



28 September 2012

Ref: 12/100

Prof. Arnold Schilder
Chairman
International Auditing and Assurance Standards Board
International Federation of Accountants
529 Fifth Avenue, 6th Floor
New York,
New York 10017 USA

Dear Professor Schilder,

Improving the Auditor's Report

The International Association of Insurance Supervisors (IAIS) welcomes the opportunity to respond to the International Auditing and Assurance Standards Board (IAASB)'s Invitation to Comment, Improving the Auditor's Report (the ITC).

The IAIS is pleased that the IAASB has made progress in evaluating how auditor reporting can be improved to enhance the ability of users to understand increasingly complex financial reports. We believe that this is a very important work-stream and that the recommendations made in the ITC represent a positive step forward to address the expectation and information gaps. We applaud the IAASB in taking on this complex project and believe that the ITC goes a long way to address the issue that there were few early warning indicators that preceded failures during the financial crisis.

Although we agree on the whole with the recommendations made in the ITC, there are a few areas that would benefit from further clarity to ensure consistency of application and to preserve the respective roles of management and auditors:

We agree with the concept of Auditor Commentary, however, we feel that the description made in the ITC is broad and could allow the auditor to provide original information about the entity that management has not provided. We believe that it is the responsibility of management, and not the auditors, to provide information about an entity. In our view, Auditor Commentary should provide information to allow users to understand how the auditor concludes on the financial statement as a whole considering specific assessments on the most judgmental aspects of the audit. As such, we are supportive of Auditor Commentary that follows the example on the valuation of financial instruments included in the illustrative auditor's report in the ITC.

Where valuations or estimates involve a high degree of subjectivity, we believe that management should disclose the range of possible outcomes in notes to the financial statements. We suggest that the IAASB and the IASB work together to improve these disclosures. Audit Commentary should draw attention to those notes and comment on the work the auditor did to satisfy themselves on the range or valuation developed by management.

We recognise the difficulty in developing standards that achieve the right balance between providing useful information that helps users to understand the financial statements and providing an excessive amount of information that would overwhelm users. As such, we encourage the IAASB to provide more detail on the objectives of Auditor Commentary, and to set out clear principles and illustrative examples to assist the auditor in identifying the relevant entity-specific matters and in defining the nature and extent of the communication in the auditor's report. Illustrative examples specific to insurance entities would be helpful.

We believe that there is a need to more strongly preserve the separate responsibilities of management and those charged with governance (TCWG). We view TCWG as independent of management and therefore recommend that the descriptions of the responsibilities of TCWG and management be provided in separate paragraphs in the auditor report to highlight this independence.

Regarding going concern assumptions, we note that there is considerable scope for the interpretation of "going concern" and "material uncertainty." There is a need for consistency and sensitivity in such disclosures for insurance entities. As such, we encourage the IAASB to work with the IASB toward a common understanding of the purposes of going concern assessments, and financial statement disclosures on going concern and material uncertainty.

As international convergence is important in these areas, we encourage the IAASB to liaise with the US Public Company Accounting Oversight Board (PCAOB) and the European Commission as these bodies are also developing requirements regarding the content of the audit reporting.

We again are fully supportive of the work efforts of the IAASB on auditor reporting and we encourage the IAASB to continue to refine their proposals as per our comments above.

The appendix provides the IAIS' responses to the questions set out in the paper.

If you have questions regarding this letter, please contact Aina Liepins at the IAIS Secretariat (tel: +41 61 280 8199; email: aina.liepins@bis.org) or Richard Thorpe, Chair of the IAIS Accounting and Auditing Issues Subcommittee (tel: +44 (0) 20 7066 3160; email: richard.thorpe@fsa.gov.uk).

Yours faithfully

The image shows two handwritten signatures in blue ink. The signature on the left is 'P. Braumüller' and the signature on the right is 'M. Mächler'.

Peter Braumüller
Chairman, Executive Committee

Monica Mächler
Chair, Technical Committee

Appendix: responses to questions raised in the paper

1. Overall, do you believe the IAASB's suggested improvements sufficiently enhance the relevance and informational value of the auditor's report, in the view of possible impediments (including costs)? Why or why not?

We are supportive of the IAASB's efforts towards reducing the information gap and improving the relevance of auditor reporting and are particularly supportive of adding additional Auditor Commentary and expanding on the disclosures on the responsibilities of management, the external auditor and TCWG.

2. Are there other alternatives to improve the auditor's report, or auditor reporting more broadly, that should be considered by the IAASB, either alone or in coordination with others? Please explain your answer.

We support the aim of improving the communication between auditor and stakeholders and consider that it is desirable for auditors to provide assurance on a greater range of information that is relevant for shareholders. Nevertheless, the role of the auditor should not be extended to provide comfort on information on the financial health or future solvency of companies or the quality of management's strategic choices.

In order to reduce the expectation gap relative to the statutory audit of insurers' financial statements, we believe that it would be worthwhile to consider and possibly extend the responsibility of the auditor on the review of areas fundamental to the quality and the relevance of the financial reporting as a whole, such as:

- validation of the performance indicator (e.g. embedded value) calculation used to provide sensitivity information in the disclosures required by accounting standards
- assessment of the quality of the internal controls over financial reporting
- assessment of the quality of the risk management procedures and controls
- assessment of the public reporting concerning solvency
- key performance indicators included in the MD&A

As international convergence is very important in this area, we encourage the IAASB to work further on an extension of the responsibility of the auditor and to coordinate this work with the PCAOB and the European Commission.

More generally, we would see considerable merit in discussing with the IAASB how an International Auditing Practice Note on the audit of insurance contracts could be developed.

3. Do you believe the concept of Auditor Commentary is an appropriate response to the call for auditors to provide more information to users through the auditor's report? Why or why not? (See paragraphs 35–64.)

We agree that there may be great benefit in exploring the concept of Auditor Commentary where in the auditor's judgment further information needs to be provided about matters particularly important to the users' understanding of the financial

statements or the audit itself. We believe that Auditor Commentaries will provide management with incentives for improved disclosure.

We also agree that additional guidance is needed. To provide more useful information to users and to reduce the information gap, we believe that the Audit Commentary should focus on explaining the nature of the audit work done to provide a view on the level of risk associated with valuations or estimates used by management in the preparation of financial reports. Care must be taken to achieve a balance between auditors commenting on management disclosures and auditors not creating new disclosures by providing information that management has not itself disclosed.

Where valuations or estimates involve a high degree of subjectivity, we believe that management should disclose the range of possible outcomes. We suggest that the IAASB and the IASB work together to improve these disclosures. Audit Commentary should draw attention to the notes relative to the discussions of the range of possible outcomes where an estimate involves a high degree of subjectivity and should explain the nature of audit work done and the level of risk associated with a valuation/estimate (i.e. refer to the illustrative example on the valuation of financial instruments on page 10 of the ITC).

Moreover, we support the IAASB's preliminary view that the more holistic concept of Auditor Commentary should replace the existing of "Emphasis of Matter" and "Other Matter" paragraphs.

4. Do you agree that the matters to be addressed in the Auditor Commentary should be left to the judgment of the auditor, with guidance in the standards to inform the auditor's judgment? Why or why not? If not, what do you believe should be done to further facilitate the auditor's decision-making process in selecting the matters to include in the Auditor Commentary? (See paragraphs 43–50.)

We agree that the future standard should leave the auditor to apply his professional judgment in determining the matters that are most important to user's understanding of the audited financial statements or the audit. Audit Commentary would be most relevant when it is tailored to the facts and circumstances of the entity.

However, we believe that there is a need for the IAASB to develop principles to help auditors to exercise their judgment in determining the information and the level of detail to include in their report. In particular, we believe that the principles should highlight that auditors need to be careful:

- not to provide information about the entity that has not been disclosed by the entity itself
- to ensure that any additional information about the context and the conduct of the audit or matters particularly important to the user's understanding of the financial statements cannot be seen by the users as a way of expressing an implicit qualified opinion
- to avoid boilerplate or standardised explanations that would fail to provide valuable information regarding the specificities of the audited entity. The information provided should be most entity specific as possible

In our view, the Auditor Commentary should be limited to the following matters of judgment:

- areas of significant management judgment (e.g., in relation to the entity's accounting practices, including accounting policies, accounting estimates, and financial statement disclosures)
- significant or unusual transactions (e.g., significant related party transactions or restatements)
- changes in accounting policy that are not due to a change in an accounting standard and when there is significant (actual or potential) impact on net income or, for regulated entities, key regulatory ratios (e.g., capital ratios)
- matters of audit significance, including areas of significant auditor judgment in conducting the audit relative to recognition, valuation and presentation matters that would generally be discussed with the engagement control reviewer and TCWG

On the other hand, we believe that the matters linked to the audit strategy are not relevant and understandable for the users and could increase the expectation gap. These matters should be restricted to communication to TCWG.

The concept of Auditor Commentary should not result in the auditor's report becoming a substitute for the financial statements. That is why the Auditor Commentary should only highlight the most relevant information already disclosed in the financial statement.

At this stage, we believe that while introducing the concept of Auditor Commentary is a positive step forward, further clarity is still needed. The concept, as currently described in the illustrative examples (see question 5), could allow the auditor to provide either additional information about the entity not provided by the management or information that is not relevant to users.

5. Do the illustrative examples of Auditor Commentary have the informational or decision making value users see? Why or why not? If not, what aspects are not valuable, or what is missing? Specifically, what are your views about including a description of audit procedures and related results in Auditor Commentary? (See paragraphs 58–61.)

We encourage the IAASB to develop illustrative examples of Auditor Commentary for insurance entities that cover risks specific to the insurance industry and to individual insurance entities to improve relevance and encourage consistency in reporting for the sector.

We are not convinced that the illustrative paragraphs on audit strategy and involvement of other auditors provide valuable information to the users:

- As it is presented, the paragraph on audit strategy (paragraph 4) relating to the new system to record revenue and receivables may have more relevance to TCWG than to users of financial reports. Moreover, it is possible that the auditor may be providing information about changes in the IT systems that may not be disclosed in the financial statement notes. As explained in question 4, we believe that the Auditor Commentary should not result in the auditor providing information about the entity that the entity has not disclosed itself. Further, since this particular paragraph does not provide conclusions about the work or discussion as to whether risks have increased or decreased from prior periods, it may be

misinterpreted to suggest that remaining risk exists not covered by the audit procedures.

6. What are the implications for the financial reporting process of including Auditor Commentary in the auditor's report, including implications for the roles of management and those charged with governance (TCWG), the timing of financial statements, and costs? (See paragraphs 38 and 62–64.)

We believe that including Auditor Commentary in the auditor's report will have a positive impact on the quality of the financial reporting process.

Indeed, this requirement would encourage earlier and more extensive discussions between the auditor, the entity's management and the audit committee about disclosures the auditor intends to make in his report and the links to disclosures needed in the financial statements.

As Auditor Commentary is intended to draw the user's attention to the most significant matters in the financial statements, the auditor should only highlight financial information already disclosed in the financial statement. We do not believe that this requirement would be costly.

During the audit process, auditors already summarize their findings on the most critical matters of the audit in order to justify their opinion on the financial statements as a whole. We believe that addition of Auditor's Commentaries in the auditor report would encourage a better assessment of these elements and promote stronger communication between management and the audit committee, without being overly burdensome.

7. Do you agree that providing Auditor Commentary for certain audits (e.g., audits of public interest entities (PIEs)), and leaving its inclusion to the discretion of the auditor for other audits is appropriate? Why or why not? If not, what other criteria might be used for determining the audits for which Auditor Commentary should be provided? (See paragraphs 51–56.)

Consistent with the recommendations contained in the ITC at paragraph 53, we agree that the definition of public interest entities should be extended to include financial institutions.

In our view, Auditor Commentary should be required for all audits. Having different forms of the auditor's report for different types of entities could lead users to draw unintended or inappropriate conclusions about the relative quality of their financial statements; for example, the financial statements of unlisted entities might be considered to be of lower quality than those of listed entities.

8. What are your views on the value and impediments of the suggested auditor statements related to going concern, which address the appropriateness of management's use of the going concern assumption and whether material uncertainties have been identified? Do you believe these statements provide useful information and are appropriate? Why or why not? (See paragraphs 24–34.)

We believe that a move to more transparency on the assessment of the going concern assumption would likely tend to improve the quality of the corporate governance and the

auditors work in this area. Disclosure would also enhance users' understanding of the related risks and uncertainties as well as their ability to challenge management.

We agree that it would be useful to require the auditor to include in the auditor's report, having regard to the applicable financial reporting framework, a conclusion regarding the appropriateness of management's use of the going concern assumption. In addition we believe that the transparency of the information would be improved by including a specific statement regarding whether, based on the audit work, the auditors have identified material uncertainties related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. However, if such events or conditions exist, we believe that management should provide an assessment of this in the financial statement notes, with the auditor's comments being based on management's assessment.

International convergence is important in the area of going concern. The PCAOB and the European Commission are also developing requirements and it would be useful to have coordination in this area.

There is considerable scope for differing interpretations of a going concern and material uncertainty in the accounting framework and we believe that the IASB could develop guidance on circumstances in which the going concern basis of accounting would not be appropriate. We encourage the IAASB to work with the IASB toward a common international understanding of the purposes of going concern assessment and financial statement disclosures about going concern and material uncertainty related to going concern.

There is a need for sensitivity and consistency in disclosures on the going concern assumption for insurance entities. We encourage the IAASB to develop requirements specific to insurance entities in this area.

To ensure financial statement users understand that management decides whether the going concern assumption is appropriate, we also suggest that the description of management's responsibilities for going concern assumption, along with an explanation of the meaning of the going concern assumption, would be better placed in the section on Going Concern along with the auditor's discussion on going concern to highlight the respective responsibilities of management and the auditors. The current proposal has these disclosures a page apart.

9. What are your views on the value and impediments of including additional information in the auditor's report about the auditor's judgments and processes to support the auditor's statement that no material uncertainties have been identified? (See paragraphs 30–31.)

In our view it is essential that auditors not provide information about an entity that the entity itself has not disclosed. We believe that auditors should not disclose information on material uncertainty that the entity itself has not disclosed, although the auditor should consider how such information impacts their ability to provide an unqualified audit opinion.

The concept of material uncertainty is not defined and requires more clarity to promote consistency of application.

10. What are your views on the value and impediments of the suggested auditor statement in relation to other information? (See paragraphs 65–71.)

Because the credibility of the audited financial statements may be undermined by material inconsistencies between the audited financial statements and other information (i.e. financial and non-financial information which is included, either by law, regulation or custom, in a document containing audited financial statements and the auditor’s report therein), it is important that the auditors take responsibility for reporting on other information.

We agree that the auditor’s report should include a statement about whether the auditor has identified material inconsistencies between the other information the auditor is required to read and the audited statement information. The auditor’s report should also make clear which other information was reviewed.

Misstatements of fact (i.e. other information that is unrelated to matters appearing in the audited financial statements that is incorrectly stated or presented) could also undermine the credibility of the document containing audited financial statements. Where the auditor becomes aware of material misstatements of fact that are not remediated, we believe that the auditor should be required to disclose these misstatements in the auditor’s report in the section “Other information” and consider the impact of such on the audit opinion. This will improve the discussions between the auditor and management and also encourage management to provide appropriate disclosures.

11. Do you believe the enhanced descriptions of the responsibilities of management, TCWG, and the auditor in the illustrative auditor’s report are helpful to users’ understanding of the nature and scope of an audit? Why or why not? Do you have suggestions for other improvements to the description of the auditor’s responsibilities? (See paragraphs 81–86.)

We believe that enhanced descriptions of the responsibilities of management, TCWG and the auditors would be helpful to users’ understanding of the nature and scope of an audit.

Grouping responsibilities of TCWG with that of management under one heading implies that TCWG and management are one entity. TCWG represent shareholders and it is important to separate the responsibilities of TCWG from those of management to highlight this distinction.

Management’s responsibilities with respect to the going concern assumption may be better placed in closer proximity to the Auditor’s Commentary on the use of the going concern assumption.

The description of auditors’ responsibilities is clear. However, the last point in the description says that auditors “communicate” with TCWG on certain matters. The use of the word “communicate” implies a less formal relationship than in fact exists, and we recommend replacing with it with “report.”

12. The auditor's report could usefully include a description of the information contained in the report containing audited financial statements that is not covered by the audit. What are your views on the value and impediments of disclosing the name of the engagement partner? (See paragraphs 72–73.)

We agree with the IAASB proposal to require the disclosure of the engagement partner's name in the auditor's report. This requirement enhances the transparency and provides the engagement partner with a greater sense of personal accountability.

It should be noted that in some jurisdictions, the hiring of the auditor of a financial institution involves a preapproval by the supervisor that focuses on both the audit firm and the engagement partner.

13. What are your views on the value and impediments of the suggested disclosure regarding the involvement of other auditors? Do you believe that such a disclosure should be included in all relevant circumstances, or left to the auditor's judgment as part of Auditor Commentary? (See paragraphs 77–80.)

It should remain clear that the group auditor maintains responsibility for the financial statements. We believe that information about the involvement of other auditors should be provided because this additional disclosure may improve transparency by providing users with information that enables them to evaluate the other auditors in the same manner that they evaluate the group auditor. For example, users could determine if the other auditors are subject to an audit inspection regime and consider any public inspection reports. As the PCAOB has issued a standard-setting proposal that would mandate a disclosure about other auditors involved in the engagement, whether or not the group auditor chooses to divide responsibility we, therefore, advocate consistency between the PCAOB, the IAASB and the European Commission to ensure comparability.

14. What are your views on explicitly allowing the standardized material describing the auditor's responsibilities to be relocated to a website of the appropriate authority, or to an appendix to the auditor's report? (See paragraphs 83–84.)

The standardised material describing auditor's responsibilities must be retained in the auditor's report. We believe that users should be able to read the auditor's report as a stand-alone document.

15. What are your views on whether the IAASB's suggested structure of the illustrative report, including placement of the auditor's opinion and the Auditor Commentary section towards the beginning of the report, gives appropriate emphasis to matters of most importance to users? (See paragraphs 17–20.)

The auditor's opinion is the key output from the audit, and should thus be the focus of the report. As it is helpful to have context for the audit process on which the opinion is expressed, we believe that the description of the respective responsibilities of management and the auditors would be more appropriately included just after the opinion.

The section on “Other information” is not directly related to the opinion on the financial statement and would be better placed just before the “Report on other legal and regulatory requirements”.

16. What are your views regarding the need for global consistency in auditors’ reports when ISAs, or national auditing standards that incorporate or are otherwise based on ISAs, are used? (See paragraphs 21–23 and 87–90.)

We believe that the IAASB found an adequate balance between the need for consistency in auditor reporting across jurisdictions and the need for an auditor’s report that is relevant in the context of the laws and regulations in each jurisdiction.

17. What are your views as to whether the IAASB should mandate the ordering of items in a manner similar to that shown in the illustrative report, unless law or regulation require otherwise? Would this provide sufficient flexibility to accommodate national reporting requirements or practices? (See paragraph 17 and Appendix 4.)

We believe that mandating the ordering of items would improve comparability and enable users to easily locate and compare information required for decision making. The approach in appendix 4 appears to provide sufficient flexibility to accommodate national financial reporting régimes.

18. In your view, are the IAASB’s suggested improvements appropriate for entities of all sizes and in both the public and private sectors? What considerations specific to audits of small- and medium-sized entities (SMEs) and public sector entities should the IAASB further take into account in approaching its standard-setting proposals? (See paragraphs 91–95.)

The IAASB’s suggested improvements should apply to the auditor reports of all entities. As set out in our response to question 7, having different forms of auditor reports for different sizes and types of entities could lead users to draw unintended or inappropriate conclusions about the relative quality of their financial statements.