

For the attention of Jim Sylph  
International Federation of Accountants  
545 Fifth Avenue, 14th Floor  
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USA

4 April 2008

Dear Sir

**IAASB Exposure Draft – Audit Evidence Regarding Specific Financial Statement Account Balances and Disclosures**

We appreciate the opportunity to comment on the IAASB's Proposed Redrafted ISA 501, *Audit Evidence Regarding Specific Financial Statement Account Balances and Disclosures*.

Following extensive consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of member firms who commented on this Exposure Draft. "PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

**Overall comments**

We do not support the proposed redrafted ISA 501. This ISA—a mix of required procedures related to specific financial statement amounts and disclosures—has always been somewhat of an anomaly in the body of ISAs. The explanatory guidance in the extant ISA was quite procedural, but the bold lettered requirements remained at a relatively principle-based level. In applying the Clarity redrafting conventions, much of the "how to" guidance has been elevated. The result is an overly procedural standard that is out of character with the other ISAs. We believe the original intent of this ISA was to mandate certain procedures, not how to do those procedures and, therefore, do not support the proposed Redrafted ISA.

**Request for comments on the application of the Clarity drafting conventions**

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

Although the proposed objective is outcome-oriented, it is out of character with the objectives of other ISAs in specifying the need to obtain sufficient appropriate audit evidence regarding specific assertions related to specific line items. Furthermore, we question whether the procedures specified in the proposed ISA are sufficient to meet the stated objectives. The purpose of the extant ISA was simply to mandate certain procedures rather than to articulate what would be necessary to obtain sufficient appropriate audit evidence about specific assertions for certain line items.

It is difficult to envisage how the objective could be stated more appropriately because, even if the objective were to focus on mandating the procedure, the requirements, themselves, introduce conditions that clearly contemplate circumstances when the procedures are not required.

For these reasons, we question whether this ISA should have an objective in its own right. Rather, ISA 501 supports the objective in ISA 500 to design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion. We recommend that ISA 501 should not have an objective of its own, but rather should be considered to be a subset of ISA 500. This could be achieved by either referring to ISA 500's objective in 501, or, if that is not

deemed to be an acceptable approach under the Clarity conventions, including the requirements and application material from ISA 501 in ISA 500 directly.

**Have the criteria for requirements been applied appropriately and consistently?**

There have been a number of elevations from the guidance and, although their elevation reflects appropriate application of the Clarity redrafting conventions, the result is an ISA that is inconsistent in character with other ISAs. Therefore, we do not support the proposed elevations.

As noted in our introductory comments, although extant ISA 501 contained reasonably detailed explanatory guidance, the bold lettered requirements remained at a relatively principle-based level, reflecting the original intent of the Board to mandate certain procedures, not how they should be performed.

Elevating the ‘how to’ level of detail into the requirements establishes a precedent that could lead to the introduction of further procedural requirements in other ISAs, or equally, the proliferation of ISAs with individual requirements for specific assertions for various line items in the financial statements. We are strongly of the view that this is inappropriate in a set of principles-based standards.

The requirements of proposed redrafted ISA 501 should remain at the principles-based level and include no more detail than the requirements in the extant ISA, focussing on the procedures that need to be performed, rather than how to do them. The following comments illustrate this point.

*Attendance at physical inventory counting*

- The extant paragraph 5 required the auditor to attend the entity’s “physical inventory counting” unless impracticable. The other requirements in this section in the extant ISA focussed on what to do if unable to attend the physical inventory count on the date planned, and when attendance is impracticable. In the redrafted ISA, this has been translated into five requirements, two of which specify very detailed procedures. At a minimum, we believe that the elevation of the detailed procedures in paragraphs 4 and 8 are excessive detail and unwarranted in a principles-based standard.
- We are also concerned that paragraph 4 in the redrafted ISA has inadvertently changed the meaning of the requirement in the extant ISA. The extant ISA required the auditor to attend the entity’s “physical inventory counting” and recognised that this could serve as a test of controls, or a substantive procedure (depending on the auditor’s risk assessment and planned approach). Thus, the auditor could apply judgment to determine the nature and extent of observation that was necessary in the circumstances to obtain the audit evidence needed.

Paragraph 4 of the redrafted ISA, however, requires the auditor to attend the inventory physical “count” or “counts” of the entity. This changes the focus from obtaining evidence about the entity’s process of counting its physical inventory to a requirement to observe the specific count or counts. We are concerned that this change in wording inadvertently implies a need to attend the entity’s inventory counts as a substantive procedure. The redrafted ISA does not take account of the systems and controls implemented by the entity or by groups across their subsidiary undertakings, nor recognise that the auditor may observe inventory counts as a means to test the entity’s controls over inventory.

As a result, we are concerned that the redrafted ISA has been substantively changed from the extant ISA and unnecessarily restricts the auditor from considering the most effective and efficient way to obtain sufficient appropriate audit evidence about the entity’s physical counting process and the existence and condition of the inventory.

*Litigation and claims*

- The redrafted ISA also elevates a number of specific procedures in the application guidance regarding litigations and claims to requirements. We question whether those specific procedures need to be embedded in the requirements in this ISA. Some of those procedures, such as review of minutes of meetings of those charged with governance, are procedures mentioned elsewhere in the ISAs and therefore could be covered in the application material by reference to those other procedures.

- Paragraph 10 requires that, where the auditor assesses there to be a risk of material misstatement in relation to litigation or claims, the auditor should seek direct communication with the entity's external counsel. Whilst this will often be the most appropriate approach, it may not always be so, as many companies use their own internal counsel to deal with claims, especially in the early stages of such claims. Thus, this requirement does not meet the test of being applicable in all circumstances. The second procedure is already modified by the condition of "when considered necessary". Therefore, we question whether this paragraph fully qualifies as a requirement, or whether it could be dealt with as application guidance to paragraph 9 of proposed ISA 501, based on the requirement to respond to assessed risks in ISA 330.
- It is also unclear in paragraph 12 why evidence about litigation and claims is singled out for subsequent events review, as such review is required under ISA 560 in respect of all audit evidence and, in particular, where the risk of subsequent events being significant to the financial statements is higher (for example, in the case of litigation or claims). We therefore recommend that this paragraph also be repositioned as application material.

### **Request for specific comments**

#### ***Long-term investments***

As noted in the Explanatory Memorandum, given changes in financial reporting frameworks since the issuance of extant ISA 501, the term "long-term investments" is no longer broadly used and current financial reporting requirements place less emphasis on whether the intention is to hold an investment on a long-term basis and more emphasis on considering impairments in value. As such, we strongly support the IAASB's proposal to delete the requirements and guidance on long-term investments from ISA 501, on the grounds that the issues it was attempting to address are now effectively covered by the requirements and guidance on auditing the valuation and disclosure of estimation uncertainty in ISA 540.

### **Other comments**

#### ***Segment information***

As with long-term investments, the proposed requirements and guidance in the ISA on segment information may not remain useful in a meaningful way because of developments in the accounting standards. Financial reporting requirements regarding an entity's operating segments are moving from mandating an approach defining segment information on geographic or lines of service bases, to one based on how the chief operating decision maker allocates resources and assesses the performance of components of an entity; that is, an approach more closely reflecting how "management manages the business".

IFRS 8, effective for periods beginning on or after 1 January 2009, with early application permitted, introduces a new approach to segment disclosures. This approach raises different audit challenges, for example, the identification of the chief operating decision maker may not always be obvious, as the function may be performed by one person or a group of people. In addition, as segment information does not have to be prepared in accordance with generally accepted accounting principles, and instead of the auditor focusing on whether a component's financial information conforms with GAAP (as would be the case under IAS 14), the auditor's work effort is likely to be directed to obtaining evidence that the segment information disclosed in the financial statements is that used by the entity's chief operating decision maker, that the basis on which the information has been prepared is the basis disclosed, and that the disclosures are adequate, and that all significant segment items are reconciled to consolidated totals in the financial statements.

Whilst the extant ISA included an important principle that the auditor considers segment information in relation to the financial statements taken as a whole, rather than in relation to the procedures that would be necessary to express an opinion on the segment information standing alone, we question whether the proposed requirements and guidance in ISA 501 remain useful and whether they may even be potentially misleading in the near term.

We recommend that the IAASB considers the continued relevance of the existing requirements and guidance, and whether they ought to be deleted pending a more comprehensive revision.

We would be happy to discuss our views further with you. If you have any questions regarding this letter, please contact Roger Marshall (+44 20 7804 4866).

Yours faithfully,

PricewaterhouseCoopers