



James Gunn, Technical Director
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Submitted by e-mail

Subject: Invitation to Comment (ITC) on IAASB's indicative direction for the future auditor's report

Ref: B2012.55
Amsterdam, 5 October 2012

Dear Mr. Gunn,

We welcome the opportunity to respond to your Invitation to Comment (ITC) on IAASB's indicative direction proposed for the future auditor's report. By way of background, and to put our comments in context, Eumedion is the Dutch based corporate governance forum for institutional investors with interests in Dutch listed companies. Our 69 Dutch and non-Dutch participants - with a long term investment horizon - have together more than EUR 1 trillion assets under management.

We are very much supportive of the IAASB's efforts to respond to the demand from users of financial statements, including investors, to hear more from the statutory auditor. Notwithstanding the responsibility of the management board and the board of directors (hereafter: the Boards) for the quality and completeness of the Annual Report and Accounts (hereafter: annual financial report) and other disclosed (non-)financial information, we believe that the auditor's report could become much more relevant and useful for investors. For the purpose of investors' investment decision making, further information on the entity's annual financial report and the audit process

(what the statutory auditor actually did) should be disclosed. With such information users are better able to answer and weigh the conclusions of the audit as reflected in the audit opinion.

Key points

Investors rely on the provision of relevant, reliable and understandable information, which is the responsibility of company's Boards. The disclosed information, like the financial statements, should reflect the company's considered view of the information investors need. The integrity and the quality of the annual financial report are supported and strengthened by a robust external, independent audit, carried out objectively and undertaken with professional scepticism on the part of the statutory auditor. In order to facilitate optimal asset allocation, the investor's analysis is dependent on this audit opinion.

Although the "pass/fail" nature of the opinion has high value to investors, the auditor's report as a whole contains little underlying detail and could provide more entity-specific information. The latter is also evidenced by the limited use of 'emphasis of the matter' and 'other matter' paragraphs and the absence of references to other core elements of the audit, such as the assessment of the risks in relation to the company's continuity and the underlying judgments and assumptions of the management board. We believe that institutional investors, investing in listed companies, are most exposed and affected by the lack of information. Reform of auditor reporting is needed.¹

In addition, introducing a new style of the auditor's report, such as the proposed Audit Commentary, should be synchronized with reforms in the reporting framework more broadly (e.g. the steps towards 'integrated reporting'). As the primary financial and non-financial reporting responsibility rests with the Boards, the Boards should deliver in-depth information (in the 'integrated annual report') to investors and other users about the business of a company, its strategy and the risks related to this strategy. Investors expect the Boards to give a fair view of the key risks (not only financial risks, but also strategic, operational, governance, sustainability and compliance risks and combinations of risks) which are material for achieving business objectives in the narrative report and to substantiate the going concern assumption.

The Boards should also discuss the most important issues of the statutory auditor in relation to the audit of the Annual Accounts and how these issues were addressed. If the statutory auditor believes it is important to 'alert' shareholders on specific financial or non-financial risks that are crucial for a true and fair view of the company's health and its continuity, he should use the

¹ ITC, chairman statement, p. 1.

proposed Auditor Commentary for this. He should also have this possibility if he believes, based on his professional judgement, that the Boards do not provide a fair view of the risks and/or believes that his issues are not addressed in an appropriate way. Enhanced disclosures by the Boards and the statutory auditor will enable institutional investors to act as engaged shareholders and to make sound judgments. Therefore, we would encourage the IAASB together with other bodies such as the IASB, IIRC, UK Financial Reporting Council, IFIAR and ESMA to play a major role in encouraging better communications by both listed companies and statutory auditors.

While we acknowledge that audits throughout various jurisdictions are not necessarily carried out under the same standards, we believe that a more consistent and robust application of the International Standards on Auditing (ISAs) would be critical to make the new style of auditing reporting really helpful for investors.

Below you will find our answers to some questions raised in the ITC.

Question 1

Overall, do you believe the IAASB's suggested improvements sufficiently enhance the relevance and informational value of the auditor's report, in view of possible impediments (including costs)? Why or why not?

Eumedion believes that IAASB's suggestions for improvement would significantly enhance the relevance and value of the auditor's report, while not resulting in unreasonable impediments. The proposed concept of 'Auditor Commentary', when properly used, together with the proposed auditor statements regarding 'other information' could lead to increased transparency and help to meet the information needs of institutional investors through the auditor's report. Also giving greater prominence to the auditor's opinion and the statement on going concern will have added value, as it gives investors more comfort regarding the going concern assumption of the entity's Boards.

Question 2

Are there other alternatives to improve the auditor's report, or auditor reporting more broadly, that should be further considered by the IAASB, either alone or in coordination with others? Please explain your answer.

At present, the auditor's report is the only formal means of communication between the statutory auditor and shareholders, although the statutory auditor is formally appointed by the general meeting of shareholders (at least in Europe) and is the shareholders' agent. For instance, only in

a few countries, including the Netherlands, corporate governance codes determine that the statutory auditor has to be present in the general meeting of shareholders to answer possible questions in relation to the auditor's report. In our opinion, the lack of an international requirement for statutory auditors to speak at the general meeting of shareholders is an important failure in the existing corporate governance framework and needs to be addressed. We would welcome if the IAASB, in collaboration with other policy makers on corporate governance, would work on appropriate requirements for cases when the statutory auditor of a listed company and the company's shareholders wish to communicate.

Question 3

Do you believe the concept of Auditor Commentary is an appropriate response to the call for auditors to provide more information to users through the auditor's report? Why or why not?

Eumedion supports the proposed concept of Auditor Commentary. The concept offers statutory auditors an appropriate framework to provide additional, entity-specific information regarding the annual financial report and the audit conducted, without affecting the auditor's opinion. Eumedion believes the Auditor Commentary may improve the value and complement the pass/fail nature of the opinion.

In practice the 'emphasis of matter' and 'other matter' paragraphs are rarely used, while many investors seek better understanding of the audit process and what is most important in the annual financial report. Eumedion expects the new concept could meet these needs and provide for better disclosures. It should draw attention to certain matters from those that are "*fundamental* to users' understanding of the financial statements" to matters "*likely* to be most important to users' understanding of the financial statements".

We agree that the Audit Commentary should not be used as a substitute for (a) either a qualified or an adverse opinion or for (b) the Boards' responsibility for the quality and completeness of the annual financial report.

Eumedion notes that a standardised and too extensive provision of Auditor Commentary would diminish the effectiveness of the auditor's communication on key audit matters. Therefore, it is vital to allow flexibility for the statutory auditor to determine which key audit matters are most relevant to users' understanding of the audit. Nonetheless, the statutory auditor should always consider including in the Audit Commentary information on the important aspects of his audit, such as materiality and the scope of the audit, and important findings in relation to the annual financial report.

Question 4

Do you agree that the matters to be addressed in Auditor Commentary should be left to the judgment of the auditor, with guidance in the standards to inform the auditor's judgment? Why or why not? If not, what do you believe should be done to further facilitate the auditor's decision-making process in selecting the matters to include in Auditor Commentary? 1 (See paragraphs 43–50).

Eumedion generally agrees. The statutory auditor should be allowed to determine which matters are important to address in Auditor Commentary for users' understanding of the annual financial report and the audit process. But it should also be made clear, in the standards and by the examples and other guidance, that the statutory auditor has the possibility to comment on the important aspects of his audit, such as risks, materiality, his findings and on the important aspects of the Annual Accounts, such as the most significant balance sheet items. Eumedion supports the IAASB approach to develop guidance for statutory auditors to help them to make informed decisions in determining the information to include in Auditor Commentary.

Question 5

Do the illustrative examples of Auditor Commentary have the informational or decision-making value users seek? Why or why not? If not, what aspects are not valuable, or what is missing? Specifically, what are your views about including a description of audit procedures and related results in Auditor Commentary?

Eumedion generally believes that the five illustrative examples on page 10 make clear that the concept of Auditor Commentary may have additional informational value for institutional investors and other users. The examples' topics, content and tone show that the concept offers flexibility and could be tailored to the entity's features and circumstances based on the auditors' judgment of the what is important for users.

However, we feel that the current example to a large extent refers to the Annual Accounts. We would also like to hear the views of the statutory auditor on his work and the audit process. For instance, the extent to which reaching the auditor's opinion has involved issues with a high degree of uncertainty and also the most important matters that has been discussed with the audit committee, in case the company refuses to do so.

Question 6

What are the implications for the financial reporting process of including Auditor Commentary in the auditor's report, including implications for the roles of management and those charged with governance (TCWG), the timing of financial statements, and costs?

Eumedion believes the implications for the financial reporting process should not be overstated. The primary responsibility for financial and non-financial reporting will rest with the Board. The Boards are responsible to deliver in-depth information to investors and other users about the business of the company, its strategy, its governance structure, its principal risks and its financial performance. We also expect from Boards to substantiate the going concern assumption and to report on the significant issues they have considered in relation to the Annual Accounts and how these were addressed, having regard to matters communicated by the statutory auditor. We believe that including an Auditor Commentary will not make substantial changes to the reporting process. We would assume that the statutory auditor will provide the Boards a draft of his commentary, and this could lead to the decision by the Board to include additional information in the annual financial report, which would also be beneficial for the users of the annual financial report.

With regard to costs, Eumedion is convinced that the benefits in terms of increased confidence in corporate reporting and audit quality will outweigh possible additional costs associated with the preparation of Audit Commentary. The increased confidence creates value in itself, for example through reducing risk and thereby the cost of capital, which is beneficial for economic activity.

Question 7

Do you agree that providing Auditor Commentary for certain audits (e.g., audits of public interest entities (PIEs)), and leaving its inclusion to the discretion of the auditor for other audits is appropriate? Why or why not? If not, what other criteria might be used for determining the audits for which Auditor Commentary should be provided?

Given Eumedion's perspective, our answer is confined to listed companies. We generally believe that the concept of Audit Commentary is relevant and beneficial for all listed companies and their stakeholders. We also see great merit in the principle of consistent reporting by all listed entities, regardless their size and where their shares are listed or traded. Less informative auditor's reporting for smaller listed companies could make investors less interested in those companies' performance and future prospects.

Question 8

What are your views on the value and impediments of the suggested auditor statements related to going concern, which address the appropriateness of management's use of the going concern assumption and whether material uncertainties have been identified? Do you believe these statements provide useful information and are appropriate? Why or why not?

IAASB suggests that statutory auditor should include in its auditor's report:

- (i) a conclusion regarding the appropriateness of the management's use of the going concern assumption;
- (ii) a statement on whether or not material uncertainties related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern have been identified.

Eumedion believes that these proposals would be helpful and informative to investors, as the statutory auditor will be required to provide explicit statements on the entity's going concern assumption. Yet, it is most important that, as indicated earlier, all Boards draft a concise and understandable going concern paragraph in the annual financial report in which all significant issues are described that supports the Board's assessment of whether the company is a going concern.

Another issue are the various interpretations existing about what constitutes a going concern. Also, the description of a material uncertainty as "a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern [for the foreseeable future]" is not very clear. Clear and consistent definitions internationally and across international accounting and auditing standards and company law requirements would be important for consistent interpretations. Eumedion would support the IAASB engaging in discussions with other national and international accounting and auditing standard setters and the European Commission, about what constitutes a going concern and what establishes a material uncertainty.

Question 9

What are your views on the value and impediments of including additional information in the auditor's report about the auditor's judgments and processes to support the auditor's statement that no material uncertainties have been identified?

In principle, Eumedion believes that when the statutory auditor judges that non material uncertainties have been identified, there is no need to include additional information to support

this statement. Potential information overload should be avoided ('cutting the clutter'). However, under certain circumstances adding additional information may have value, as in situations when the statutory auditor has determined that no material uncertainties exist, despite the fact that events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern (described in paragraph 30).

While Eumedion believes that information about the entity should in principle not be disclosed by the statutory auditor, a different situation may appear when the statutory auditor has identified material uncertainties with respect to going concern that have not been disclosed properly in the annual financial report as mentioned in paragraph 31. In such a case, Eumedion would expect the statutory auditor to disclose these uncertainties in his going concern statement in the interests of the users.

Question 10

What are your views on the value and impediments of the suggested auditor statement in relation to other information?

Eumedion supports the suggested requirement to include an explicit statement in auditor reports on whether material inconsistencies in the audited information and other information have been identified. Also important is the suggestion that the statutory auditor identify in the auditor's report the specific other information read. When the statutory auditor has identified a material inconsistency for which revision is necessary and management refuses to make a revision, the auditor's statement on other information should imply a detailed explanation as highlighted in appendix 2, paragraph 2.

The suggestion to include a disclaimer that the statutory auditor has not audited the other information as part of the audit might also add value in terms of avoiding misinterpretation of the works and findings of the statutory auditor.

Question 11

Do you believe the enhanced descriptions of the responsibilities of management, TCWG, and the auditor -in the illustrative auditor's report- are helpful to users' understanding of the nature and scope of an audit? Why or why not? Do you have suggestions for other improvements to the description of the auditor's responsibilities?

Eumedion supports the suggested enhancements to the description of the statutory auditor's responsibility in explaining more fully the concept of a risk-based audit, thereby clarifying the technical terms in the framework of an ISA audit. A sophisticated description of the statutory

auditor's responsibilities in relation to specific matters could be of great value for many institutional investors (e.g. fraud, internal control, accounting policies and estimates; structure and content of the financial statements and disclosures).

Question 14

What are your views on explicitly allowing the standardized material describing the auditor's responsibilities to be relocated to a website of the appropriate authority, or to an appendix to the auditor's report?

Notwithstanding the relevance of descriptions on responsibilities, standardised wording in the auditor's report itself to fully describe auditor's tasks and what the audit is about, could be considered as somewhat redundant. Especially as the Annual Accounts are now often accessed through the internet, there are other ways in which the information on statutory auditor's responsibilities (including disclaimers) could be provided. Thus, Eumedion would support allowing auditor reports to make references to entities' and audit firms' websites the information on responsibilities can be read. This would help focus attention on more company-specific audit information.

Question 15

What are your views on whether the IAASB's suggested structure of the illustrative report, including placement of the auditor's opinion and the Auditor Commentary section towards the beginning of the report, gives appropriate emphasis to matters of most importance to users?

Eumedion does not consider a change in the structure of the auditor's report to be very important. We believe that strengthening the auditor's report's content through the inclusion of more entity-specific information (statements on going concern, audit commentary) based on the audit work and findings, is more vital for institutional investors than mandating the precise ordering of the elements on a global scale.

Question 16

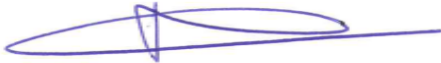
What are your views regarding the need for global consistency in auditors' reports when ISAs, or national auditing standards that incorporate or are otherwise based on ISAs, are used?

IAASB rightly identifies that various models exist for auditor reporting driven by various social-economic, legal and cultural factors. Eumedion believes IAASB is right in trying to find the right balance in the need for global consistency and comparability and the need to increase the value

of auditor reporting by including flexibility to accommodate national circumstances. The suggested building block approach offers an appropriate concept to achieve this crucial balance.

If you would like to discuss our views in further detail, please do not hesitate to contact us. Our contact person is Wouter Kuijpers (wouter.kuijpers@eumedion.nl; tel. + 31 20 7085882)

Yours sincerely,

A handwritten signature in blue ink, consisting of a series of loops and a long horizontal stroke extending to the right.

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