)

Paragraphs A4 and A5 describe examples of audit evidence that can be obtained as part of the current period's audit procedures. Paragraph A4 appropriately refers to the specific financial statement assertions over which some audit evidence can be obtained by performing procedures over the collection (payment) of opening accounts receivable (payable). However, paragraph A5 does not list the specific financial statement assertions which would be addressed by obtaining confirmations. Instead, the language indicates that, "In certain cases, the auditor may be able to obtain confirmation of opening balances with third parties, for example, for long-term debt and investments." This could be read to imply that confirmation alone will provide sufficient appropriate audit evidence for these balances. We do not believe that would be appropriate for investments, as confirmation can only provide evidence over existence when investments are confirmed on an investment-by-investment basis (as opposed to confirmation of investments in the aggregate). Further, confirmation of investments does not provide audit evidence to support the valuation assertion. To avoid this implication, we suggest revising paragraph A5 to state:

> "...In certain cases, the auditor may be able to obtain **some audit evidence** ~~**confirmation**~~ regarding opening balances **through confirmation** with third parties, for example, for long-term debt and investments..."

Appendix

The "circumstances" described in the preface to the illustrative report would be clearer if they were written in full sentences rather than sentence fragments. Also, the wording should clarify that the circumstances are examples, rather than an all-inclusive listing.