



EFFAS THE EUROPEAN FEDERATION OF FINANCIAL ANALYSTS SOCIETIES

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Re : European Commission Consultation on the adoption of International Standards on Auditing

Dear Mr. McCreevy,

The European Federation of Financial Analyst Societies (EFFAS) welcomes the Consultation of the European Commission on the adoption of international standards on auditing (ISA's). In response to the Consultation, please find hereafter our answers to each question asked.

(1) Is the international acceptance of the ISA's sufficiently demonstrated?

We consider that the international acceptance of the International Standards on Auditing (ISA's) as issued by the International Auditing and Assurance Standards Board (IAASB) is sufficiently demonstrated, for the following reasons:

- ✓ As the consultation paper mentions: *"Many public authorities, including audit regulators have adopted ISA or made public their decision to converge their standards towards the ISA including Australia, Canada, China, The Netherlands, South Africa and the United Kingdom/Ireland"*:
 - in more than 100 jurisdictions, audits are based either directly on ISA's or on domestic standards which are derived from ISA's;
 - in the United States, the Auditing Standards Board of the AICPA, which sets standards for unlisted companies, has resolved to bring its standards (US GAAS) in line with ISA's which, as demonstrated by the MARC (Maastricht Accounting, auditing and information management, Research Center) study recently issued by the European Commission, depart from the PCAOB standards only in a limited number of areas;

- as the consultation paper also mentions, the Financial Stability Board has effectively identified ISA as one of the 12 key sets of standards for sound financial systems¹.
- ✓ On 11 June 2009, IOSCO publicly encouraged the acceptance of audits performed in accordance with clarified ISA's for cross-border listings and the consideration of the clarified ISA when setting auditing standards for national purposes.
- ✓ As a result of their network organization's membership of the Forum of the Firms, member firms of more than 20 of the largest networks of audit firms will in any event incorporate the clarified ISA's into their firm's audit methodologies and ISQC into their firm's quality control policies and procedures.

Further to the widely demonstrated international recognition, the EFFAS considers that the governance and due process of the IAASB provides the necessary guarantee to ensure that the public interest is best served:

Suggestion of justifications

- the representatives of the public interest, including audit regulators, are already actively involved in the standard setting of the IAASB;
- the IAASB has public members who must be individuals who are, and will be seen to be, capable of representing the broad public interest;
- half of the members of the IAASB are non practitioners;
- observers, including the EC, have a right to speak at IAASB meetings and more generally to raise issues and present arguments during all stages of the standard setting process;
- involvement of the IAASB Consultative Advisory Group (CAG) whose members represent a balance of geographical representation and regulators, international organizations (including the EC), users and preparers;
- public oversight by the Public Interest Oversight Board (PIOB) (made up 10 members, including 2 members nominated by the European Commission, 4 members nominated by IOSCO and others by the Basel Committee on Banking Supervision, the International Association of insurance Supervisors and the World Bank) which has its mandate from the Monitoring Group².

(2) What degree of importance do you attach to the fact that the Commission may amend the standards?

As the University of Duisberg-Essen study concluded, *“adoption of the clarified ISA through the European Union (EU) would contribute to the credibility and quality of financial statements and to audit quality in the EU, and to a greater acceptance of audit reports*

¹ See http://www.financialstabilityboard.org/cos/key_standards.htm

² The Monitoring Group represents public authorities and assesses the governance and the proper functioning of the IAASB

outside of their home jurisdictions within and outside of the E³U". Such positive effects would be undermined if the Commission was to modify the clarified ISA's adopted by the IAASB. Fortunately so far, as mentioned in page 6 of the Consultation paper, "*the Commission services currently do not foresee the circumstances in which modifications of the contents of the clarified ISA's would be necessary*".

In this context, if the Commission was nevertheless to amend the standards for any reason not yet identified, we consider the circumstances under which the Commission, in cooperation with the Member States, would amend the ISA's should be restricted to extreme circumstances where the European public good is at stake. This should be a last resort solution, applicable only after the Commission has raised any objections it may have through the avenues of the usual due process and based on the opinion of the European oversight authorities.

Consequently, we support maintaining early and active involvement of the Commission, in cooperation with the Member States, in the existing due process directly involving stakeholders, used to create and modify ISA's, to ensure that the ISA's being developed meet the criterion of being favorable to the European public good. Such early intervention in the process should serve to avoid the need for any later amendments to ISA's.

(3) To what extent are "add-ons" or "carve-outs" by Member States acceptable?

We consider that Member State add-ons and carve-outs are not acceptable in principle as they run opposite to the goal of harmonized international auditing standards that will serve to increase audit quality and enhancing confidence in the reliability, comparability and consistency of financial statements in the EU. Nevertheless, the audit directive clearly states in its article 26 the circumstances under which national add-ons and, in exceptional cases, carve-outs are possible. We consider that carve-outs would undermine the brand of "high quality audit" and should therefore be limited to cases where the requirements of an ISA are clearly contrary to local law. Similarly, add-ons should be limited to cases where additional requirements are necessary to comply with local law. Any such add-ons or carve-outs would also contribute not to furthering the internal marketing for audit services. Moreover, as foreseen in the Directive, these should be allowed for a limited period of time only. Thus, we consider that the European Commission should develop a due process for the consideration and acceptance of specific national legal requirements relating to the scope of statutory audits in individual EU Member States following Article 26 of the Statutory Audit Directive.

Independently of the question of add-ons and carve-outs, it should be noted that Member States are entitled to have specific standards in addition to the ISA's to respond to local legal requirements where ISA's are not dealing with this situation.

(4) Do you have any comments on the overall cost/benefit analysis presented in the University of Duisburg-Essen study?

³ Evaluation of the possible adoption of International Standards of Auditing (ISA's) in the EU – Executive Summary, University of Duisburg-Essen, P. 9, point 3.7.

We are in accord with the overall conclusion of the University of Duisburg-Essen study that *“On balance, an adoption of the clarified ISA’s through the EU would contribute to the credibility and quality of financial statements and to audit quality in the EC, and to a greater acceptance of audit reports outside of their home jurisdictions within and outside of the EU. There are significant net benefits expected from ISA adoption through the EU beyond any adoption through the Forum of Firms (FOF) or EU member states”*.

Furthermore, we believe that the costs increase is mainly concentrated on specific ISA’s, i.e. these that have been revised, such as ISA 600, ISA 540. The topics considered by those ISA’s are definitively more complex in the case of larger audit clients and we can therefore expect that the audit of SME’s will not be impacted to such a large extent by the reversion of those standards.

We believe that the overall, main long-term benefit of the adoption of ISA would be at the level of audit quality throughout the EU, especially in case of transnational audits, which of course could not be measured by the University of Duisburg-Essen study. Over time Member State Oversight Bodies should be in position to judge this effect.

(5) Should the Application Material be part of the adoption process and acknowledged as “best practice”?

Yes, we agree that the Application and Explanatory Material contained in each ISA should be part of the adoption process to ensure the understandability, the coherence and the quality of the standards. In this respect, ISA 200 on “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with ISA” clearly states in its paragraph 19 that: *“The auditor shall have an understanding of the entire text of an ISA, including its application and other explanatory material, to understand its objectives and to apply its requirements properly. (Ref: Para.A58-A66)”*. It adds in its paragraph A58 that the entire text of an ISA is relevant to an understanding of the objectives stated in an ISA and the proper application of the requirements of an ISA. Paragraph A59 clarifies that where necessary, the application and other explanatory material provides further explanation of the requirements of an ISA and guidance for carrying them out. (...)While such guidance does not in itself impose a requirement, it is relevant to the proper application of the requirements of an ISA. The application and other explanatory material may also provide background information on matters addressed in an ISA.

However, the publication/adoption method to be chosen should make it clear that although the application material is part of the ISA’s, it is guidance rather than a specific requirement or norm that has to be applied.

Although we agree, as mentioned above, that the application material should be given special status, different from the requirements, we are of the opinion that it should not be acknowledged as “best practice” in the legal instrument adopting the ISA’s but as “Application and Other Explanatory Material” whereby it maintains its authority as stated in the ISA’s and whereby such authority is explained or defined in the introductory notes to the legal instrument adopting the ISA’s.

As suggested in the consultation paper, we support a regulation as the legally binding instrument to be used by the Commission to adopt the ISA's for use in the EU. Any other solutions would result in a lesser degree of harmonization.

(6) Should ISQC1 on internal quality controls be part of the adoption process?

As the consultation paper mentions, ISA's and ISQC1 are interrelated, especially in that ISA 220 requires the engagement partner to assess compliance with the audit firm's internal system of quality control when conducting an audit. ISA220 is based on the premises that the firm is subject to ISQC1 or to national requirements that are least as demanding. To our view, it seems it is very difficult to assess whether national requirements are at least as demanding as ISQC1.

It is therefore necessary to consider whether it is possible to adopt ISA 220 without adopting ISQC1. ISA 220 imposes requirements to the engagement partner which already imply that the firm has a system of quality control which cover at least:

- a proper supervision;
- consultations on difficult or litigious matters;
- quality control reviews, including a process to deal with differences of opinion arising between the engagement partner and the engagement quality control reviewer;
- a monitoring process.

Therefore, in practice, the proper adoption of ISA 220 implies that the firm has a system of quality control which complies with ISQC1.

From a European perspective, ISQC1 adoption will provide the Member State Oversight Bodies with a common standard against which to weigh the quality control systems of audit firms. The University of Duisburg-Essen study concluded that the introduction of ISQC1 would increase the benefits of ISA adoption at EU level by enhancing the regulation effect of ISA adoption and that ISQC1 would form the basis for the harmonization of the methodology for inspections or external quality reviews of audit firms⁴.

Adoption of ISQC1 will also contribute to the harmonization of the audit offer in the EU and towards the development of an internal market for audit services.

(7) In case of adoption of the ISA's at EU level, would a common reference to "ISA's as adopted in the EU" in all auditors' reports in the EU be sufficient? Or, is further harmonization of audit reports necessary?

⁴ University of Duisburg-Essen study, p.9

In our view, the reference in the audit report should be compliant with ISA's but not to ISA's as adopted in the EU since we believe that the objective should be to adopt international auditing standards, without EU carve-outs or add-ons.

With respect to the question about whether further harmonization of the audit report is necessary, we consider that ISA 700 provides a structure of the independent auditor's report that is sufficiently detailed to ensure the consistency of the auditor report, at least with respect to its first part which deals with the audit opinion. Consequently, we consider that further harmonization of audit reports is not necessary.

(8) Do you support adoption of ISA's at EU level?

Yes

(9) If yes, which of the following options do you support?

Option 1 – ISA's should be adopted for the audit of the consolidated accounts of the listed companies (IFRS accounts);

Option 2 – ISA's should be adopted for the statutory audit of all companies except for the audits of small companies where Member States would be free to choose which audit standards should be applied;

Option 3 – ISA's should be adopted for statutory audit of all companies, including small companies for which an audit is required.

We support option 3 as we believe that this is the option that best serves the principle of "an audit is an audit" and advances consistent audit quality throughout the EU and so enhances confidence in the reliability of financial reporting.

Such a position comforts our opinion that the ISA's are scalable, i.e. adaptable to the audit of entities of all sizes.

The other options present the following disadvantages to potentially result in:

- a confusion in the minds of users of financial statements such as financial analysts (sell-side, buy-side, credit analysts, ...) as to the nature and level of assurance provided in any given circumstance and a consequent lowering of confidence in the reliability of financial reporting;
- an increased complexity in the conduct of transnational audits incorporating different methodologies for different components;
- an increase in costs for all audit firms that are present in both markets (small and bigger companies) due to the need to deploy dual methodologies, tools, training...

(10) Do you have comments on the timing in case of an adoption of the ISA's?

In our view,

- ideally, the European Commission should adopt in "one-shot" the ISA's for audits of financial statements in the EU for periods beginning on or after 15 December 2009, the IAASB effective date for the implementation of clarified ISA's;
- if, for any reason, the adoption was to be postponed, it remains of the utmost importance that is done "one-shot" in any case;

- furthermore, we consider that the European Commission should as soon as possible after its analysis of the responses to this consultation paper announce its timetable for the adoption and implementation in EU Member States of ISA's for audits of financial statements in the EU.

Yours sincerely,

Giampaolo Trasi
Chairman of EFFAS

Stéphane Bellanger
SFAF Member