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Dear Mr Sylph

**Proposed New International Standard on Auditing ISA 265,  
Communicating Deficiencies in Internal Control and Related  
Conforming Amendments to Other ISAs (ISA 265)**

The Committee of European Banking Supervisors welcomes the opportunity to comment on the proposed New International Standard on Auditing ISA 265, Communicating Deficiencies in Internal Control and Related Conforming Amendments to Other ISAs (ISA 265).

Through their opinions on annual accounts and annual reports, external auditors constitute an integral part of the public oversight model and contribute to the financial stability of the market. As banking supervisors we therefore have an interest in ensuring that auditing standards, which are the basis for audit work, are of a high quality and are clear and capable of consistent application.

We have some concerns about the scope of the ISA as well as the application of the revised definition to the audit risk ISAs. We provide more detail on these points, and other comments on the ED in the attached appendix.

Our comments were coordinated by our Expert Group on Financial Information (EGFI), and especially by its Subgroup on Auditing, which is under the direction of Pat Sucher from the FSA, UK.

If you have any questions regarding our comments, please feel free to contact the chairman of EGFI, Arnoud Vossen (+44.20.7382.1792) or Miss Pat Sucher (+44.20.7066.5644).

Yours sincerely



Kerstin af Jochnick  
Chair

## **Appendix**

### **Comments on Proposed New ISA 265, Communicating Deficiencies in Internal Control and Related Conforming Amendments to Other ISAs (ISA 265)**

#### **1) Question on the obtaining of audit evidence on the operating effectiveness of other controls.**

We believe the IAASB's approach in ISA 265 is appropriate for the reasons provided.

#### **2) Question on the application of the clarity drafting conventions**

##### **Objective**

We believe this is appropriate, though see our comment under 'general comments' about the ISA.

##### **General comments:**

#### **1) Scope of the ISA**

We noted that the proposed ISA deals with the auditor's responsibility to communicate appropriately to management and those charged with governance deficiencies in internal control that the auditor has identified in an audit of the financial statements. In paragraph 2, ISA 265 then discusses how the auditor is required to obtain an understanding of internal control relevant to the audit when identifying and assessing the deficiencies in internal control. This is background to the necessity to communicate any such significant deficiencies. It is text that will be moved from the extant ISA 315 and placed in ISA 265. We believe that, given the coverage on identifying weaknesses in internal control in ISA 315, it is appropriate that this text should remain in ISA 315 or, at least be repeated in ISA 315 and ISA 265.

#### **2) Definition of significant deficiency**

In the explanatory memorandum the IAASB sets out its rationale for not defining material weakness. While we understand and accept that rationale and note that this is also accepted by the European Commission, we are not sure whether the approach of the IAASB to this subject is entirely clear. As far as we can see, the IAASB has defined significant deficiency in a way that it encapsulates material weakness, but is not the same. Therefore an auditor is likely to report more weaknesses, as significant deficiencies, to those charged with governance and management than if the auditor was reporting on material weaknesses i.e. significant deficiency has a lower threshold for reporting than material weakness.

If our understanding is correct, then we could support the IAASB's approach.

However, at the same time we do have concerns about replacing an accepted term in ISAs, 'material weakness', with a term 'significant deficiency' that is only defined in relation to the need to report to those charged with governance. A significant deficiency is only one that the auditor would consider merits the attention of those charged with governance.

#### **3) Communication of Identified Deficiencies to Management**

For 'Communication of Identified Deficiencies to Management', it follows from the explanatory memorandum that the IAASB believes that requiring the auditor to communicate all identified deficiencies formally to management in writing

could place an undue and excessive documentation burden on the auditor, particularly in smaller entity audits and that accordingly, the IAASB agreed that the communication to management need not be in writing.

Though CEBS understands the IAASB's rationale, we query whether communicating such deficiencies in writing to management does indeed place such an excessive burden on the auditor, as the auditor would normally document in their audit work-papers any such communication with management. Communication of such deficiencies to management (and significant deficiencies to management and those charged with governance) is an important subsidiary outcome of the audit. Having a written record for management and auditors of what has been communicated is not only useful for auditors and management, but would add value from a public interest perspective. We therefore suggest the ISA should indicate that significant, non-trivial deficiencies should be communicated in writing to management.

**Comments to specific paragraphs:**

Para 9(a): We believe the exception included in this paragraph should be clarified as it does not seem to be self-evident without the application material included in A3.

Para 9(b): As regard the second exception for communicating deficiencies to the management CEBS is of the view that ISA 265 should require in this context that the auditor communicates with those charged with governance.

Para 10.: With regard to the communication of significant deficiencies with those charged with governance, ISA 265 should clarify that these deficiencies also need to be communicated - preferably in writing - to management unless of course the circumstances described under 9 (b) apply.

Para A10. CEBS is of the view that the last two sentences of this paragraph would be better placed in section 'Determination of Whether Identified Deficiencies Constitute Significant Deficiencies' of the application material. The IAASB may even consider moving these sentences to the requirements (under para. 8)