IAASB Consultation Paper: Proposed Strategy for 2020-2023 and work plan for 2020-2021

Dear Mr. Schilder,

The European Securities and Markets Authority (ESMA) considered the International Auditing and Assurance Standards Board (IAASB) Consultation Paper on Proposed Strategy for 2020-2023 and work plan for 2020-2021 (CP) and thanks you for the opportunity to contribute to the IAASB’s due process. The views expressed in this letter reflect the perspective of security regulators and aim to enhance investor protection and promote stable and well-functioning financial markets.

ESMA welcomes that the IAASB publicly consults on various aspects of its proposed strategy and work programme. While ESMA considers that the proposed strategy represents a good step in the right direction and is adequate given the current constraints of the international audit standard-setting process and resources available to the IAASB, ESMA would like to propose a further focus and increased ambition regarding specific areas as further detailed below.

While ESMA appreciates that the IAASB consults both on its 2020-2023 strategy and detailed biannual work programme, ESMA notes that the most significant part of the ‘strategic actions’ focuses on the period covered by the work programme. While this might be due to the uncertainty related to the long-term strategy of the organisation resulting from the ongoing governance review, ESMA suggests that the public consultation on the long-term strategy and the short-term work programme be decoupled in the future. This would allow the IAASB to focus in its long-term strategy consultation on those actions that are relevant from a strategic perspective without having to describe and analyse detailed aspects related to the short-term results in the work programme. This approach would enable the IAASB to formulate its strategy in simpler terms, focusing on the main issues rather than on details on each and every project envisaged.

Proposed Strategy for 2020-2023

ESMA agrees with the environmental drivers identified in the proposed IAASB strategy and Work Plan. However, even though ESMA agrees that main areas have been correctly identified, it considers that the corresponding strategic actions should be more ambitious in order to achieve a commensurate response to the environmental assessment.
Advancement in, and Use of, Technology/Changing Reporting Needs of Stakeholders

ESMA strongly agrees that the development of the auditing standards needs to take into account prominent corporate reporting developments, including stakeholders' increasing focus on non-financial information and the impact of technological advancements. ESMA notes that the pattern of consumption of financial information is also evolving, relying to an increasing extent on a structured electronic format. Consequently, ESMA encourages the IAASB to consider the impact of this development on audit and assurance engagements and consider how to ensure market confidence in the use of such financial information.

Qualitative Features of the Auditing Standards

ESMA highlights the need for the auditing standards to be clear and understandable as well as enforceable. While ESMA strongly supports principle-based standard setting, it considers that the ultimate focus of the IAASB should be that standards can be applied in an objective and consistent manner. Consequently, ESMA is of the view that the focus on consistent application should be reflected in the proposed strategy.

Audit Quality Enhancements

ESMA strongly supports the strategic focus on audit quality. From the perspective of securities regulators, ESMA considers that improvement of audit quality is essential for the effective functioning and confidence in the integrity of the capital markets. ESMA welcomes the recent publication of amendments to ISA 220 Quality Control at the Engagement Level and the increased focus on audit quality in the form of two exposure drafts on quality management. In addition, a new separate standard in the form of the exposure draft on International Standard on Quality Management 2, with more specific requirements for the engagement quality reviews, is an important step forward to clarify requirements. However, ESMA believes there remains the need to provide on-going implementation support in order to support the proper and robust implementation and application of the quality management requirements.

Consequently, ESMA welcomes that audit quality features prominently in the strategic actions proposed for the next period. This focus should also consider the link to the audit committee. ESMA highlights that audit committees are important in enhancing audit quality. Reflecting this, audit committees are being called on to play a more active role on behalf of investors and other stakeholders, not only in overseeing the financial reporting process, but also in their oversight of the independence of external auditors and interaction with them. Several bodies (including International Organisation of Securities Commissions (IOSCO)\(^1\) and the Public Company Accounting Oversight Board (PCAOB)\(^2\) in the United States) have recently issued reports to assist audit committees in relation to audit quality. ESMA encourages the IAASB to reflect the role of the audit committee in the proposed strategy regarding audit quality.

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\(^2\) PCAOB's relevant topics for audit committees to consider discussing with their auditors throughout the audit (March 2019): [https://pacabbs.org/pdf/sections/Documents/2019-Staff-Interactions-Outlook-Audit-Committees.pdf](https://pacabbs.org/pdf/sections/Documents/2019-Staff-Interactions-Outlook-Audit-Committees.pdf)
Increasing Complexity and Its Implications

ESMA agrees that the business environment has become more complex and that a number of financial reporting standards (such as IFRS 9 Financial Instruments, IFRS 15 Revenue from Contracts with Customers, IFRS 17 Insurance Contracts or IAS 36 Impairment of Assets) require the use of significant estimates and management judgement. In this context, ESMA agrees that further guidance and implementation support might be required on the recently published auditing standards, such as ISA 540 (Revised) Auditing Accounting Estimates and Related Disclosures, especially when referring to the audit of judgements and complex models.

Changing Expectations and Public Confidence in Audits

ESMA also strongly agrees that stakeholders’ expectations on what auditors should be required to do are changing, especially with regards to the detection and reporting of fraud and consideration of going concern issues. ESMA notes that public reactions to a number of corporate reporting failures over the last several years seem to indicate a growing gap between the work which investors and other stakeholders expect auditors to undertake and what auditing standards require. Therefore, ESMA considers that when developing new guidance, the IAASB should focus on addressing this expectation gap, inter alia by providing authoritative guidance in some of the areas where shortcomings have been identified as a result of the financial crisis or corporate reporting failures over the last years. This might require the IAASB to re-prioritise strategic actions towards consideration of fraud, going concern and professional scepticism and to allocate sufficient resources to deliver on these changes in the auditing standards within the period covered by the IAASB strategy.

Mechanisms for addressing issues and challenges on a more timely basis

While ESMA agrees that the IAASB should develop a new mechanism for addressing issues and challenges on a timelier basis, ESMA notes that these mechanisms need to be balanced with the authoritative status of any new guidance and with the need for the appropriate due process. Whereas ESMA does not oppose the development of non-authoritative practical guidance in the form of educational material, it highlights that the authoritative guidance should still be sufficiently robust and comprehensive to address all relevant issues arising from the audit process. Therefore, ESMA disagrees with the proposal to address audit issues that are specific to significant industries (such as banking and insurance) or to specific topics (such as financial instruments) solely by non-authoritative guidance, as suggested in Appendix II to the CP. In this context, ESMA reiterates its position included in its Comment Letter to the Proposed Strategy and Work Programme for 2015-2019\(^1\) and in its comment letter on ISA 540 (Revised)\(^4\) that, if the IAASB decides that the development of specific guidance is appropriate for audit of banks and insurance companies, this should be provided in the form of authoritative guidance as part of (or in appendix to) the respective standards.

ESMA strongly supports the initiative to provide maintenance of auditing standards by allowing the IAASB to develop narrow-scope amendments to the existing standards as this would allow the IAASB to provide more timely responses to market developments. On the other hand, ESMA

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\(^1\) Comment Letter, Proposed IAASB, Strategy and Work Program for 2015-2019, ESMA, 4 April 2014, (ESMA/2014/363)

\(^4\) Comment Letter, Proposed ISA 540 (Revised), ESMA, Paris, 26 July 2017 (ESMA/32-52-91)
is of the view that the IAASB should carefully consider the development of an interpretations mechanism to clarify the principles already included in the standards as well as to provide insight into the intentions of the Board when developing the standards. While ESMA can support such a mechanism, it notes that the Board’s intentions when developing the standards could be more usefully reflected in the basis for conclusions accompanying publication of the new standards and providing the rationale for taking decisions when the standards were developed. Consequently, ESMA is of the view that all the maintenance activity should ensure high quality and enforceability of the narrow-scope amendments and interpretations.

Collaboration opportunities

ESMA considers that the cooperation between accounting and auditing standards setters (i.e. cooperation between the International Accounting Standards Board (IASB) and IAASB) should be significantly reinforced. This is of increasing importance due to the development of new complex accounting standards that increase reliance on management judgement and use of complex models that rely on long forecasting periods. This complexity may raise questions about auditability especially in the first years of implementation of the accounting standards. Therefore, ESMA welcomes the planned post-implementation reviews of the recently implemented ISAs and encourages the IAASB to address any issues arising from these post-implementation reviews or from gaps identified in these new standards on a timely basis.

Furthermore, ESMA is of the view that transversal issues between accounting and auditing standard setters, such as consideration of materiality and assessment of going concern, need to be discussed as part of the IAASB’s effort to address the expectation gap mentioned above.

Finally, ESMA reiterates its encouragement to the IAASB to enhance its cooperation with regulatory oversight bodies, similar to the model established by the IASB with the securities regulators (such as IOSCO and ESMA).

Work plan for 2020-2021

While ESMA acknowledges that the work plan for 2020-2021 already includes a number of projects, ESMA encourages the IAASB to step up its ambitions in a number of areas that are key in delivering on the strategic actions identified above. In particular, ESMA considers that the following standards should have higher priority within the work plan:

ISA 500 Audit Evidence and Professional Scepticism
ESMA strongly supports revision of the requirement on audit evidence in ISA 500. Given the key role of audit quality in the audit process, ESMA in particular welcomes the research project on professional scepticism. In our view further standard-setting activities to embed more rigour into the application of professional scepticism is urgently needed. Therefore, ESMA suggests that that the IAASB includes the development of due process documents on these two issues in the 2020-2021 work plan.

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4 Comment Letter, Enhancing Audit Quality In the Public Interest: A focus on Professional Scepticism, Quality Control and Group Audits, ESMA, 25 May 2015, (ESMA/2016/728)
ISA 570 Going Concern

While the IAASB highlights the changes in stakeholders’ expectations regarding auditors’ assessment of going concern, ESMA notes that the detailed work plan does not include any standard-setting activity in this respect. ESMA encourages the IAASB to prioritise this topic and to initiate a research project to evaluate how to respond to investors’ demands in this area.

New topics: Non-financial reporting, non-GAAP measures and electronic reporting

ESMA welcomes that the work plan includes plans to develop non-authoritative guidance to Extended External Reporting (EER). While ESMA would have preferred that the IAASB provided authoritative guidance in this respect, it strongly welcomes the development of guidance on the EER assurance. ESMA encourages the IAASB to develop a robust framework for assurance on non-financial reporting (such as ESG factors or specific climate disclosures) which will address the specificities of this type of reporting. Such framework should cover, inter alia, the longer period over which entities need to assess the issues, audit of specific management judgements needed to develop these forms of reporting and the assessment of materiality in the EER.

ESMA also considers that the IAASB should evaluate and strengthen auditors’ role in relation to other information and company performance measures, including alternative performance measures (i.e. non-GAAP financial measures) which are provided within the financial statements as well as outside of financial statements but inside the annual report. In particular, we encourage the IAASB to explore the need for, and the form of, additional guidance and changes to existing ISAs in light of the significant use of such non-GAAP measures.

Finally, ESMA considers that the work plan should include specific standard-setting activity for assurance of financial information provided in a structured electronic format. ESMA observes that the specific challenges of auditing financial information (e.g. financial statements) presented in a structured electronic format are not currently addressed by the ISAs. In light of the fact that financial information is increasingly consumed in a structured electronic format, ESMA would welcome authoritative international guidance in this area.

In case you have any questions or comments regarding this letter, I suggest you contact Evert van Walsum, Head of the Investors and Issuers Department (Evert.vanWalsum@esma.europa.eu).

Yours sincerely,

Steven Maijoor