



## **BASEL COMMITTEE ON BANKING SUPERVISION**

**BANK FOR INTERNATIONAL SETTLEMENTS**

**Chairman**

### **Via e-mail**

Mr James Gunn  
Technical Director  
International Auditing and Assurance  
Standards Board  
545 Fifth Avenue, 14th Floor  
New York, New York 10017 USA

16 September 2011

### **Consultation paper on *Enhancing the Value of Auditor Reporting: Exploring Options for Change***

Dear Mr Gunn

The Basel Committee on Banking Supervision ('the Committee') welcomes the opportunity to comment on the IAASB's consultation paper *Enhancing the Value of Auditor Reporting: Exploring Options for Change*.

The Committee believes that this project is timely and important given the perceptions that auditor reporting did not meet the informational needs of financial statement users in the recent financial crisis. This crisis raised concerns with both the information and expectations gaps as demand increased for additional and more pertinent information about audited entities, the processes that support the quality of their financial reporting and the audit of the financial statements. The Committee believes that the issues and suggestions raised in this paper, along with other possible suggestions that may be proposed during the consultation process, could lead to practical solutions. These would help to bridge the information and expectations gaps, recognising that certain sources of the information gap are the responsibility of management and those charged with governance – not auditors – to fill.

High-quality audits enhance market confidence, particularly in times of severe market stress. Similarly, quality auditor reporting is fundamental for financial stability and market confidence. Many of our members have prudential supervisory frameworks that rely on audited financial statements. Additional information provided by auditors' reports may help supervisors and other users to identify potential problems at individual financial institutions earlier. Regulated banks also use their clients' audited financial statements as a component in their credit decision process. Furthermore, sound auditing and audit reporting have an impact on the quality of financial reporting.

We encourage the IAASB, when considering changes to auditor reporting, to keep the existing division of reporting responsibilities between the senior management of the reporting entity and its auditors. This implies that the auditor should not originate disclosures about matters that are the responsibility of senior management. In addition, the changes to auditor reporting should not impair the

auditor's independence. More specifically, the fundamental role of the auditor to provide an independent opinion on the financial statements prepared by management should remain unchanged.

We support a clear, conclusive and decisive opinion of the external auditor on the financial statements. Therefore, we prefer retaining a "binary" audit opinion (ie pass/fail model). However, we also believe that it is important to explore ways to supplement this unequivocal opinion with further details about the audit process, significant risks, approaches taken and judgments made (eg through a separate report). This would help address the information gap.

To help reduce the expectations gap, we recommend that the IAASB consider what the auditor's report should communicate, including clarify what an audit is (and what it is not).

Many supervisory authorities have expressed interest in some form of assurance provided by the external auditor about the existence of internal control over financial reporting and its effectiveness in the audited entity, either on a regular basis or upon request. Although supervisory authorities often have the possibility to ask for more assurance in this area, other financial statement users who do not have this authority may also find this assurance beneficial for their use of financial statements. In this context the IAASB could consider the possibility to extend the audit report to cover this issue.

Additionally, to improve the information provided by the external auditor to the board of directors, the IAASB could consider developing a more detailed audit report. In Germany, such an enhanced audit report, known as "long form" audit report is submitted to the board of directors and to the supervisory authorities of banking institutions only. This report summarizes in more detail, among other things, the audit procedures performed by the auditor, the key findings of the audit, the significant risks facing the entity, the accounting methods used, the judgements made by management, as well as an explanation of the legal and economic situation of the entity.

Further, as already observed in our June 2011 comment letter on the IAASB's discussion paper *The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications*,<sup>1</sup> we believe that the auditor's report should clarify that the auditor's opinion on the financial statements as a whole encompasses the disclosures in the notes to the financial statements:

*Presently, we understand that it is not always clear for the users of financial statements to understand the context in which disclosures have been audited. That is, there is a lack of clarity as to whether financial statement disclosures were audited in the context of the auditor expressing an opinion on the financial statements as a whole, or whether the auditor has verified that the financial statements contain all disclosures required by the financial reporting framework with all the necessary details (ie the "check list" approach to auditing).*

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<sup>1</sup> This comment letter is available from the BIS website at <http://www.bis.org/bcbs/commentletters/commentletters.htm>.

The Committee believes that the IAASB should continue its efforts to promote international consistency in auditor reporting in order to reduce unintended confusion. The US Public Company Accounting Oversight Board's concept release, *Possible Changes to the Auditor's Report*<sup>2</sup> presents an opportunity to work toward international convergence.

Finally, although the consultation paper discusses possible ways to improve auditor reporting, it does not directly address the quality of the audit work performed that forms the basis for the information provided in the auditor's report. Changes to auditor reporting per se will not ensure that audits are conducted in accordance with applicable auditing standards and are of high quality. Thus, while we are supportive of and commend the IAASB's efforts to enhance the value of auditor reporting, we also encourage the IAASB to continue its work to explore the topic of audit quality, and the role of auditing and assurance standards in promoting it.

We look forward to reviewing and providing comments on specific proposals that emanate from this consultation process.

These comments have been prepared by the Committee's Accounting Task Force, chaired by Sylvie Mathérat, Deputy Director General at the Bank of France. If you have any questions regarding our comments, please feel free to contact Mrs Mathérat (+33 1 4292 2602), Marc Pickeur at the National Bank of Belgium (+32 2 221 3999), or Xavier-Yves Zanota at the Basel Committee Secretariat (+41 61 280 8613).

Yours sincerely



Stefan Ingves

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<sup>2</sup> Public Company Accounting Oversight Board Release No. 2011-003, June 21, 2011, which is available at [http://pcaobus.org/Rules/Rulemaking/Docket034/Concept\\_Release.pdf](http://pcaobus.org/Rules/Rulemaking/Docket034/Concept_Release.pdf).