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THE CHAIRPERSON

James Gunn
Technical Director
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21 November 2013

Exposure Draft: Reporting on Audited Financial Statements: Proposed New and revised International Standards on Auditing (ISAs)

Dear Mr Gunn

The European Banking Authority (EBA) welcomes the opportunity to comment on the IAASB's Exposure Draft on Reporting on Audited Financial Statements (hereinafter referred to as ED).

Consistent with the EBA's reply to the IAASB's Invitation to Comment (ITC): Improving the Auditor's Report on 15 October 2012, we would like to re-emphasise that the EBA, has a strong interest in promoting sound and high quality auditing standards for the banking and financial industry which, in line with high quality financial reporting by banks, are key elements of market confidence and discipline.

The EBA supports the IAASB's project on Auditor Reporting, which should improve market confidence in the audit of banks through increased transparency of the audit work performed and the encouragement of positive auditor behaviour. However, we believe that some of the proposals need to be developed further, so as to improve consistency in application and to promote higher quality in auditor's reporting.

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 ED. However, they do not provide answers to every question raised by the ED.

If you have any questions regarding our comments, please feel free to contact Ms. Patricia Sucher (+44 20 3461 8159), the Chair of the technical group that coordinated the response.

Yours sincerely

(signed)

Andrea Enria

CC: Ms Patricia Sucher, Chair of the technical group

Enc: EBA's comments on the Exposure Draft on Reporting on Audited Financial Statements

Appendix

General Comments

The EBA supports the proposals for a new International Standard on Auditing (ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*) and revised International Standards on Auditing (hereinafter referred as "proposed ISAs") aiming at improving auditor's reporting as we believe they will help to contribute to a clearer and more informative audit report.

We understand the challenges in striking the right balance between providing a useful audit report and the appropriate level of information to be disclosed in an auditor's report. However, as explained in the paragraphs below, some of the proposals could be improved to encourage more consistent application of the proposed ISAs.

Scope

The previous ITC on Improving the Auditor's Report proposed an enhanced auditor commentary be mandatory in auditors' reports of public interest entities (PIEs). The proposed ISA 701 limits its mandatory application to the audits of listed entities, with provisions for voluntary application or if national laws or regulation require so. Thus, the new requirements on auditor reporting will cover the audits of listed banks only (amongst the other listed entities). The EBA believes that the scope of the ED should include the audits of all banks (regardless of whether the bank is listed or not), given the important role that banks play in financial stability. A bank audit typically comprises areas involving significant auditor judgement or areas in which there may be greater challenge in obtaining sufficient audit evidence. This would be the case in the critical areas of loan impairment and fair value accounting estimates, where management uses various assumptions and inputs, which may be more difficult for the auditor to validate. We believe that more extensive auditor reporting could help to improve the quality of bank audits in these areas and the oversight function by those charged with governance.

Ordering of elements in the auditor's report

The EBA welcomes the proposed clarification of the structure of the auditor's report which should help users of financial statements to obtain a better understanding of the management and auditor's responsibilities.

The EBA welcomes the change from the ITC to no longer mandate the ordering of elements in the auditor's report. Nevertheless, as expressed in our previous comment Letter, we reiterate our support to give more prominence to the auditor's opinion by the mandatory placing of the opinion at the beginning of the report.

Key Audit Matters (KAMs)

The requirements in the proposed ISA 701 should increase transparency and usefulness of the auditor's report to the users of financial statements. In addition, they should encourage better communication with those charged with governance, thus contributing to an improved performance of the oversight function.

However, the EBA believes that the description of the auditor's objective in paragraph 6 of the proposed ISA 701 could be enhanced by making references to the importance and usefulness of the information for users' understanding of those matters that were of most significance in the audit of the entity's financial statements of the current period (as noted in paragraph 2 of the proposed ISA 701). A clearer and stronger objective would help to assist auditors in determining the KAMs to be disclosed in the auditor's report.

In addition, the interaction of the proposed ISA 701 and the proposed ISA 706 (Revised) requires further clarification. Paragraph A2 to the proposed ISA 706 (Revised) suggested that when a financial statement matter which is in the auditor's view of fundamental importance to the users' understanding of the financial statements is communicated as KAM in an auditor's report, it may not need to be included as an Emphasis of Matter (EoM) Paragraph. The EBA is concerned with this approach as, in our view this could undermine the different objectives of the proposed ISA 701 and ISA 706¹. It is likely that a financial statement matter which is fundamental to users' understanding of the financial statements, e.g. provisions for litigations, could be an EoM because of the uncertainty relating to its future outcome, but it could also be covered in KAM given that it involves significant auditor judgment. We would not presume that inclusion of KAMs in the auditor's report would necessarily lead to less EoM.

The EBA agrees that, as set out in paragraph A37 to the proposed ISA 701, the auditor should seek to avoid the primary origination of information about the entity in the auditor's report as this is the responsibility of management and those charged with governance, unless the additional information is critical to the auditor's description of the key audit matter (subject to restrictions by other law or regulation). In line with the proposed ISA 700 (Revised), the proposed ISA 701 should encourage auditors to challenge management that all matters that are fundamental to users' understanding of the financial statements are appropriately disclosed, and if they are not, the auditor should consider issuing a modified audit opinion.

The EBA acknowledges the challenges in developing requirements that encourage consistent but not boilerplate disclosures in the auditors' report. In this respect, the IAASB could emphasise further that the description of KAMs be entity-specific thereby avoiding describing generic or abstract matters in standardised language. In addition, some of the texts in paragraphs A31 and A38 of the proposed ISA 701 could be included in paragraph 10 of the proposed standard to achieve a more consistent and comprehensive description of KAMs by auditors.

Going Concern

¹ The objective of the proposed ISA 701 is to require auditors to communicate matters that were of significance in the audit of the financial statements. The objective of the proposed ISA 706 (Revised) is to draw the users' attention to a matter(s) presented or disclosed in the financial statements that is fundamental to users' understanding of the financial statements.

The EBA supports the proposal for a separate section in the audit report that highlights the appropriateness of management's use of the going concern assumption. However, the proposed requirement under paragraph 20 of ISA 570 (Revised), *Going Concern* to include a statement in the auditor report that 'neither management nor the auditor can guarantee the entity's ability to continue as a going concern' gives it a negative overtone which could cast doubts on the perceived quality of the audit work performed. The EBA recommends redrafting this statement to avoid diminishing the audit assurance provided by the auditors.

Also, as acknowledged by the IAASB in the ED, there are a number of areas for potential improvement with regards to the disclosure of the audit work performed on going concern. When this may be an area of significant focus for the audit, or it includes significant scope for judgment, we believe that the proposed revised ISA 570 could be developed further, for example through specific guidance, to require the auditor to provide more information about the audit work performed to gain assurance in the auditor's report.

Compliance with Independence and Other Relevant Ethical Requirements

The EBA agrees with disclosing the source(s) of independence and other relevant ethical requirements in the auditor's report. We agree that such requirement will increase transparency on the basis on which the audit has been conducted. It is particularly important for the auditor to comply with ethical requirements as a basis for conducting the audit. The proposed disclosure of that fact in the auditor's report will provide more focus on auditor's independence, while it could also increase users' confidence in the quality of audit of the financial statements.

Report on Other Legal and Regulatory Requirements: Disclosure of the Name of the Engagement Partner

As stated in our previous comment letter on the IAASB's Invitation to Comment: "Improving the Auditor's Report", we reiterate our support for the proposal to require disclosure of the name of the engagement partner for the audits of financial statements which is already a requirement under the EU legislative framework. This should increase the transparency of the auditor's report for users of financial statements and should require a greater sense of personal responsibility and accountability by the engagement partners, thus contributing to an improved audit quality. For the same reasons explained in our comment above (under "Scope" section), we would expect that this requirement is extended to audits of all banks and not limited to only listed entities.

Other Considerations

The EBA reiterates its support of a continuous dialogue between the IAASB and the relevant EU legislative bodies and PCAOB to encourage consistency and quality on auditor reporting. A higher degree of convergence of international standards should strengthen the market's confidence in the audit profession.