

April 8, 2004

Mr. James Sylph
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Exposure Draft, ISA 700 (Revised), “The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements” ISA 200, “Objective and General Principles Governing an Audit of Financial Statements” Amendment to ISA 210, “Terms of Audit Engagements” and Conforming Amendments

Dear Mr. Sylph:

The American Institute of Certified Public Accountants (the AICPA) is pleased to comment on the above referenced exposure draft, *ISA 700 (Revised), “The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements” ISA 200, “Objective and General Principles Governing an Audit of Financial Statements” Amendment to ISA 210, “Terms of Audit Engagements” and Conforming Amendments*

We support the proposed standards’ intent to provide clearer guidance on the form and content of the auditor’s report; however, we have some serious concerns related to the proposed standards. We believe the following issues must be addressed appropriately before the final International Standard on Auditing (ISA) is issued.

Communication of the auditor’s responsibility for reporting on internal control

Paragraph 33(c) of the proposed ISA 700 requires the auditor’s report to state that, “an audit includes considering internal control relevant to the entity’s preparation of the financial statements as a basis for designing procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company’s internal control.”

In some jurisdictions, particularly in the United States, auditors of public companies are required to report on the internal controls of the entity being audited. We are concerned that the statement in the proposed auditor’s report that an audit includes considering internal control, especially in environments where some audits include a report on internal controls, may confuse users as to the level of work done on internal controls. Furthermore, users of the auditor’s report may be left wondering what was found in the auditor’s consideration of internal control.

We believe that the auditor’s report should acknowledge the auditor’s requirement to report material weaknesses in internal control to management and those charged with governance. Such a statement would complete the discussion on the auditor’s responsibility with respect to

internal control. Furthermore, such a statement would inform the users of the auditor's report that there may be important information that is not contained in the financial statements and the auditor's report. It would have the added benefit of making clear that the auditor is not the only source of information to "general users," in effect directing such users to where to obtain that information. We suggest the following language, "Communication of material weaknesses in internal control that come to the auditor's attention is made to management and those charged with governance."

Relationship with the assurance framework

One of the original goals of this project was to provide guidance to the auditor who is reporting on other legal or regulatory requirements in addition to the financial statements. The proposed standard notes that the form and content of this section of the report will vary depending on the nature of the auditor's other reporting responsibilities. We believe that auditor should be required to comply with the International Standards on Assurance Engagements (ISAEs) (which is supported by the overarching "Framework" for assurance engagements recently issued.) when reporting on other legal or regulatory requirements. We believe that this requirement, clearly stated in the final standard, will have the following benefits:

- It would emphasize the requirement for the auditor to be associated only with subject matters that can be consistently evaluated against suitable criteria. We do not believe that it is in the public interest for the auditor to be reporting on subject matters that do not meet this threshold.
- It would provide the profession with a tool that is very helpful in educating legislators and regulators who attempt, in the future, to impose reporting requirements on auditors that might not comply with the ISAEs. The AICPA has considerable experience in working with legislators and regulators to ensure that the reporting requirements that they impose are in conformity with the professional standards. The success of these efforts is dependent on having a clear set of professional standards that the AICPA can refer to in these endeavors.
- It would raise the awareness of the ISAEs.

We can accept that some "grand fathering" of practices prevalent as of a point in time may be needed; but to ignore the newly issued Framework and related ISAE renders this proposed standard flawed. Allowing the auditor to report on subject matter information without complying with the ISAEs will be setting a troubling precedent that, in the end, will render the ISAEs ineffective and unenforceable.

Scope: Consideration of all ISAs relevant to the auditor's report

The proposed standard addresses the auditor's report on a full-set of general-purpose financial statements, when there are no modifications to the auditor's report. We understand that the IAASB intends to consider projects on 701, *Modifications to the Independent Auditor's Report*, and 800, *The Independent Auditor's Report on Special Purpose Audit Engagements*, in the near future. It is impossible to anticipate the implications of the proposed standard without knowing how ISAs 701 and 800 will address modified auditor's reports and special reports. We believe

that the commentators on the proposed standard are not being given the opportunity to see the whole picture. Therefore, the comments that the IAASB receives on the proposed standard may be incomplete. We would support delaying the issuance of this standard, and exposing and issuing the three related standards simultaneously. In fact, we question whether the exposure of this standard alone constitutes proper due process.

We would consider issuing this standard alone to be a fatal flaw if the International Auditing and Assurance Standards Board (IAASB) does not undertake the projects on ISAs 701 and 800 immediately. Furthermore, the task forces that address those projects must be given the authority to amend a newly issued ISA 700 to address any issues that are unanticipated at this time, but will become apparent as those future projects move forward.

Reading the agenda materials for the April 2004 IAASB meeting, we notice that the task force that is amending ISA 701 has proposed that it will revise emphasis of matter requirements with the intention of placing the revised discussion in ISA 700 as part of a conforming change. We agree that guidance on emphasis of a matter belongs in ISA 700, but we believe that this proposed change goes far beyond what can be classified as a “conforming change.” It would be more appropriate to expose and issue these three standards simultaneously.

As an example of a circumstance that might not be appropriately addressed in the group of standards, in the United States, non-public broker-dealers of securities file a balance sheet only, with related disclosures, with the Securities and Exchange Commission. The auditor reports on this presentation as a complete presentation, albeit understood that this presentation is for regulatory purposes and for broker-dealer customers, under the US reporting framework. The proposed ISA would require this presentation to be reported on under ISA 800. Since we do not know how ISA 800 will treat reporting on this purportedly “incomplete” set of financial statements, we cannot comment on the appropriateness of the scope of the proposed ISA.

Considering internal control as a basis for designing procedures

Paragraph 33(c) of the proposed ISA 700 requires the auditor’s report to state that, “an audit includes considering internal control relevant to the entity’s preparation of the financial statements as a basis for designing procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company’s internal control.” We believe that the following language should be added so that it is clear that the auditor is not expressing an opinion on the effectiveness of the company’s internal control:

“an audit includes considering internal control relevant to the entity’s preparation of the financial statements as a basis for designing procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company’s internal control; therefore, we do not express an opinion on the effectiveness of the company’s internal control.”

Reasonableness of significant estimates

The second paragraph in the “Auditor’s responsibility” section of the example report in paragraph 51 states: “An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant estimates made by management, as well as evaluating the overall financial statement presentation and disclosures.” This statement begs the questions: How does the reasonableness of significant estimates compare with the reasonableness of other measurements and disclosures presented in the financial statements? Is this “reasonableness” more or less than “reasonable assurance?”

Since most of the numbers in the financial statements are estimates, we suggest the sentence be reworded as follows: “An audit also includes evaluating the appropriateness of accounting policies used and ~~the reasonableness of significant estimates made by management, as well as~~ evaluating the overall financial statement presentation and disclosures, including significant estimates made by management.”

Management’s responsibility

The second sentence in the “Management’s responsibility” section of the example report in paragraph 51 is very long and difficult to read. We suggest the following edit: “This responsibility includes maintaining internal control relevant to the preparation of financial statements that are free of material misstatement, whether due to fraud or error; Management’s responsibility also includes selecting and applying appropriate accounting policies that are consistent with IFRS; and making accounting estimates that are reasonable in the circumstances.”

Sufficiency of disclosures

Proposed ISA 700, paragraph 9 states that “The auditor considers whether, in the auditor’s judgment:... (b) The information presented in the financial statements, including accounting policies, is relevant, reliable, comparable, and understandable. and (d) The financial statements provide sufficient disclosures to enable users to understand the impact of particular transactions or events ...” We believe that there is a strong presumption that adherence to officially established accounting principles would, in nearly all instances, result in information in the financial statements being relevant, reliable, comparable and understandable. Furthermore, it also would be presumed that such financial statements would not be misleading. The sufficiency of the disclosures should first be measured against the criteria set by the financial reporting framework. We believe that the requirements in paragraph 9 should be for the auditor to consider whether, in the auditor’s judgment, the financial statements are prepared in accordance with the financial reporting framework, and provide disclosures that are required by the financial reporting framework.

We believe that the guidance in paragraph 10 appropriately discusses the situation in which compliance with the financial reporting framework results in financial statements that are misleading.

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Thank you for the opportunity to comment on this Exposure Draft. If you have any questions regarding the comments in this letter, please contact Susan Jones at +1-212-596-6197, or sjones@aicpa.org.

Respectfully submitted,

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Chair, International Auditing Standards Subcommittee