



Organización Internacional de Comisiones de Valores
International Organisation of Securities Commissions
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Organizaçào Internacional das Comissões de Valore

May 10, 2007

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 Edcomments@ifac.org

Re: Proposed Redrafted International Standard on Auditing 320 (Revised) and 450, *Materiality in Planning and Performing an Audit and Evaluation of Misstatements Identified during the Audit*

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 standards on auditing ISA 320 and 450 *Materiality in Planning and Performing an Audit and Evaluation of Misstatements Identified during the Audit* (ISA 320 ED; ISA 450 ED). As an international organization of securities regulators representing the public interest, IOSCO SC 1 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.

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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.

We have organized our comments in this letter by including our most significant general comments and responses to questions in the ED in the main body of this letter. In addition, the Appendix to this letter contains some detailed comments for editing and clarification.

General Comments

Split of Previous ED into Two

We welcome the split of the previous ISA 320, *Auditing Materiality* into an ISA regarding materiality in planning and performing an audit and a separate ISA for evaluating misstatements. This separation enhances the clarity and flow of the requirements and related application materials and guidance, and we commend the Board's action in this effort. In a few places we would like to see a stronger linkage made between the two standards by adding cross references, and we have noted these in the Appendix to this letter.

Qualitative Aspects of Materiality

We continue to believe that ISA 320 should provide greater coverage and emphasis on the qualitative factors that can influence materiality as well as quantitative factors. We suggest the following:

- Add a bullet under paragraph 2 to further emphasize the qualitative aspects of materiality in the context of an audit (or elaborate further in the second bullet point about how the nature of an item can affect materiality).
- Revise paragraph 11 to include analyzing relevant qualitative information for purposes of assessing the risks of material misstatement and designing further audit procedures to respond to assessed risks.
- As part of the documentation requirement in paragraph 14, include mention of significant qualitative factors considered in the determination of materiality

Also, in ISA 450 it would be helpful to provide additional required procedures, guidance and documentation in evaluating the qualitative aspects of uncorrected misstatements.

Responses to Specific Questions in the Exposure Draft

1. *Is the objective to be achieved by the auditor, stated in each of the proposed redrafted ISAs, appropriate?*

In the ISA 320 ED, the proposed objective seems to be process based and not outcome based. We encourage the board to evaluate how this objective will relate to the overall objective of the auditor in the revised Preface. Also, the purpose of the reference made from the objective in ISA 320 to a specific paragraph in the Application Material is unclear. It is in our understanding that each objective should stand on its own. If some of the content in paragraph A2 is needed to make the understanding of the objective clear, perhaps one or more sentences might be added into the statement of the objective.

In the ISA 450 ED, we suggest that the second objective add the phrase “if any,” in referencing the effect of uncorrected misstatements to help alleviate any impression that an auditor should just expect to encounter them.

Our comments on objectives in individual ISAs are made against a backdrop of concern about the recent change to the Preface to the ISAs. Paragraph 15 of the Preface now states that an auditor ‘aims to achieve these objectives’. Saying that an auditor aims to achieve objectives in individual ISAs can be read as implying that such objectives merely indicate the direction of the auditor’s work – there is no sense, no emphasis that an auditor should make every effort to achieve the objectives. The Preface should use words that clearly impart a sense of striving to achieve objectives and convey that there is a strong obligation to achieve the objectives in all the relevant individual ISAs. Using terminology such as “aims to” achieve all objectives conveys a message, intentionally or not, that the obligation on the auditor to achieve the objectives has weakened. If the objectives in individual ISAs do not carry a very high level of obligation, what is to prevent auditors from considering them optional so long as the auditor believes he or she has achieved the overall objective of the auditor?

We understand that there may be situations where an auditor cannot meet a particular ISA objective, and we recognize that paragraph 15 in the Preface now directs the auditor to evaluate whether the effect of not meeting an individual ISA objective prevents the auditor from meeting the overall objective of the auditor. We also are aware of the ISA 200 provisions that if the auditor concludes that the overall objective has not been achieved or cannot be achieved, the auditor must modify the auditor’s opinion accordingly or withdraw from the engagement.

With the requirement in place for an auditor to evaluate whether the inability to meet an individual ISA objective prevents the auditor from achieving the auditor’s overall objective, it does not seem necessary also to make a general statement that the auditor ‘aims to achieve’ the objectives.

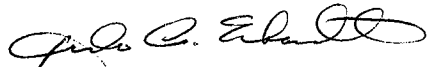
As it is the objectives in individual ISAs that drive the requirements and also the need for the auditor to “stand back” and evaluate whether sufficient evidence has been obtained, a high level of obligation to meet the objectives is very important. We ask the Board to address this issue with further work on the formulation and wording of specific objectives and the nature of the general obligation associated with them.

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?*

Please refer to the Appendix for specific areas of our concerns and related comments.

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 at 202-551-5300, or contact any member of the SC 1's Auditing Subcommittee.

Sincerely,



Julie A. Erhardt

Chair

IOSCO Standing Committee No. 1

Editing and Clarification Comments – ISA 320 ED

Definition of Materiality

We note the discussion in paragraph 11 and 12 of the “Basis for Conclusion” document, in which the board concludes that it would be more appropriate to describe the characteristics of materiality often discussed in financial reporting frameworks instead of developing a stand-alone definition for materiality; however, it is unclear how the materiality definition currently in the “Glossary of Terms” will be applied in other ISAs. We ask the board to clarify how it plans to address the current materiality definition in this and other ISAs.

Paragraphs 6 and A13

We believe that the Board should incorporate some of the application material in paragraph A13 into the materials in paragraph 6 and then use this to form a set of requirements for the auditor to perform. We believe it is extremely important to stress that the determination of amount or amounts is not a simple mechanical calculation and requires the auditor to exercise professional judgment. The auditor needs to consider all factors such as the qualitative aspects of materiality in establishing the materiality level or levels.

Paragraph 10

We believe that the Board should replace “shall also consider” in the first sentence with “shall also assess”.

In this regard, we are not satisfied that the Board has adequately reacted to concerns expressed by IOSCO and others over the use of the term “shall consider” in ISA requirements. In nearly every case where the term “shall consider”, has been used, we believe the more appropriate verb would be “determine, assess, or evaluate.” We recognize that there may be occasional instances when “shall consider” is the most appropriate term because all that is expected is for the auditor to “think about” something; however, we think such instances should be relatively infrequent.

Paragraph 46 of the Clarity Basis for Conclusions document states that “shall consider” reflects a reasonable action, “particularly when the auditor is expected to review a matter and evaluate whether it is applicable in the circumstances in order to make a judgment or decide on a course of action.” The Basis for Conclusions further states, “In some cases, an alternative phrase that communicates the same intent in as clear and unambiguous manner is not possible. The IAASB is satisfied that the changes made to the ISAs improve their clarity, and that those requirements that retain the use of ‘shall consider’ are appropriate.”

We fail to understand the justification in paragraph 46 for retaining the term “shall consider”, especially when the Board then uses then the word “evaluate” to explain the action that an auditor is expected to perform under “shall consider.” If the term “shall consider” can be explained as meaning “to evaluate”, why not just say “to evaluate”? The term “evaluate” contains a stronger and more specific sense of the action needed than “consider.”

In addition, we continue to be concerned that the term “shall consider” is a rather soft term that can have a very wide range of meanings. It can range from simply “thinking about something” to a more substantive evaluation that leads to a conscious choice or decision. We are concerned that use of the term “shall consider” in requirements of a standard is not likely to contribute to consistent understanding or practice.

Paragraphs 12 and 13

We recommend inserting a cross-reference between paragraphs 12 and 13 under the caption “Considerations as the Audit Progresses” and paragraph 6 of the ISA 450 ED under the similarly titled caption “Considerations as the Audit Progresses”, and provide additional application guidance for the auditor to consider the impact on materiality for planning and performing an audit from the misstatements identified during the performance of ISA 450 requirements as the audit is carried out. In addition, reference should also be made to the “Planning Activities” section of ISA 315-Clarified and to the “Identifying and Assessing the Risks of Material Misstatement” section of ISA330-Clarified with reference to discussing the need to make changes to the audit plan.

We also suggest replacing “shall reconsider” in the second line in paragraph 13 with “shall determine.”

Paragraph A7

The point being made in the application guidance in this paragraph should appear in the "Requirements" section of the ISA in or near paragraph 9. One would expect that the materiality level for a greater or lesser financial reporting period would be different in relation to financial reporting for a 12-month period and such explanation could help to avoid an auditor's misunderstanding that the materiality level for an annual period may be used in periods of greater or lesser length.

Paragraph A14

We believe the auditor will need to change the materiality level or levels when it appears the actual financial results are likely to be substantially different from the anticipated period end financial results that were used to determine the materiality level or levels. We suggest placing the term “may need” in the last sentence with “shall determine the need” to be consistent with the language used in paragraph 12.

Editing and Clarification Comments – ISA 450 ED

Paragraph 4(d)

We recommend including the definition of “fraud” in the Definitions section to emphasize the differences between misstatements due to error versus misstatements due to fraud.

Paragraph 4(f)

Replace the word “accumulated” with “identified”.

Paragraphs 5 and A1

What is viewed as “inconsequential” or “clearly trivial” by one person may be viewed differently by another. While we recognize that it is not possible to eliminate all differences in views that might come into play in making such a judgment, we suggest that it could be helpful if the Board would provide one or more examples of items that are clearly trivial in the Application Material section, or otherwise develop this point further.

Paragraph 6

Replace “shall consider” with “shall determine” to be consistent with the term used in paragraph 7. In addition, as stated in our comments on paragraphs 12 and 13 of the ISA 320 ED, we recommend greater linkage by cross referencing this paragraph and paragraphs 12 and 13 of ISA 320, as well as relevant sections in ISA 315 and ISA 330.

Paragraph 8

The conditionality in this requirement (“if management...”) made the statement somewhat confusing. If what is intended here is that the auditor has a requirement to perform audit procedures following management recalculation or making changes in classes of transactions, account balances, disclosures and corrected misstatements, this could be stated more clearly.

Paragraph 10

We are concerned that the requirement described in this paragraph calls only for the auditor to obtain an understanding of management’s reasons for refusing to make a correction. We believe an auditor should take management’s reasons for not correcting misstatements into account and assess the validity of those reasons when evaluating whether the financial statements as a whole are free from material misstatement. Furthermore, the auditor should be required to evaluate whether such situations have an effect on the auditor’s earlier evaluation of management’s integrity and whether the procedures as prescribed in paragraph 34 of ISQC1. The cross reference to paragraph 17 regarding communication of the effects of uncorrected misstatements to those charged with governance also contains no coverage of the need to evaluate the reason given by management for not correcting a misstatement.

Paragraph 15

In addition to communicating with those charged with governance the individual effect that material uncorrected misstatements may have on the opinion in the auditor’s report, we recommend adding mention of the aggregated effects. This change will be consistent with the requirement in paragraph 20 (c).

Paragraph A17

We suggest adding “in accordance with the applicable financial reporting framework” at the end of the second sentence. The current draft seems to indicate only compliance with the individual auditor’s evaluation approach.

Paragraph 19

We don’t think this paragraph goes far enough in making the link that there indeed will be an effect on the auditors’ report if the auditor concludes that, or is unable to conclude whether, the financial statements as a whole are materially misstated. This is because the paragraph merely calls upon an auditor to “consider” the effect on its opinion. Considering it, or thinking about it, stops short of mandating that there will be an effect. Making all the considerations by the ISA only to, in the end, not mandate that the auditor communicate to investors through its opinion that the financial statements are materially misstated or that the auditor is unable to conclude that they are not does not, we believe, serve investors. To address these points we suggest replacing the term “shall consider” with the term “shall reflect” or words to that effect. We also suggest revising this paragraph to provide a cross reference to ISA 705/706 so that the auditor will be prompted as to what type of opinion he or she should be issuing.

Paragraph 20 (c)

We recommend the auditor’s documentation should also include reference to prior period uncorrected misstatements in order for the auditor to evaluate potential effects on the current year financial statements, depending upon requirements of the financial reporting framework.