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Dear Mr. Sylph

Ref.: Exposure Drafts: ISAs 705 & 706 "Modifications to the Opinion in the Independent Auditor's Report and Emphasis of Matter Paragraphs and Other Matters Paragraphs"

The Committee of European Banking Supervisors welcomes the opportunity to comment on the IAASB Exposure Drafts: "Modifications to the Opinion in the Independent Auditor's Report and Emphasis of Matter Paragraphs and Other Matters Paragraphs" (ISAs)

Through their opinions on annual accounts and annual reports, external auditors constitute an integral part of the public oversight model. As banking supervisors, we therefore have an interest in ensuring that auditing standards, which are the basis for audit work, are of a high quality and are clear and capable of consistent application.

We generally welcome the revised ISAs; however we do have some reservations about how they may be interpreted in some circumstances and have some further suggestions for clarification. In the attached note we provide our more detailed comments on the ISAs.

Our comments were coordinated by our Expert Group on Accounting and Auditing (EGAA), and especially by its Sub-Working Group on Auditing, which is under the direction of Pat Sucher from the FSA, UK.

If you have any questions regarding our comments, please feel free to contact the chairman of EGAA, Prof Arnold Schilder (+31.20.524.3360), the deputy chairman of EGAA, Arnoud Vossen (+31.20.524.3903) or Miss Pat Sucher (+44.20.7066.5644).

Yours sincerely

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Detailed Comments on the ISAs

General comment

We are concerned about the prevalent use of the caveat 'ordinarily' in some of these two standards. For example, it is included in paragraphs 26, 27, 30 and 32 in respect of ISA 705. We believe this may lead to inconsistent application by auditors, as it would seem to lessen the requirement on the auditor to modify the audit opinion where appropriate.

In the following sections we provide our responses to your specific questions, and then raise some other points which require clarification or consideration.

Specific questions

1. Should paragraph 33 of ISA 705 be retained?

Paragraph 33 states: 'The existence of one or more significant uncertainties does not in itself result in an inability for the auditor to form an opinion. In extreme cases involving multiple uncertainties, the auditor may, however, conclude that the cumulative nature and possible effect of the multiple uncertainties are such that it is not possible to form an opinion and, accordingly, the auditor expresses a disclaimer of opinion.'

The issue here is where auditors would decide whether an item or item(s) are emphases of matter and where they amount to a disclaimer of opinion. We would be concerned that, on the basis of paragraph 33, which is placed in this 'disclaimer of opinion' section, an auditor might decide too quickly and inappropriately to issue a disclaimer of opinion. Therefore, on balance we would suggest that the wording needs to be clarified to make it clear that the auditor should only consider a 'disclaimer of opinion' where there are multiple uncertainties and the effect is material and pervasive. This would follow the language used in paragraph 31.

2. Is the use of sub-headings desirable in auditors' reports with modifications to the opinions and auditors' reports with an emphasis of matters paragraph or an other matters paragraph?

It is desirable to present sub-headings in the auditors' report, as it will aid users' understanding of what is presented and help ensure that there is less confusion over the status of emphasis of matters paragraphs and modification of opinion paragraphs.

3. Does the use of the terms 'significant uncertainty' and 'material uncertainty' cause confusion?

Generally, we would prefer that the same language be used throughout the ISAs to avoid problems of miss-interpretation, particularly when ISAs are translated into other languages. Alternatively, if there are substantial reasons why different words are used for the same item (e.g. as suggested in the explanatory memorandum because IFRS use one word, and ISAs another for the same term) then it should be explained clearly that, though two different words are being used, they have the same meaning.

Other matters

ISA 705

Definition of pervasive

Para 24 of ISA 705 covers the issue of pervasiveness, but we are concerned that it may not be clear enough to users or presented early enough in the ISA, when it is such an important term. Paragraph 24 does state what the auditor should consider by explaining what pervasiveness is not e.g. if there are specific items, which can be clearly explained, then it is not pervasive. It then comments that pervasiveness occurs when it materially affects amounts and presentation of numerous financial statement items – though it could also be a single item. We believe there is a need for greater definition of what is meant by pervasive, to aid consistent application. It may also be helpful to emphasise the issue of pervasiveness holistically i.e. that for item(s) to be pervasive, they must affect financial statements as a whole.

Qualifications if 'readily quantifiable'

In paragraph 27, it is stated that 'when a disagreement with management relates to specific financial statement line items, and is readily quantifiable.....the auditor ordinarily expresses a qualified opinion.'

It is not clear to us what happens if the area of disagreement is an aspect of a disclosure note in the financial statements not readily quantifiable. It is clearly stated that disagreement over a disclosure note could also lead to a qualification (in paragraphs 11 and 16). However, this is not carried through and made explicit in paragraph 27. Here it is stated in the section on 'qualified opinion', that if an item is readily quantifiable, there should be a qualification. By implication, disagreement over an item which is not quantifiable (e.g. aspects of a disclosure note) would not lead to a qualification. We would welcome some clarification of this aspect.

ISA 706

We welcome the tightening of the requirements for including an emphasis of matter paragraph in an audit report, and the necessity to include an emphasis of matter paragraph when the conditions laid out in paragraphs 6 & 10 are met. This should drive consistency of application and ensure that emphases of matter paragraphs are not used inappropriately (e.g. when a qualified opinion would be appropriate). However we do have some concerns.

Status of paragraphs 6 & 10

There seems to be an inconsistent approach to the requirements in these paragraphs. Paragraph 6 is a clear 'should' statement in bold. Paragraph 10 is a present tense requirement in grey lettering. Subsequent references to these two paragraphs in paragraphs 12 and 14 imply that, for there to be an emphasis of matter paragraph, the conditions and criteria in paragraphs 6 and 10 must all be met. We would therefore suggest that it would aid consistent application if the contents of paragraph 10 were also translated into clear 'should' statements, in bold text, rather than the current present tense.

Examples provided

Though we appreciate the way in which the ISA limits the use of emphasis of matter paragraphs, it could be clarified how the examples provided meet the criteria that are laid out. In addition, it could be clarified that the examples provided in paragraph 12 'may' meet the criteria in paragraphs 6 & 10. The examples in paragraph 12 would not always lead to emphases of matter paragraphs.