

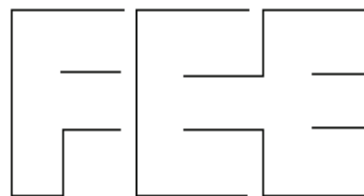
Date  
29 April 2008

Le Président

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des Experts  
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International Auditing and Assurance Standards Board (IAASB)  
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[Edcomments@ifac.org](mailto:Edcomments@ifac.org)

Dear Mr. Sylph,

**Re: Exposure Draft – Proposed ISA 265 on Communicating Deficiencies in Internal Control and Related Conforming Amendments to Other ISAs**

As the representative organisation of the European accountancy profession, FEE is pleased to comment on the Exposure Draft – Proposed International Standard on Auditing (ISA) 265 Communicating Deficiencies in Internal Control and Related Conforming Amendments to Other ISAs (Proposed ISA 265).

We have significant concerns about certain aspects of Proposed ISA 265. These are expressed under the header Main Comments. Our other comments which follow would further enhance the standard.

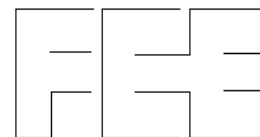
## **Main Comments**

### **Linkage with material weaknesses in internal control**

FEE notes the IAASB's approach in Proposed ISA 265 and the references it makes to significant deficiencies in internal control. The rationale for this approach is contained in the Explanatory Memorandum to Proposed ISA 265, which material will not be reproduced within the (final) standard.

However, FEE believes that the explanations included in the Explanatory Memorandum in relation to material weaknesses in internal control are crucial for the proper understanding of Proposed ISA 265. Therefore, we are of the opinion that the following additional "Introduction Paragraphs" should be placed between current paragraphs 2 and 3:

"The range of deficiencies that the auditor might judge are sufficiently important for management to be made aware of them could be extensive. Accordingly, prioritisation is necessary so that the attention of those charged with governance is directed at the more significant weaknesses only. The term "significant deficiency" is used for this purpose.



The term “material weakness” is frequently used to describe a threshold for reporting control matters to management and those charged with governance, whether publicly or privately. Reporting “significant deficiencies” in accordance with this ISA will include matters that previously would have been termed “material weaknesses” in a private report.”

This explicit clarification would, we believe, help avoid the undesirable and unintended consequence of regulators and/or the courts defining material weakness differently for public reporting purposes.

### **Consistency between objective and paragraph 9**

The Objective explicitly recognises the essential role of the auditor’s professional judgement in determining whether an identified deficiency “...is of sufficient importance...” to be communicated to management and/or those charged with governance. In our view, because of its reference to ‘all deficiencies in internal control other than those that are clearly trivial’, paragraph 9 as presently drafted is inconsistent with the ISA’s objective, potentially imposes an impractical burden upon the auditor and risks management’s attention being “diverted” from the essentials because of unnecessary detailed communications. Therefore, we propose paragraph 9 commences “The auditor shall communicate all deficiencies in internal control (other than those that, in the auditor’s professional judgement, are not of sufficient importance) identified during the audit to management...”

### **Consistency with Proposed ISA 260**

We are of the opinion that ISA 260 (Revised) on ‘Communication with Those Charged with Governance’ and Proposed ISA 265 are of a complementary nature and should therefore be consistent in their approach and in the way in which matters are communicated.

Proposed ISA 260 (Revised), paragraph 17, requires communication in writing with those charged with governance regarding auditor independence and *significant* findings from the audit. However, it allows for oral communication on other matters with appropriate documentation in the auditor’s working papers. We believe that Proposed ISA 265 should be consistent with this approach. We agree with paragraph 10 of Proposed ISA 265 whereby significant deficiencies are communicated to those charged with governance in writing, but recommend the Application and Other Explanatory Material explicitly addresses (in paragraph A18) the possibility that other deficiencies are communicated orally.

Proposed ISA 260 (Revised) recognises the importance of effective two-way communication during an audit of financial statements, Proposed ISA 265 is silent as far as two-way communication between those charged with governance and the auditor is concerned. We recommend that Proposed ISA 265 be consistent with Proposed ISA 260 (Revised) by explicitly recognising the benefits of two-way communication.

## **Other Comments**

### **Objective**

#### *Paragraph 5*

As demonstrated by the requirements which follow, we believe that it is the objective to communicate deficiencies in internal control appropriately to management and/or (rather than “or”) those charged with governance, depending on the importance of the deficiencies.

## Definitions

### *Paragraph 6 (a)*

It could be argued that there is inconsistency between the objective of Proposed ISA 265 to communicate ...'deficiencies of sufficient importance to merit ... attention' and the definition of deficiencies in internal control, which currently refers to 'misstatements in the financial statements' without any further qualification or quantification.

We recommend that the Application and Other Explanatory Material, for instance in or after paragraph A9 on 'Communication of Identified Deficiencies to Management', clarifies which factors are to be taken into consideration to determine which deficiencies in internal control are of sufficient importance to be communicated. One such factor is the probability that the deficiency in internal control results in a *material* misstatement in the financial statements.

## Requirements

### *Paragraph 9 (b)*

Paragraph 9 (b) would be enhanced by explaining what the auditor does if it is inappropriate to communicate directly to management. Is the only alternative communication to those charged with governance and does this make the matter to be communicated automatically a significant deficiency? A reference to paragraphs 21 to 23 (reporting non-compliance) ] to those charged with governance) of Proposed ISA 250 on 'The Auditor's Responsibilities relating to Laws and Regulations in an Audit of Financial Statements' might be useful in this respect. It would also be helpful to include other examples in the Application and Other Explanatory Material.

### *Paragraph 11b*

We question whether the level of prescription [in respect of the "disclaimer"] in paragraph 11(b) is justified in every case or whether the auditor could use professional judgment to determine the content of written, as opposed to oral communication, with the detailed commentary moved to the Application and Other Explanatory Material. For example, if equivalent details are already stipulated in the terms of engagement, formally agreed between the auditor and the audit client, it seems unnecessary to repeat those details in a written communication on significant deficiencies.

## Application and Other Explanatory Material

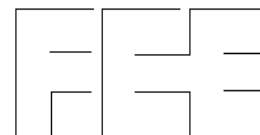
### *Paragraphs A3, A12 and 9 (a)*

Paragraphs 9 (a) and A12 indicate that if there are compensating controls the auditor need not report the significant deficiency, provided the auditor has evidence that the compensating control(s) work(s). However, it is not necessary for the auditor to obtain such evidence, i.e. there is a choice.

We propose that the last sentence of paragraph A3 be deleted as its content is better explained in paragraph A12.

### *Paragraph A15*

Paragraph A15 indicates that communication must be timely and those to those charged with governance are expected to be made no later than the archiving date (paragraph A15 says that as communications are part of the final assembly of the file, they have to be completed within that timeframe). We are not in favour of putting a time limit on communications as this may cause practical difficulty and may not be justified.



## Answers to the question on Proposed ISA 265

- 1. Do you agree with the guidance in paragraphs A1 to A3 and paragraph A12 in relation to paragraph 9 that audit evidence regarding the effective design and implementation of other controls is not in itself sufficient to support a conclusion that a deficiency does not exist?**

Provided that appropriate changes are made to paragraphs 9 (b) and A3 as suggested above in our comments on Requirements and on Application and Other Explanatory Material, we agree with this guidance.

If you have any further questions about our views on these matters, please do not hesitate to contact us.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'JP', followed by a long horizontal line that extends across the width of the signature.

Jacques Potdevin  
President

Ref.:AUD/JP/HB-SH