



**EUROPEAN COMMISSION**

Internal Market DG

Director-General  
Acting Director

**17.01.05 0217**

Brussels,  
MARKT/2004/010

Mr. Jim Sylph  
Technical Director  
International Auditing and Assurance  
Standards Board  
545 Fifth Avenue, 14<sup>th</sup> Floor  
USA - New York, NY 10 017

**Subject: Comment on Exposure Draft "Clarifying Professional Requirements in International Standards Issued by the IAASB" and consultation paper "Improving the Clarity and Structure of IAASB Standards and Related Considerations for Practice Statements".**

Dear Mr Sylph,

As you are aware, the Commission proposed on 16 March 2004 a Directive on Statutory Audit. Article 26 of the Directive will invite the European Commission to consider applying international auditing standards for statutory audits conducted within Member States. Subject to the adoption of this Directive by European Parliament and Council, the European Union may become one of the major users of the International Standards on Auditing (ISA) issued by the IAASB.

The IAASB should give the highest possible priority to this project, in particular compared to the development of new standards. This is of paramount importance for the EU which might move to ISA in the next years. As such, the language and structure of standards with which the EU is going to live for a long period of time are key matters. At this point in time, we particularly welcome this initiative to consult on both language and structure of the standards. This is a unique opportunity to meet the criteria for a smooth adoption by the EU.

In drafting this response we have taken account of comments expressed by representative supervisory/regulatory authorities of Member States of the European Union. Our comments may however neither necessarily reflect the unanimous views of all Member States, nor pre-empt the future decision to finally adopt ISAs under the future Directive on statutory audit.

We have summarised our views below:

- We generally support upgrading the language and structure of ISAs. Language: we support the use of “should” and “shall” (although we have a slight preference for “must” instead of “shall”). Structure: separating the standards from the guidance in one way or another is key. We favour Option A offered in your exposure draft.
- The European institutions have decided to improve their legislative approach through the Better Regulation program. This is meant to ensure that regulation is proportionate, but also effective<sup>1</sup> and enforceable once adopted under EU law. Ensuring that the regulatory environment and effective implementation is simple and of high quality is a key objective of the European Union.
- We invite the Board to ensure that ISAs will remain as principle based as possible. We believe that principle based approaches are the best way to address all types of situations in the field. Principle based approach leaves enough room for “professional judgment”, and avoid the inflation of too detailed prescription. The prominence of ethical professional behaviour is reminded in the Commission proposal for a Directive on statutory audit. In addition, a principles based approach is bound to help auditing standards converge throughout the world. We consider that this will be a key for the future success of ISAs.
- We would support any consideration to accommodate the specificities of the audits of SMEs, and inclusion of the Board’s conclusions in the conduct of the “Clarity” project.
- When going through the policy statement and consultation paper, it appears clearly to us that it would be more effective to revise the standards, not only in respect of their language, but also in respect of their structure. This is why we support designing a set of clear drafting guidelines encompassing such issues as language (use of “shall” or “must”, “should”), principle based approach, provisions proportionate to the objective pursued, and considering SME issues. We urge the Board to state such drafting guidelines in Statements with sufficient authority.
- Finally, the question of how to apply “Clarity” to the existing standards, and the timing thereto, is key. The Commission and assisting committees may start reviewing certain aspects related to ISAs starting 2005 or 2006 with the view of a possible subsequent adoption of ISAs. We therefore support the retrospective application, even at the cost of delaying the Board’s current work program for a few months. The Board should publish an agenda for the review of the standards with “Clarity”, so that the complete revision of the standards is performed by mid 2007.

Our detailed answers, observations and comments to your questions are attached in Annex.

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<sup>1</sup> Communication from the Commission – Action plan « Simplifying and improving the regulatory environment” – 5.6.2002 and European Council declaration of 7 December 2004 – Advancing regulatory reform in Europe

We remain at your disposal for any queries.

Yours sincerely,



P. DELSAUX

c.c.: Jorgen Tiedje, European Commission, MARKT/G5

## **1. COMMENTS ON THE EXPOSURE DRAFT**

- 1.1. Do respondents agree with the view of the IAASB, or would a statement of “equal authority” assist in clarifying the responsibilities of the professional accountant?**

We agree with the view of the Board. The authority should only derive from the language and words used.

- 1.2. Do respondents agree with the proposed categories of professional requirements and the related obligations they would impose on professional accountants? Please state the reasons in support for your response.**

We agree with the approach proposed by the Board. The auditing standards should provide a minimum level of legal certainty to the users.

- 1.3. Do respondents believe that the proposals will improve the quality and consistency of audits? Please state the reasons in support for your response.**

We anticipate that by stating mandatory requirements, the proposals will improve consistency of audits, including within the EU. Therefore, in our opinion, this is not bound to solely improve the audit quality which depends rather on ethics, professional behaviour and judgement.

- 1.4. Do respondents agree with the proposed requirement for the professional accountant, when departing from a presumptive requirement, to document why the professional accountant decided to depart, and how the alternative procedure(s) performed in the circumstances were sufficient to achieve the objectives of the presumptive requirement? Please state the reasons in support for your response.**

We fully support the logic of documenting departures. But, keeping in mind the objectives of the EU with the “better regulation” project, we would like to see in parallel the Board developing drafting guidelines and enforceable criteria for the use of the proposed requirements.

- 1.5. Do respondents agree with the applicability of the proposed documentation requirement to departures from existing International Standards before they are revised? Please state the reasons in support for your response.**

No, because the existing standards were drafted using other conventions than those introduced by “Clarity”. This is one of the reasons why we support a retrospective application of Clarity.

**1.6. Will the proposed terms “shall” and “should” result in translation difficulties? The IAASB had considered the word “must” as an alternative to “shall” – would this alternative resolve any identified translation difficulties?**

As stated in the current text of the forthcoming EU Directive on statutory audit, adopted auditing standards shall be published in full in each of the official languages of the Community, in the Official Journal of the European Union. Because of this, translation issues are important matters to consider for the Commission.

The use of “shall” and “should” are part of the English language. The European Community respects each language’s idioms and practice. There is no reason why standards drafted in English should avoid using the full range of options offered by this language, even though this may entail translation difficulties in some of the languages of the Community.

However, from past experience on IAS / IFRS translation, we learnt that some translation difficulties can be better addressed if the English text uses the word “must” instead of “shall”. Indeed, the difference between “shall” and “should” may appear insufficient. The use of “must” could leave less room to misleading interpretation during translation.

**1.7. Does the anticipated increase in the number of bold type requirements that may arise by adopting the proposals raise concern over the specificity and level at which professional requirements are set? Please state the reasons in support for your response.**

There is somehow confusion between “bold type” lettering and the requirements which it underpins. The authority of the text should lie with the wording itself, not with the font. As such, the increase of bold type text is not an issue *per se*.

The underlying question seems to be rather about the number of requirements. We have always made clear that we support principle based provisions, proportionate to the objective pursued. We strongly support seeing the Board developing clear-cut drafting guidelines or a framework to define the conditions and criteria for the use of “shalls” and “shoulds”, in order not to miss valid requirements, but also to avoid undue inflation of such use.

In addition, principles based approach is better fitted to multicultural needs, and likely to enhance the convergence of auditing standards throughout the world. Article 45.5 (d) of the current text of the Directive seeks equivalence assessments of standards used outside the EU.

**1.8. Do respondents agree with the decision of the IAASB to retain the bold type convention?**

We will definitely not be able to maintain the bold lettering convention in the Official Journal of the European Union.

Bold type should be seen as a non binding tool helping the reader to spot more easily the frame and important statements of a standard. Bold type text should not have any language or authoritative meaning.

**1.9. Do respondents agree that the IAASB should apply the proposals on a prospective basis? Please state the reasons in support for your response.**

No (see also § 1.5).

Given the scale of the amendments to the standards, applying the proposals on a prospective basis is not enough to provide the users with sufficient legal certainty. Having two inconsistent language, and possibly structure conventions at the same time will not make standards easy to use and understand. In addition, transposing auditing standards into the Community legislation will entail time consuming requirements for EU bodies: possibly a technical review, an endorsement process, and the translation and publishing of the standards in each of the official languages of the Community, in the Official Journal of the European Union. Any change made to the standards after initial adoption will result in costly and time consuming procedures, compared to the added value.

We stand at a critical period in time. At a certain point in time, EU users of ISAs will need a stable platform to operate in a secure environment. Meanwhile, the IAASB is seeking to clarify the standards, with such effect that the wording of the standards is significantly modified. In such context, we have no option but to support revision of all standards retrospectively in a short period of time, even at the cost of delaying current Board's work program for a few months.

This is an ambitious exercise. When going through the policy statement and consultation paper, it appears clearly to us that it would be more effective to revise the standards, not only in respect of their language, but also in respect of their structure. This is why we support designing a whole set of clear drafting guidelines encompassing such issues as language (use of "shall" or "must", "should"), principle based approach, provisions proportionate to the objective pursued, and considering SME issues. We urge the Board to state such drafting guidelines in Statements with sufficient authority.

Having said that, the next issue is the timing. The Commission and assisting committees may start reviewing certain aspects related to ISAs starting 2005 or 2006 with the view of a possible subsequent adoption of ISAs. We invite the Board to publish an agenda for the review of the language and structure of the standards with "Clarity", so that the complete revision of the standards is performed by mid 2007.

## 2. COMMENTS ON THE CONSULTATION PAPER

- 2.1. Has the length and style of these standards aided or impaired their understandability and clarity? Please explain the reasons that are persuasive in reaching your view and provide examples that help illustrate your view.**

The trend towards longer standards observed in recent releases may reflect a shift towards a more rules based approach, which we do not approve (see § 1.7), but also the increasing complexity of the auditor's environment.

- 2.2. If there is concern over the length of the standards, please also explain what is viewed as being problematic – the amount of explanatory guidance provided, the scope of matters addressed or other aspects of the standards. How do respondents consider such matters might be resolved?**

See above.

- 2.3. Has the degree of detail provided in the standards aided or hindered their adoption or implementation? Please provide specific details of the circumstances that have arisen as a result of the style in which ISAs are written.**

The Commission has not yet adopted or implemented ISAs, but has already gained experience in adopting IAS /IFRS in the past. The more rules based and prescriptive the standards – as opposed to principles based – the more lengthy the adoption, and the more difficult the convergence or equivalence assessment exercises are.

- 2.4. Are there other options for improvement in standards that should be considered by the IAASB?**

Yes.

Along with the EU “better regulation” project, the Commission supports principles based standards, the avoidance of duplicated text, and short sentences.

- 2.5. Do respondents believe that the IAASB should continue with its present style of ISAs, or is there a need for ISAs to be restructured? What are the reasons that are persuasive in reaching your view?**

We support restructuring the ISAs in order to allow easier adoption and inclusion of ISAs in the EU regulation, and in order to deal with particular issues such as the audit of SMEs. See also § 2.6.

**2.6. If ISAs are to be restructured, which option should be pursued and why? Are there other options that the IAASB should consider, particularly in helping with the ability for auditors of both large and small- and medium-sized entities to implement ISAs?**

We support Option A. Option B could be acceptable provided that the first part is the stand alone standard, and that this is clearly stated in the body of the text. In order to facilitate the adoption and enforcement process of auditing standards, there is a need for a clear-cut structure. We suggest the following guidelines to substantiate two distinct components:

- A first component, comprised of the whole set of text necessary to represent the stand alone standard. This might become subject of law in the EU. The ISAs must clearly state that a standard is only comprised of this component. This component may include objectives, definitions, mandatory professional requirements, references, etc. which, altogether form the standard.
- A second component including only non binding guidance and explanatory material. As such, it should not add any professional requirements to the standard, and the guidance would be clearly evidenced as not being part of the standard.
- *Particular issues: audit of SMEs*

International auditing standards will apply in the near future not only to the audit of listed companies, but also to all statutory audits performed in the EU. This encompasses the audit of several millions of private companies, and not only that of 7,000 to 8,000 listed companies.

We support the idea of accommodating the needs for the audits of SMEs, and particularly the idea of taking advantage of the "clarity" project to take this matter on board. We could support any solution that would allow addressing appropriately specific issues implied by the audit of SMEs.

**2.7. Notwithstanding the decisions of the IAASB regarding the proposed Policy Statement (see accompanying Exposure Draft), in the event there is strong support for the restructuring of ISAs, do respondents agree that any such restructuring should be applied on a prospective basis? Or should restructuring be applied prospectively, but on a priority basis first to a limited number of ISAs that have attracted concerns about their length and complexity, namely the IAASB's recently issued audit risk and fraud ISAs? If so, what are the reasons that are persuasive in reaching your view?**

Please refer to § 1.9.

- 2.8. Do respondents believe that identifying “fundamental principles underlying an ISA audit” would aid in communicating the principles that underlie the professional requirements in ISAs and ultimately help drive the auditor’s professional judgment? Please give reasons for your answer.**

Yes, it would help drive the auditor’s judgement, although this would in our opinion not be decisive because we understand that the principles identified so far by the Board have been picked up here and there from existing material in the ISAs.

For the sake of clarity, “fundamental principles underlying an ISA audit” should not be confused with the “principle based approach” we support for the conduct of an audit. The principles we refer to in § 1.7 and 2.4, would represent a broader set of principles, including professional requirements.

- 2.9. Should the establishment of such principles be considered a high, medium, or low priority of the IAASB for the immediate future?**

Developing clear cut policy and drafting standards with a principle based approach should remain high priorities.

The proposal for a modernised Directive on statutory audit stresses the importance of ethical professional behaviours. We fully subscribe to the idea of cross-cutting fundamental principles proposed by the Board. Though an important exercise, we would rate this at lower priority rank at this stage. The Board should rather focus for now on other priorities such as implementing the Clarity project.

- 2.10. Do respondents consider the proposed fundamental principles to be complete and appropriate, and do respondents believe the method by which they have been derived to be appropriate? If not, what matters do respondents believe should be considered in development of the fundamental principles?**

See § 2.9.

- 2.11. Do respondents believe that the fundamental principles should be expanded to serve as a basis for all assurance engagements?**

We support application at least to statutory audits.

- 2.12. Do respondents agree with the proposed authority to be afforded the fundamental principles?**

We agree.

Fundamental principles governing professional behaviour, including those derived from the Code of Ethics, should have the appropriate – highest – authority.

- 2.12. a. Do respondents believe the present description of the authority of Practice Statements to be clear and understandable? If so, do**

**respondents agree with the authority that is afforded them? If not, what should be the authority of Practice Statements?**

The authority to be given to IAPS will depend on their content (which we comment in §2.14). As potential future “users” of IAPSs, we do not support the idea of an expedited approval process following from the fact that IAPS may carry lower authority. In our view, although not meant to contain professional requirements in addition to ISAs, the IAPSs carry some authority deriving directly from the subject that is being dealt with. As mentioned in Articles 2 and 26 of the 8<sup>th</sup> Directive, the Commission may adopt any “related Statements and Standards”, including IAPS if needed. We favour the solution where IAPS would follow the same due process as ISAs. Absent relevant due process, this might as such be a reason for rejecting the adoption of an IAPS under Article 26(3) of the Directive.

**2.13. Given the existing authority of Practice Statements and their use in providing additional guidance to International Standards, should the IAASB change the style in which Practice Statements are written? To the extent they are derived from professional requirements contained in an International Standard, should Practice Statements enunciate professional requirements?**

The question to this answer heavily depends on how the Board intends to use IAPSs. But our general view is that IAPSs should not enunciate professional requirements in addition to ISAs.

**2.14. Taking account of the options identified above, what future role should the IAASB consider for Practice Statements? Are there other options that the IAASB should consider? Please explain why a particular option is being suggested and how it might be of benefit.**

Given our preference for Option A as stated in § 2.6, IAPSs would include the explanatory material presently included in ISAs. Our perception is that in addition IAPSs may deal with issues that cannot be dealt with by ISAs. For instance, IAPSs can be used to cover industry-related matters (specific issues to consider for the audit of banks, assurance, or listed companies, ...), or events limited in time (year 2000, transitional periods, ...).

Generally, recurring or cross-cutting topics should form part of ISAs themselves. For instance, the use of IT in an audit should fully form part of ISAs because IT is now widely spread throughout the audited entities. This should be the same for specific instruments or techniques (the audit of derivatives, long term contracts, ...) that are likely to be met any time in various industries.

As has been contemplated for ISA 600 – the audit of groups, IAPS related to a specific ISA should rather form part of the guidance and background information of the ISA.