



EUROPEAN COURT OF AUDITORS

Director of the Presidency

Luxembourg, 22 November 2013
LOP009358EN01-13PP-OR.doc

James Gunn
Technical Director
International Auditing and Assurance Standards Board (IAASB)

Subject: Comments of the European Court of Auditors on exposure draft - Reporting on audited financial statements: proposed new and revised International Standards on Auditing (ISAs)

Dear Mr Gunn,

We welcome the opportunity to comment on the above-mentioned exposure draft.

The European Court of Auditors ("the Court") is the Supreme Audit Institution (SAI) of the European Union. It is responsible - inter alia - for the external audit of the general budget of the Union. In its annual report, it provides a statement of assurance as to the reliability of the EU's annual accounts and as to the legality and regularity of the underlying transactions and information supporting this statement. It also carries out performance audits and reports the results of these in about 15 special reports each year. The annual and special reports are used by the European Parliament to "grant discharge" to the executive body, the European Commission, for its stewardship of the general budget. The Court is also responsible for auditing the financial statements and underlying transactions of about forty other bodies each year.

The financial statements covering the general budget of the EU which are the subject of the Court's statement of assurance and annual report are, in effect, whole-of-government accounts.

The comments that follow have been prepared by senior technical staff working in the Court's services responsible for auditing methodology, quality assurance, audit supervision and for the statement of assurance. For organisational reasons, they have not been submitted to the College or any of its bodies for adoption and thus do not represent an official view of the institution.

We will limit our comments to those questions that, in our context, seem to be the most significant.

Key audit matters (KAMs)

Questions 2, 3 and 8

2. Do respondents believe the proposed requirements and related application material in proposed ISA 701 provide an appropriate framework to guide the auditor's judgement in determining the key audit matters? If not why? Do respondents believe the application of proposed ISA 701 will result in reasonably consistent auditor judgements about what matters are determined to be the key audit matters? If not, why?

3. Do respondents believe the proposed requirements and related application material in proposed ISA 701 provide sufficient direction to enable the auditor to appropriately consider what should be included in the descriptions of individual key audit matters to be communicated in the auditor's report? If not, why?

8. Do respondents agree with the IAASB's decision to retain the concepts of Emphasis of Matter paragraphs and Other Matter paragraphs, even when the auditor is required to communicate key audit matters, and how such concepts have been differentiated in the proposed ISAs? If not, why?

- a) In our view, further consideration needs to be given in particular to the interplay between qualified and adverse audit opinions and KAMs.
- b) It seems to us that a decision in year n+1 to no longer express the same qualified or adverse opinion that was expressed in year n would in some cases be a KAM in year n+1. In such circumstances, the KAM would have to be drafted particularly carefully and it may be worthwhile to provide an example in the ISA.
- c) If KAMs are introduced, we consider that emphasis of matter and other matter paragraphs should no longer be permitted.
- d) Users may find a combination of basis for opinion and KAM paragraphs difficult to understand.
- e) Paragraph 8 of proposed ISA 701 gives guidance on the identification of key audit matters. The two starting criteria are that they are matters that were communicated with those charged with governance and were areas of significant audit attention. In our view, a distinction needs to be made in the guidance between:
 - i. areas of the audit that are intrinsically difficult to carry out (and thus almost automatically generate discussions with the client/significant audit attention without necessarily being KAMs), such as the valuation of complex assets, and
 - ii. matters of significant difference between the auditor and the client.
- f) Furthermore, care would have to be taken to avoid KAMs becoming tools to address inadequate or incomplete financial reporting. This could be an implementing challenge for us as our principle audit client does not have a narrative report accompanying its financial statements.

- g) Taken together, points a) to f) above suggest that the proposals will add to the difficulty in formulating an appropriate audit report and thus give rise to significant implementation problems.

Question 4

4. Which of the illustrative examples of key audit matters, or features of them, did respondents find most useful or informative, and why? Which examples, or features of them, were seen as less useful or lacking in informational value, and why? Respondents are invited to provide any additional feedback on the usefulness of the individual examples of key audit matters, including areas for improvement.

- h) (point repeated from b) above). It seems to us that a decision in year n+1 to no longer express the same qualified or adverse opinion that was expressed in year n would in some cases be a KAM in year n+1. In such circumstances, the KAM would have to be drafted particularly carefully and it may be worthwhile to provide an example in the ISA.
- i) We note that the illustrative material (for example, on long-term contracts on page 14 of the Explanatory Memorandum) uses a negative assurance formulation when stating “we did not find evidence of the existence of side agreements”. Further thought is needed on this so as to avoid ambiguities in the illustrative material and increase its suitability.

Question 6

6. Do respondents believe it is appropriate for proposed ISA 701 to allow for the possibility that the auditor may determine that there are no key audit matters to communicate?

(a) If so, do respondents agree with the proposed requirements addressing such circumstances?

- j) We believe strongly that there should be a possibility of having no KAMs and agree with the proposed requirements.

Going concern

Question 9

9. Do respondents agree with the statements included in the illustrative auditor's reports relating to:

(a) The appropriateness of management's use of the going concern basis of accounting in the preparation of the entity's financial statements?

(b) Whether the auditor has identified a material uncertainty that may cast significant doubt on the entity's ability to concern, including when such an uncertainty has been identified (see the Appendix of proposed ISA 570 (Revised))?

In this regard, the IAASB is particularly interested in views as to whether such reporting, and the potential implications thereof, will be misunderstood or misinterpreted by users of the financial statements.

- k) We believe that further consideration of this aspect of the proposals is needed, in particular for entities – for example, many public sector entities and (for different

reasons) entities in the retail sector have balance sheets which make going concern look like an issue when this is not necessarily the case.

- l) It may be appropriate for INTOSAI, when developing a proposed International Standard of Supreme Audit Institutions (ISSAI) based on the present proposed revisions, to consider a wider interpretation of the concept of going concern in the public sector which might encompass the financial and/or administrative sustainability of programmes/entities, the reliability of any financing guarantee provided by a government in the context of an excessive budgetary deficit, etc.

Question 10

10. What are respondents' views as to whether an explicit statement that neither management nor the auditor can guarantee the entity's ability to continue as a going concern should be required in the auditor's report whether or not a material uncertainty has been identified?

- m) Such a statement would have political implications in the audit of public sector bodies (and probably elsewhere too).
- n) There is a risk that the profession will move towards some sort of disclaimer of responsibility rather than providing a meaningful case-by-case statement on going concern.
- o) For a stakeholder that receives many reports (such as a pension fund or a national parliament), the statement provided by auditors is likely to be standardised, repetitive and largely redundant.

Other improvements to Proposed ISA 700 (Revised)

Question 13

13. What are the respondents' views as to the appropriateness of the changes to ISA 700 described in paragraph 102 and how the proposed changes have been articulated?

- p) In our view, it is not appropriate to provide information on the responsibility of the auditor in a separate document or website: it should remain with the opinion.

Question 14

14. What are the respondents' views on the proposal not to mandate the ordering of sections of the auditor's report in any way, even when law, regulation or national auditing standards do not require a specific order? Do respondents believe the level of prescription [...] reflects an appropriate balance between [...] consistency [...] and the need for flexibility [...].

- q) This is an interesting proposal. In our view, there are advantages to a consistent approach to ordering the different elements of the audit opinion and we see some advantages to the status quo.
- r) As the main stakeholder of the reports of an SAI is often the same body for most/all of its reports (typically the national parliament), a large degree of consistency is desirable. Saying essentially the same thing about different audited entities, but saying it in a different order, risks becoming a source of confusion for these users.

We hope that the IAASB will find our comments useful. Should you have any questions or need clarification of any of the above, please do not hesitate to contact us.

Yours sincerely,



Geoffrey Simpson