



COMMITTEE OF EUROPEAN SECURITIES REGULATORS
THE CHAIRMAN

European Commission
DG Internal Market and Services
Auditing, Unit-F4
SPA 2 (JII) 01/112
1049 BRUSSELS
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RE: Consultation on the Adoption of International Standards on Auditing

The Committee of European Securities Regulators (CESR), through its standing committee on financial reporting (CESR-Fin), has considered the consultation document issued by the Directorate General for Internal Market and Services on the “Adoption of International Standards on Auditing”.

We welcome the European Commission’s initiative and thank you for this opportunity to comment on your consultation document. We are supportive of the introduction of International Standards on Auditing in the European Union and would like to take the opportunity presented by this consultation to point to some areas which are worthy of further consideration.

We agree with the European Commission that there is a great deal of evidence that points to a wide and growing international acceptance of International Standards on Auditing, as published by the International Auditing and Assurance Standards Board (IAASB). CESR would also like to draw attention to the potential benefits of having broadly harmonised standards on auditing that may arise with the introduction of ISAs into the EU.

In principle we also believe that the European Commission might consider further harmonisation in other areas of assurance reporting when and if the time is right.

Our detailed comments are set out in the Appendix to this letter.

We hope that you find our comments helpful and would be happy to discuss all or any of these issues further with you.

Yours sincerely,

Eddy Wymeersch

Appendix 1 – CESR’s detailed responses to the questions asked in the consultation paper

Question 1

Is international acceptance of the ISAs sufficiently demonstrated?

High quality financial reporting is an objective CESR has strongly supported publicly as is the goal of achieving high quality audits on the financial information produced. CESR believes that the two objectives are mutually reinforcing parts of the more general goals of corporate transparency and market integrity.

The IAASB, which sets International Standards on Auditing, has carried out over a number of years a project, known as the Clarity Project, to restructure and improve ISAs. CESR appreciates the improvements in the ISA requirements that have resulted from the Clarity Project which we believe will encourage wider international acceptance of the ISAs themselves.

In this same vein, the International Organisation of Securities Commissions (“IOSCO”) published a statement in June 2009 encouraging its members to support the use of ISAs for cross-border offerings. CESR notes along with IOSCO that many securities regulators already accept audits performed in accordance with ISAs in their capital markets. Also, in over half of EU member States, versions of ISAs have been adopted into national auditing standards with additional requirements for local circumstances and furthermore in a number of the other EU member States, versions of the ISAs have been translated and directly transposed to form the basis for the preparation of national auditing standards¹.

CESR believes all these facts point to an already wide and growing international acceptance of ISAs.

Question 2

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

CESR is supportive of convergence on the standards assuring the quality of audits. We believe an auditor being able to make reference to a single international set of auditing standard would be of benefit to European issuers, their investors, auditors and users of financial statements generally.

However, if audit standards are to be valued and accepted internationally, standard-setters and the standard-setting process must also command credibility and respect, which implies independence and accountability. We think it is crucial that processes within the standard setter are so organised that adequate consultation is built into the standard-setting process at an early stage. The composition of the standard-setting bodies and the strict adherence by these bodies to due process before finalising each and every standard is also important. Within the framework of this due process, thought needs also to be given to how specifically European views might be put forward in a pro-active fashion.

Notwithstanding the existence of such a process, we could envisage rare circumstances - particularly with regards to supplementing the standards - where it might be beneficial to the European public interest for the European Commission to retain an ability to amend standards where needed prior to their endorsement. We consequently support the European Commission’s proposals for a European endorsement process. However, we would recommend using such a facility with precaution and only

¹ FEE Policy Statement *International Standards on Auditing (ISAs)*, April 2009.



in highly rare circumstances as it could lead to an erosion of the coherence of such standards and of their international acceptability.

We would also emphasise that the true opportunity presented by the introduction of ISAs into the EU is that of increased harmonisation and convergence both on a European and on an international level. In order to promote that harmonisation, we would encourage the European Commission to continue its strong involvement in the audit standard setting process and to continue focusing the IAASB on issues relevant to Europe with a view to being in a position to endorse ISAs wherever possible in the form that they are published by the IAASB.

Question 3

To what extent are “add-ons” or “carve-outs” by Member States acceptable?

Article 26.3 of the Audit Directive (2006/43/EC) explicitly allows member States to impose additional requirements (“add-ons”) or “in exceptional cases” to carve out parts of International Standards on Auditing once the European Commission has decided to implement them in the EU. CESR believes that it is important that the exact meaning of the two terms “add-ons” and “carve-outs” is clear to all constituents, to ensure they are being interpreted consistently.

In our responses to the consultation paper CESR has assumed that neither ‘add-ons’ nor ‘carve-outs’ can affect the actual audit process itself as required by the ISAs once a decision has been made to implement them in the EU.

CESR acknowledges that national laws can require auditors to fulfil additional obligations or perform additional duties which although related to the scope covered by the audit in that particular jurisdiction do not in themselves affect how the audit itself has to be performed. CESR also believes it would be valuable for all constituents to have a clear overview of what these different requirements are from jurisdiction to jurisdiction.

We would also point out that, although we could envisage that Member States might “add on” to the requirements of the ISAs for the reasons we set out in the previous paragraph, we have great difficulty envisaging circumstances where “carve outs” from the standards would be possible whilst preserving the integrity of the audit process.

Question 4

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

We expect that convergence on how audits are conducted will prove highly beneficial to users and do not see any reason to question the conclusions drawn by the University of Duisburg/Essen’s study that such benefits overall will outweigh the costs identified. However we do not feel able to offer any specific comments on the study as we were not able to analyse it in depth.

Given IFAC has undertaken the Clarity Project recognising that improvements in the standards were needed to raise the quality of the audit and has decided to require its members to implement those improvements, CESR believes that certain costs associated with the implementation of ISAs will be consequently incurred in any event by many European auditors due to their membership of IFAC. CESR therefore thinks that cost might not be an insurmountable argument against adopting ISAs.

In any event we believe the potential benefits of convergence and harmonisation that introducing ISAs into the EU may well bring should outweigh the potential costs of their introduction.

Question 5



Should the Application Material be part of the adoption process and acknowledged as “Best Practice”?

ISA 200 – *Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with ISAs* grants a special status to the Application Material, and CESR is consequently of the view that the Application Material is indispensable for the correct application of the ISAs. We would thus recommend including the guidance as part of the adoption process. This inclusion should be done in such a way as to ensure that no confusion arises between what are the actual requirements of a standard and those of the application material and that the application material cannot be modified or interpreted differently in different member States.

To ensure consistency CESR would prefer the European Commission to use the same terminology as ISA 200 and to refer to the material as Application and Other Explanatory Material and not to use the terminology “Best Practice”.

Question 6

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

Given the important role of internal quality control systems in promoting the quality of audits, CESR would like to stress its belief that ensuring audit firms possess good internal systems of quality control is key to a successful implementation of any European-wide audit system. The European Commission is therefore right to focus attention on this issue.

CESR thinks that the implementation of ISQC1 could well have a beneficial impact on the consistent application of International Auditing Standards and on the control environment within audit firms, helping to ensure their independence and promoting respect for ethical standards. We also note that some ISAs contain cross reference to ISQC1 and believe that having it as part of the European adoption process could facilitate consistent application of the ISAs themselves. CESR is thus supportive of the move to considering adopting ISQC1 along with the ISAs.

However, we note that the adoption of ISQC1 is not required by ISA 220 – *Quality Control for Audit Work* as this standard has been carefully crafted to work with any other system of requirements relating to an audit firm’s internal quality control, as long as those other requirements areas are at least as demanding as ISQC1. CESR believes this approach adopted in ISA 220 could work well for those member states that do in fact already have requirements similar to or more demanding than those of ISQC1 applying to their audit firms.

However, equally only applying this approach would leave those member states that do not have such existing requirements in place with a gap in their audit compliance requirements that might otherwise be filled by the adoption of ISQC1. Consequently CESR feels that the European Commission should explore the possibility of adopting ISQC1 as a minimum requirement thereby allowing member states which have equivalent or more demanding requirements to ISQC1 to continue with those requirements but guaranteeing the requirements of ISQC1 in those member states that do not have such alternative requirements.

Question 7

In case of adoption of the ISAs at EU level would a common reference to “ISAs as adopted in the EU” in all auditors’ reports in the EU be sufficient? Or is further harmonisation of audit reports necessary?

International harmonisation is one of the key reasons why CESR supports the introduction of the ISAs in the European Union. We therefore think that a statement that the audit was conducted in compliance with the ISAs would be advantageous for investors and users of audited financial statements.



We acknowledge that the current drafting of the 8th Directive allows Member States to “add on” or “carve out” from the ISAs. We would invite the Commission to consider further how and to what extent using the option to carve out, if this were to happen, is consistent with the ability to make the statement “ISAs as adopted in the EU”.

We also agree with the Commission that currently ISA 700 – *The Independent Auditor's Report on General Purpose Financial Statements* allows a certain level of flexibility and would probably make it possible to have different reporting formats in different member States.

This said, CESR believes it is by no means certain that the use of a large number of different audit reports will develop in practice in Europe as a result of the flexibility allowed under ISA 700. Consequently, although CESR is ultimately in favour of convergence in this area too, we believe that it may be premature to initiate the possibly considerable legislative changes needed at European level to achieve full harmonisation of audit reporting. CESR believes that before such effort is expended (and potential cost incurred), the European Commission should wait and evaluate the effects of introducing ISAs into the European Union and see whether the IAASB might by then have initiated any further work to address this issue.

Question 8

Do you support the adoption of ISAs at the EU level?

Considering the importance of international and European harmonisation in the field of audit activities and given the reasoning in our answers to the questions above, CESR supports overall the introduction in the European Union of International Standards on Auditing (ISAs) as published by the International Auditing and Assurance Board (IAASB), subject to a suitable European endorsement procedure.

Question 9

If yes to question 8, which of the following options would you support?

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

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

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

As securities regulators we are most concerned with the statutory audits of the accounts of publicly traded companies. We think that, if ISAs were to be adopted in the EU, a move which we support, then they should certainly apply to the audits of the accounts of all public interest companies as defined in the Audit Directive.

Although strictly outside of our remit, CESR would also point out that many companies that are currently not publicly traded may shortly become so and that indeed many non-publicly traded companies may be equal in size to some companies that are publicly traded particularly at the lower end of the market capitalisation table. We wonder therefore whether introducing different treatments for companies under the Audit Directive based on a concept of size may not bring with it a risk of upsetting the equality of treatment between smaller listed and non-listed companies.

We also think it would promote clarity if investors, preparers and auditors did not have to work with the concept of two or more sets of auditing standards which would tend to undermine confidence in every audit being performed to the highest quality standards possible. Similarly, allowing different



types of “audit” within the European Union may undermine the standing of European audits in the international arena. CESR would therefore be of the view that it would be beneficial for all statutory audits to be within the scope of the requirement to use ISAs.

This said, we note that a requirement that every audit be performed in accordance with ISAs could impact the organisation of smaller audit professionals, which might in turn affect competition within the audit market. We note in this respect that in August 2009 the IAASB published a Staff Questions & Answers paper *Applying ISAs Proportionately with the Size and Complexity of an Entity* that aims to apply them proportionately to the size and complexity of the entity.

If the reason for the European Commission raising the issue of introducing different requirement levels for the statutory audits of companies caught by the Directive is to reduce administrative burden, then we would point out that the outcome of the discussions on the proposals put forward as part of the European Economy Recovery Plan², and the consequent actions of the European Commission, might have an impact in this area.

Question 10

Do you have comments on the timing in case of an adoption of the ISAs?

Although we think that introducing ISAs should not mean a fundamental change to existing practice, we think audit firms should be allowed a reasonable period of time to implement ISAs properly as introducing them would probably involve additional training and changing internal methodologies and IT systems.

This said, we think implementation could be organised in such a way that allows for mandatory application for statutory audits of financial statements for reporting periods commencing on or after 1 January 2010. However this would infer an endorsement process for ISAs being in place by mid-2010 as such audits (i.e. on financial statements with a reporting period starting at 1 January 2010) would begin for some companies as early as the second half of 2010.

² http://ec.europa.eu/commission_barroso/president/pdf/Comm_20081126.pdf