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THE CHAIRPERSON

International Auditing and Assurance Standards Board
James Gunn
Technical Director
529 Fifth Avenue 6th Floor
New York
NY 10017

15 October 2012

Ref: **Improving the Auditor's Report**

Dear Mr Gunn

The European Banking Authority (EBA) welcomes the opportunity to comment on the IAASB's Invitation to Comment: Improving the Auditor's report (hereinafter referred as ITC).

Consistent with the EBA's reply to the IAASB's Consultation Paper on enhancing the value of auditor reporting on 16 September 2011, we would like to re-emphasise that the EBA has a strong interest in promoting sound audit practices which support high quality corporate reporting and that useful and understandable reporting from auditors should be an output of high quality audits.

Our comments in the Appendix are based on our perspective as a prudential banking regulator and are structured according to the topics covered by the ITC. This does not necessarily mean that our feedback provides exhaustive answers to each of the questions raised by the ITC.

If you have any questions regarding our comments, please feel free to contact Ms. Patricia Sucher (+44 20 7066 5644) in her capacity as Chair of the technical group that coordinated the response.

Yours sincerely

A handwritten signature in black ink, which appears to read 'Andrea Enria', is positioned below the text 'Yours sincerely'.

Andrea Enria

CC: Ms Patricia Sucher

Enc:

Appendix - EBA's reply to the IAASB's Invitation to Comment on Improving the Auditor'

Appendix

EBA's reply to the IAASB's Invitation to Comment on Improving the Auditor's Report

1. Overall Considerations

EBA welcomes and supports the IAASB's suggested improvements to auditor's reporting as they are a step in the right direction which should:

- enhance users' understanding of the financial statements; and
- provide greater transparency over the audit process.

However, we would like to comment on certain aspects of the IAASB's illustration of a possible improved auditor's report. Our comments are described in the sections below.

2. Auditor Commentary

We support the inclusion of the auditor commentary as it enhances the informational value of the auditor's report to the users. However, it is important that the auditor commentary strikes the right balance between consistency of presentation and flexibility in being tailored to the entity so that it provides entity specific auditor commentary.

We believe the division of responsibility between the auditors and the management should not be blurred in the pursuit of enhanced information in the auditor commentary. First and foremost, management should be encouraged to provide more robust disclosures which support the financial position presented in the financial statements of the bank. In our view it is not the auditor's responsibility to provide information that in the first place should be provided by the management.

One approach to striking an appropriate balance between the information provided by the auditor in the auditor's report, and that provided by the management in the financial statements, could be to separate out the information proposed for inclusion in the auditor commentary between information provided by i) those charged with governance (TCWG) who provide oversight of preparation and audit of financial statements; ii) management who are responsible for preparing the financial statements; and iii) auditors who are responsible for auditing the financial statements prepared by management.

In the above suggested approach, in the annual report, TCWG could include more information relating to key areas of financial reporting, describing the considerations given to these matters and conclusions drawn. Though we appreciate that it is not within the remit of the IAASB to mandate what information TCWG should provide in the annual report, we would suggest that the IAASB's approach to auditor commentary could recognise that information about key areas of financial reporting could be provided elsewhere in the annual report.

It is management's responsibility to provide detailed and robust disclosures in the financial statements. The auditors should focus on providing greater transparency over the audit process in their commentary in the auditor's report. We appreciate that this matter may not be addressed without enhancing the accounting and/ or disclosure standards and hence we would encourage the IAASB to seek to work with the IASB to improve the accounting and/ or disclosure standards in a way that would place the onus on management to provide more comprehensive, reliable and relevant disclosures.

The role of auditors is to provide an opinion on whether the financial statements as a whole are free of material misstatement and that the financial statements have been prepared in accordance with the applicable financial reporting framework (to give a true and fair view). In our view, given the role of the auditors, the auditor commentary should focus on how the auditor gained comfort on management's assertions in relation to significant areas of estimates and judgement in the financial statements, areas of significant debate with management and TCWG, areas of 'close calls' and alternative accounting treatments, and how the auditor dealt with the matters.

While providing the auditor commentary, the auditor should be guided by the over-arching principle of narrowing the information gap and the expectation gap. In this regard, the IAASB should consider providing principles and detailed guidance to enable auditors to provide commentary which is entity-specific, at the appropriate level of granularity, and avoids language which is 'boilerplate' and too standardised across entities.

We support the IAASB's approach of providing examples of auditor commentary in its proposed standard. However, we have the following observations where we believe the examples could be improved in line with our comments above:

- Avoid repeating what management are already required to provide in the financial statements if it is not adding any further information.
- Encourage entity-specific information to minimise risk of 'boilerplate' language which is replicated across all entities.
- Focus on enhancing the transparency of the audit process, auditor's evaluation of management's estimates and judgements, and the results of auditor's procedures.
- Other matters such as audit strategy could be better presented in the audit committee report and will keep the auditor's report to a reasonable length.

We support mandating auditor commentary in the auditor reporting of public interest entities (PIEs) which should, among other financial institutions, include banks. We recognise that PIEs are defined differently under different national regulations and hence careful consideration will need to be given to how the IAASB will define PIEs. In this regard we would like to draw your attention to the current proposal of the EU Commission regarding a directive which shall amend directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts¹ which provides a definition for PIEs. This definition is also referenced in the scope of application of the draft "Regulation on specific

¹ See Article 1, point 2., letter d) of the draft proposal:
http://ec.europa.eu/internal_market/auditing/docs/reform/directive_en.pdf

requirements regarding statutory audits of public interest entities” prepared by European Commission. In any case, if IAASB considers differentiating its definition from the one provided in EU Directive, then it would be advised to use a different terminology than PIEs in order to avoid misunderstandings.

For entities other than PIEs, we believe it should be left to the discretion of the national jurisdiction whether to mandate the use of auditor commentary for any non-PIEs where they believe the enhanced transparency may be beneficial to users.

Finally, we would like to emphasise the importance of audit quality. It should be made clear to readers/users of the audit report that Auditor Commentary only relates to an extra reporting requirement. Though enhanced auditor commentary should provide users with more transparency over the audit process, it is only one element of audit quality, and we encourage the IAASB to continue its work on all the other aspects which underpin audit quality.

3. Going concern

EBA supports requiring the auditor specifically to report on the appropriateness of management’s use of the going concern assumption as a greater focus on auditor reporting in this area may contribute to auditors being more robust in their challenge of management’s assumptions in this area.

There is a need to narrow the expectations gap regarding the auditor’s work and auditor’s responsibility for evaluating management’s use of the going concern assumption. The reporting by the auditor should focus on the work performed by the auditor and should provide useful entity-specific information.

We recommend the IAASB considers including a short statement or section in the auditor’s report explaining the auditor’s work/responsibility regarding the going concern assumption. Careful consideration will need to be given in the case of banks to ensure that there is consistent and clear communication regarding management’s use of the going concern assumption.

Consistent with our comments on auditor commentary, the IAASB should seek to work with the IASB to encourage more detailed and robust qualitative and quantitative disclosures on capital and liquidity by the management in the financial statements which support the going concern assumption (whether material uncertainty exists or not), which the auditor could draw upon in its reporting.

Given the potential differences between the concept of “going concern” in the ISA and IFRS frameworks, we would like to encourage the IAASB to work with the IASB to develop a common definition not only concerning the term of “going concern” but also of the term “material uncertainty” to allow for consistent application of these terms.

We would like to stress that in our view any statements by the auditor related to management’s use of the going concern assumption should be based on work performed by the auditor and should not

provide any assurance over the evaluation of potential future events which are not all predictable and which may impact on the future viability of the entity.

4. Clarifications and Transparency

As was stated above (see Point 2), EBA supports the idea that there should be separate sections which should describe responsibilities of those charged with governance and of the management. It should be clear to the user that the three bodies – TCWG, management and auditors have distinct responsibilities.

Given that most of the text on these responsibilities in the IAASB's illustration of a possible improved auditor's report in the ITC is driven by existing auditing standard, and is not entity-specific, we do not see specific added value in inclusion of it in the auditor's report. This information can be disseminated and provided to the user through different sources. The objective of the auditor's report should be to provide the auditor's opinion and to provide transparency over the audit work undertaken.

The EBA supports disclosing the name of the engagement partner in the auditor's report. This is already mandated within the EU framework and we are not aware of any significant problems concerning audit quality with its disclosure.

5. Form and Structure

Given that the audit opinion as described by the ITC represents the focal point for readers of audit reports we welcome the proposed structure of the report which gives more prominence to the opinion by placing it at the beginning of the report.

We support an unequivocal binary opinion (unqualified or qualified) to minimise risk of misinterpretation. Additional information such as the auditor commentary provided in the auditor's report should complement this binary opinion, and not be a substitute for a qualified or an adverse auditor's opinion.

In our view it is important that the IAASB cooperates with other international standard setters in revising auditor reports. We would particularly encourage the IAASB to continue their discussions with the EU legislative bodies² and the PCAOB with the aim to support and strengthen international convergence of standards on the auditor's report.

² See also the draft report prepared by the Committee of Legal Affairs of the European Parliament <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+COMPARL+PE-494.551+02+DOC+PDF+V0//EN&language=EN>