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February 15, 2008

International Auditing and Assurance Standards Board  
International Federation of Accountants  
c/o IAASB ED Comments  
545 Fifth Avenue, 14th Floor  
New York, New York 10017 USA

Attention: Mr. John Kellas, Chair

Dear Mr. Kellas:

Re Exposure Draft (ED) - ISA 265, Communicating Deficiencies in Internal Control and Related Conforming Amendments to Other ISAs

The Certified General Accountants Association of Canada (CGA-C) welcomes the opportunity to comment on the exposure draft concerning communications by auditors with management and audit committees regarding significant and other non-trivial deficiencies in internal control, identified in the conduct of an audit engagement.

**General Comments:**

We concur with the decision of the IAASB to set aside the task of defining “material weakness.” In the proposed ISA, the term “deficiency” has been used instead of “weakness” and the term “significant” instead of “material”. In our view both changes are appropriate since the term “weakness” is not as clear as “deficiency.” (in fact “weakness” can imply only lack of strength or vigor, whereas “deficiency” means inadequate or insufficient) and the revised terms provided clearer intention.

The division, based on auditor judgement, of identified control deficiencies into significant, non-trivial and trivial makes clear in the standard that, unless otherwise requested by an Audit Committee, only significant deficiencies are reported to the Committee reflecting their oversight responsibilities for control systems resulting in the production of financial statements free of material misstatement.

**Specific Comments**

In response to the request of the IAASB for comment on the matter, we agree that unless an auditor has obtained sufficient appropriate evidence regarding the operating effectiveness of compensating controls, the identified deficiency should be included in the report to either the Audit Committee or management, as appropriate. This recommendation not only ensures that the auditor meets their obligations, but also permits them to dispense with the necessity of obtaining additional audit evidence unless they choose to do so. This is a particularly practical approach in the instance of an audit of a smaller entity.

The IAASB has requested feedback on the application of the clarity drafting conventions and requested that respondents consider whether the objective for the proposed ISA is appropriate, and whether the proposed requirements are appropriate responses to that objective. CGA-C both believes that the ISA is appropriate, and that the requirements as proposed will achieve the objectives detailed within the ISA.

Paragraph A5 states: *Significant deficiencies may exist even though the auditor has not identified misstatements during the audit. The significance of a deficiency or combination of deficiencies in internal control depends not only on whether a misstatement has actually occurred, but also on the risk that a misstatement could occur and the potential magnitude of the misstatement.*

The concept of risk of occurrence may be better stated as the probability of occurrence and the magnitude of misstatement restated as the effect of occurrence. In our experience many practitioners use an X-Y axis to plot these two characteristics to help them to assess significance of a deficiency. In addition to the change in phrases we suggest that a supplementary narrative explaining the concept of the risk axis be considered for inclusion in Para A5 in order to enhance the auditor's understanding of the material.

### **Special Considerations in the Audit of Smaller Entities**

In our view the requirements set out in the ED need not be modified for the audit of smaller entities except for recognition of the fact that many smaller entity boards do not always include independent directors on their boards. In such cases, a problem arises if communication of certain identified control deficiencies to management is not appropriate. No guidance is provided in the ED for such a situation. (see A 13) We recommend the IAASB consider adding the suggestion that a practitioner contemplate reporting to independent directors if they exist, and/or consultation with competent legal counsel.

We recommend the inclusion of guidance for the benefit of smaller practice units in the area of presentation of significant identified deficiencies to those responsible for governance, and of identified deficiencies to management. This guidance might include sample reports identifying format of presentation or a listing of the various bodies of text to include in the communication as an appendix to the material.

Generally both those responsible for governance and those in management want the auditor's views on priority within the list of deficiencies in control presented to them. Guidance on the ranking of reported deficiencies would also be helpful.

For example, the deficiencies may simply be listed in order of priority based upon the auditor's judgement, using the combined criteria of probability of the occurrence of a misstatement, and the effect of such an occurrence. Other forms of presentation may be in a chart form with rankings such as High Low Medium reflecting the level of risk (probability and effect of occurrence) of misstatement represented by each identified control deficiency as assessed by the auditor.

### **Closing Comments**

The proposed ISA provides clear guidance regarding the relevant internal control-related matters to be communicated in an audit of financial statements and the proposed amendments to other ISAs (ISA 240, ISA 260, ISA 300, ISA 315, ISA 330 and ISA 600) appear to be in harmony with the content of ISA 265.

Should you wish to consult with us further on this matter we request that the IAASB correspond with Ms. Dawn McGeachy, BAccS, FCUIC, ACUIC, CGA, Senior Associate, Public Practice at [dmcgeachy@cga-canada.org](mailto:dmcgeachy@cga-canada.org) or myself at [rlefebvre@cga-canada.org](mailto:rlefebvre@cga-canada.org)

Sincerely,

[Original Signed By: ]

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Vice-President, Research & Standards