

# Policy Statement

*Standing for trust and integrity*

July 2012



## FEE Policy Statement on Adoption of International Standards on Auditing (ISAs) in the European Union

**A major driver of the quality of audits is the standards by which the audits are performed. Over the past 10 years, considerable improvements have been made to the international standards on auditing as issued by the IAASB<sup>1</sup>, not in the least following the Clarity Project<sup>2</sup>. This Policy Statement seeks to provide input in the debate on ISA adoption as well as their proportionate application.**

### The benefits of ISAs

FEE continues to call for the adoption of ISAs<sup>3</sup> for all statutory audits of financial statements in the European Union (EU) as the use of one set of international auditing standards will continue to increase audit quality and enhance confidence in the reliability, comparability and consistency of financial statements in the EU. ISAs also address many issues arising from the financial crisis such as reinforcing professional scepticism, strengthening the requirements relating to group auditors and enhancing auditor's communication. Additionally, ISA

adoption will facilitate cross-border mobility of auditors and may also decrease cost and inefficiencies in transnational audits.

Recognising that ISAs promote quality and enhance confidence in the internal market, FEE continues to call for their adoption for all statutory audits in the European Union.

### ISA adoption in the EU

#### European Commission proposal on ISA adoption

In the context of the European Commission audit reform proposals, FEE welcomes the European Commission initiative on the adoption of ISAs for all statutory audits performed in the EU.

As referred in the proposed Directive<sup>4</sup>, the Commission shall take into account any amendments brought to the ISAs<sup>5</sup>. In this respect and in order to preserve comparability, it should be ensured that **any IAASB additions/amendments to Clarified ISAs, now and in the future, are adopted on a timely basis throughout the EU.**

In accordance with the European Commission proposals<sup>6</sup>, EU Member States are responsible to ensure the compliance with ISA requirements for statutory audits performed in their jurisdictions. Furthermore, EU Member States need to ensure that any **national add-ons** that they propose will only be put forward in order to contribute a high level of credibility and quality to the financial statements while being conducive to the Union's public good. FEE is not unsupportive of such add-ons as long as they **only address national legal specificities.**

Currently, 20 EU Member States use or fully comply with Clarified ISAs for all statutory audits in their national jurisdiction without modification or with a few national additions. Therefore, we support the European Commission initiative to propose in the Directive **a Member State mechanism** to use or

comply with ISAs which should **ensure full compliance** with the Objectives, Requirements, Application and Other Explanatory Material of the Clarified ISAs for all statutory audits performed in their jurisdiction.

#### Consideration of an alternative ISA adoption mechanism

Although a Member State mechanism to adopt ISAs appears suitable in a majority of EU Member States, there is remaining concern that 7 EU Member States (Austria, France, Germany, Italy, Poland, Portugal and Spain), which includes 5 of the 6 largest EU Member States, have not yet (fully) adopted Clarified ISAs. Based on their national transposition or implementation of the 2006 Statutory Audit Directive (2006/43/EC)<sup>7</sup>, they are awaiting full adoption of Clarified ISAs by the European Commission.

In order to ensure the adoption of ISAs in these countries, due consideration should be given to an **alternative endorsement procedure** on European Union or European Commission level. In this respect, if such alternative would be considered, it would need to:

- Be as simple and "light-touch" as possible;
- Facilitate the adoption of the most current version of ISAs in their entirety; and
- Involve all relevant stakeholders to provide valuable input on EU level for the adoption of any new or amended ISAs.

<sup>1</sup> The International Auditing and Assurance Standards Board (IAASB) is an independent board under the auspices of the International Federation of Accountants (IFAC) setting the global standards for auditing

<sup>2</sup> See the IAASB Clarity Project <http://www.ifac.org/auditing-assurance/clarity-center>

<sup>3</sup> As issued by the International Auditing and Assurance Standards Board (IAASB)

<sup>4</sup> See [http://ec.europa.eu/internal\\_market/auditing/docs/reform/directive\\_en.pdf](http://ec.europa.eu/internal_market/auditing/docs/reform/directive_en.pdf), Art 26 par 3

<sup>5</sup> Amendments can be brought to the ISAs by the International Auditing and Assurance Standards Board (IAASB) which issues its standards under the oversight of the Public Interest Oversight Board (PIOB)

<sup>6</sup> See [http://ec.europa.eu/internal\\_market/auditing/docs/reform/directive\\_en.pdf](http://ec.europa.eu/internal_market/auditing/docs/reform/directive_en.pdf), Art 26 par 1

<sup>7</sup> See <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2006L0043:20080321:EN:PDF>

## The risks of not adopting ISAs in the EU

Should the European Commission proposal to adopt the ISAs for all statutory audits performed in the EU not be retained during the legislative process in the European Parliament and the EU Council of Ministers, there is a risk that some Member States would not adopt ISAs whilst others have already adopted them or will do so, thus causing different standards to be used in different countries.

Therefore, **the risks of not adopting ISAs in all EU Member States** should be taken into consideration not just for **consistency of approach and methodology** but also to ensure that certain **opportunity costs are not incurred**<sup>8</sup>, many in perpetuity. In case of not adopting ISAs in all EU Member States, costs would increase due to:

- The use of different (multiple) sets of standards by one and the same firm for statutory purposes (local standards) and for contributing to a group audit

## Proportionality of ISAs

FEE welcomes the European Commission proposal on proportionate application of ISAs for the statutory audit of Small and Medium-sized Entities (SMEs)<sup>9</sup>.

In general terms, the ISAs are designed in order to apply professional judgment to determine the audit approach in line with the nature, risk, complexity and size of the audited entity thus recognising their business reality. This means in practice that there is **no requirement to apply an ISA or those individual requirements of an ISA which are not relevant to the audit**. Professional judgement is also required to determine the extent of audit procedures when applying the ISA requirements.

The proportionate approach is also relevant for determining the appropriate quantity and content of audit documentation. ISAs do not require documentation of every matter considered or professional judgement made, but only of the significant matters and judgements, thus **avoiding a disproportionate documentation burden**.

The European Commission audit reform proposal on proportionality of ISAs would promote the elimination of any remaining perceptions that ISAs may not be fully adaptable to the needs of SMEs stemming from concerns related to regulators' exaggerated expectations in relation to audit documentation. Therefore, the explicit statement of proportionate application of ISAs for SME audit engagements and associated quality assurance reviews<sup>10</sup> would assist in **avoiding a disproportionate inspection approach by the competent authorities**.

## About FEE

FEE (Fédération des Experts-comptables Européens – Federation of European Accountants) represents 45 professional institutes of accountants and auditors from 33 European countries, including all of the 27 European Union (EU) Member States. In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 700.000 professional accountants, working in different capacities in public practice, small and big firms, government and education, who all contribute to a more efficient, transparent and sustainable European economy.

<sup>8</sup> See also [http://ec.europa.eu/internal\\_market/auditing/docs/ias/study2009/report\\_en.pdf](http://ec.europa.eu/internal_market/auditing/docs/ias/study2009/report_en.pdf)

<sup>9</sup> See [http://ec.europa.eu/internal\\_market/auditing/docs/reform/directive\\_en.pdf](http://ec.europa.eu/internal_market/auditing/docs/reform/directive_en.pdf), Art 43(a),43(b)

<sup>10</sup> See [http://ec.europa.eu/internal\\_market/auditing/docs/reform/directive\\_en.pdf](http://ec.europa.eu/internal_market/auditing/docs/reform/directive_en.pdf), Art 29(k)

<sup>11</sup> In November 2011 the Small and Medium Practices Committee (SMPC) of IFAC issued the third edition of the "Guide to Using International Standards on Auditing in the Audit of Small- and Medium-Sized Entities". This Guide could be a valuable basis to develop further guidance on proportionate application of ISAs.

<sup>12</sup> FEE has issued a Briefing Paper on Proportionality and ISAs in September 2011 ( <http://www.fee.be/fileupload/upload/Briefing%20Paper%2007%20Proportionality%20and%20ISAs%201109592011994.pdf> ) and a Policy Statement on ISAs in April 2009, including a section on the implementation of ISAs for SMEs. ( <http://www.fee.be/fileupload/upload/Auditing%20and%20Assurance%20PS%201%20International%20Standards%20on%20Auditing%20%28ISAs%29%201%20090430145200923149.pdf> )

where the group audit is performed under other European Union Member States standards;

- The requirement for amendments to methodologies, audit manuals, training, etc.;
- Costs being incurred through potential confusion of stakeholders as to what an audit entails under different Member State regimes;
- Lack of reduction in cost of capital that could otherwise be expected from ISA adoption throughout the EU.

As proposed by the European Commission, FEE continues to support full adoption of the up to date Objectives, Requirements, Application and Other Explanatory Material of the Clarified ISAs by all 27 EU Member States. Not only the benefits of ISAs but also the risks of not adopting them should be taken into consideration in examining this proposal as we strongly believe that the adoption of ISAs throughout the EU is fundamental for further development and harmonization of the internal market.

As proportionate application of ISAs would be a Member State responsibility, there may be a risk of having diversified approaches across the EU. Therefore, further national or international solutions<sup>11</sup> are welcomed to address how the application of the ISA requirements can be performed in practice in an SME audit environment. Such solutions would promote compliance and add value to the work of auditors and competent authorities.

In this respect, FEE<sup>12</sup> is committed to **promoting cooperation and harmonisation** of the audit profession across the EU. A further **international initiative** to develop solutions to contribute to the proportionate application of ISAs to meet the needs of audits of SMEs in a practical way would be helpful and FEE would be prepared to support it.

FEE welcomes the explicit statement of proportionate application of ISAs for SME audit engagements as proposed by the European Commission as it would assist in avoiding an unreasonable inspection approach applied by competent authorities including disproportionate demands for audit documentation. In this context, FEE would be supportive of a further international initiative to develop solutions on the application of the proportionality principle of ISAs that would assist the practical application of ISAs and its requirements in differing audit environments.