BUSINESSEUROPE

DG Internal Market and Services
Auditing Unit-F4
Rue de Spa 2
1049 Brussels

14 October 2009

Dear Sir or Madam,

BUSINESSEUROPE welcomes the Commission launching a public consultation on the adoption of International Standards on Auditing (ISAs). BUSINESSEUROPE supports the adoption of the ISAs.

However, the legal instrument to be applied as well as the status of the application material is still to be clarified. For BUSINESSSEUROPE it is essential that the auditing standards do not change the management's responsibilities. Auditing Standards are professional standards for the auditors and regulates the way auditors perform their audit. Management responsibilities are set out in the Company Law and should be identical regardless of whether the company is subject to an audit or not.

Therefore a formal adoption of ISA's in Europe should clearly state that the management's responsibilities mentioned in the ISA's form a premise for the drafting of the ISA's and do not impose a separate responsibility on management. We note that the ISAs clarify management's responsibilities used as a premise for drafting the standards. For BUSINESSEUROPE it is important that any future revisions do not extend these responsibilities.

You will find our responses to the questions in the attached paper.

Yours sincerely,

Jérôme P. Chauvin
Director
Legal Affairs Committee
Internal Market Committee

Encl.1

THE CONFEDERATION OF EUROPEAN BUSINESS a.i.s.b.l.

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COMMENTS

14 October 2009

CONSULTATION ON THE ADOPTION OF INTERNATIONAL STANDARDS ON AUDITING

Question 1: Is international acceptance of the ISAs sufficiently demonstrated?

We believe that the steps taken by IFAC / IAASB are contributing to an international acceptance of ISAs. However, we note that users and preparers have no representation in the Standard setting boards and that public interest representatives (essentially regulators) hold 3 out of 18 seats. We acknowledge that CAG is set up in order to consult with non-audit stakeholders and to receive input into the standard setting process, and would like to note that BUSINESSEEUROPE is a member of the CAG. We would also like to note, that the CAG as well as the Boards has a global representation, which increases the global acceptance, but we still find that the standard setting process could be enhanced if preparers and investors were represented directly in the standard setting boards.

BUSINESSEUROPE finds it unfortunate, that US has chosen not to adopt the ISAs directly, which we believe should be reflected in the distribution of seats in the IAASB and the monitoring board. Having said this, we believe that sufficient international acceptance has been demonstrated, as the standards are in general accepted on a global basis.

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

We find that amendments to the standards should be kept to an absolute minimum. The strength and benefits of international standards lies in them being identical on a global basis. If amendments are made this may dilute the benefits derived from using the international standards (especially on the cost of capital) and have an impact on the reference to the appropriate standards in the audit opinion thereby reducing the benefits for business.

As a consequence amendments should only be considered if the ISAs are in conflict with EU-legislation. It should, for instance, be ensured, that ISAs do not change management responsibility, because management responsibility is regulated in the company law directives (and appropriate national legislation), and management should have the legal certainty that their responsibilities are only regulated there. This approach also ensures that management responsibility is identical whether the company is subject to an audit or not.

It should be noted that if amendments are made these should be communicated clearly to the market by the Commission, for instance, in the form of a precise fact sheet describing the exact amendments.

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

Carve outs should not be acceptable by Member States. In order for the ISAs to become a success in Europe, the standards should be identical in all Member States. This ensures that companies and auditors alike are familiar with the requirements in the other Member States and can streamline both the preparation of documentation performed by the companies as well as the audits conducted by the auditors. If carve-outs are permitted, there is a risk that the harmonization benefits may be deluded as users (including companies) will have to access the specific carve-outs.

One should also be very careful with add-ons, as they increase the costs of audits both due to the direct costs of the specific add-ons as well as the indirect cost related to differences in documentation etc. (streamlining the reporting and auditing process). Therefore, BUSINESSEUROPE is in principle against add-ons.

Having said this, we believe there may be special areas of interest in specific Member States that are of sufficient importance to mandate an add-on. However, it should be ensured that add-ons are kept separately from the ISAs and that the audit opinion can refer to audit conducted in accordance with the ISAs. Further, reference in the audit opinion to work in relation to add-ons should, in accordance with ISA 700, be the separate paragraph "Report on Other Legal and Regulatory Requirements" below the audit opinion. This ensures that users not familiar with the specific add-ons of a specific Member States would still be able to rely on an audit opinion without looking into the special requirements.

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

BUSINESSEUROPE acknowledges the work performed in the Duisburg/Essen-study regarding the cost-benefit analysis. However, in our opinion the report does not clearly present the overall cost/benefit analysis.

According to our reading of the study, the conclusions from a business perspective are as follows:

<u>Costs</u>:

The costs are estimated on audit firm level, and the study concludes that:

- the recurring costs of an audit could increase by approximately 6% to 10% per engagement <u>depending on the size of the audit firm</u> plus overhead costs for both audit firms and regulators, and;
- the cost increases will be higher for small and medium sized entities, with estimated increases in the range of 900 – 2.600 EUR per year on the audits of medium-sized entities and extra costs for audit-clients of around 2.200 EUR (weighted average);

- the one-off costs would be approximately 13% to 14% extra per engagement plus overhead costs for both audit firms and regulators.

The study does not clearly state to what degree these costs are passed on to the clients as those responding to the Duisburg-Essen questionnaires considered that this would be something that would be determined by the market and would likely be different for different audits. (indeed it concluded that an inadequate number of big-four and mid-tier firms responded to these questions and that an insufficient number of other respondents expressed their views). However, of a total of 779 million EUR in estimated extra costs per year, half is directly attributed to business due to extra work to be performed by business. BUSINESSEUROPE finds these costs to be quite high and is concerned that the total costs will be passed on to business. BUSINESSEUROPE would like to stress that in the current economic climate business is struggling to reorganise the business in order for the cost to match the present market conditions. For these companies an increase in cost by 6 to 10 percent does not meet the expectations that business would expect from a more efficient and focussed audit and audit regulation process.

BUSINESSEUROPE noted that the main cost drivers appear to be ISA 600 “Group Audits”, which constitutes for around half of the cost increase and ISA 540 “Auditing Accounting Estimates, including Fair Value Accounting Estimates, and related Disclosures” followed by ISA 260, 265 and 550. Based on this, BUSINESSEUROPE suggests that at least these five ISAs are measured in more detail based on the detailed description of changes in the appendix. This measurement should take into account changes in the 8th-Directive and attribute costs to the Directive, if the changes are mandated by the directive and not by the auditing standards. Further, BUSINESSEUROPE suggests that the Commission should collect data on the costs associated with complying with these ISAs and ensure that the IAASB in subsequent revisions take account of these extra costs..

<u>Benefits</u>:

The study estimates that the introduction of ISAs would lead to a decrease in cost of capital of 9.950 million EUR. These estimates are on estimates of a reduction in capital costs averaging 10 basis points.

<u>Conclusion by the study</u>:

“The study concludes that, on balance, an adoption of the ISAs in the EU would result in quantitative and qualitative benefits for companies, investors and regulators. These recurrent benefits would outweigh increases in audit costs.”

BUSINESSEUROPE finds the estimated benefits to be very volatile, and BUSINESSEUROPE do not find the conclusions are supported by sufficiently robust data, especially for small and medium sized entities. However, BUSINESSEUROPE acknowledges that one of the purposes of an ISA-adoption indeed is to increase the transparency due to a higher degree of formal standardization achieved by a formal legal adoption throughout Europe and thus to decrease the cost of capital.

Having said this, BUSINESSEUROPE take note of the estimates of the study but would like to stress that the benefits derived do not relate directly to the need for increased audit work and costs as estimated in the report, but rather to the increased level of standardization (one single label). Therefore, BUSINESSEUROPE would like a more detailed analysis of the costs of the five above-mentioned standards, as BUSINESSEUROPE are not confident in both the expected cost increases and the driver behind these increases.

Question 5: Should the Application Material be part of the adoption process and acknowledged as "best practice"?

Throughout the work with the ISAs, BUSINESSEUROPE has always considered the application material as guidance rather than specific requirements or norms that has to be applied. There are numerous examples within the application material, where the examples are illustrative and where the auditor has to exercise professional judgment in order to identify the relevant areas in the audit at hand. Thus, we do not find that the application material should be part of the same adoption process as the requirements.

We would suggest finding inspiration in the area of the adoption of the international accounting standards, where only the mandatory parts are subject to an adoption process.

We would strongly oppose the Application Material to become mandatory or best practice (and in reality a list of requirements). In our view, the Application Material shouldn't change label and should be kept as material issued by the IAASB.

Question 6: Should ISQC1 on internal quality controls be part of the adoption process?

We would not object to ISQC1 becoming a part of the adoption process, as it is our understanding that the audit firm would anyhow be required to fulfil the requirements set forth in the ISQC1 and thus the standard would gain a legal status through practice.

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?

We believe, as stated above, that a common reference is needed but we suggest either just to refer to the ISAs (if all ISA's are adopted) or alternatively the "ISAs as at xx December xx" (if there is a timing issue in adopting auditing standards in Europe). If there would exist carve-outs, which we do not support, then there needs to be a uniform reference and a clear communication from the Commission to the public as to the extent of the carve-out.

Further, we would suggest that the Commission requires the section with "Management Responsibility" only to refer to the appropriate paragraph in the Management Report, where the management in a separate paragraph essentially states the same responsibilities as the section in the Audit Report. We would like to underline that Management Responsibility is regulated in the company law directives, and that the section in the Auditors Report is more designed to shift focus away from the work performed by the auditor. By removing the section with the management responsibilities it becomes a little more clear for the reader what work the auditor has performed and the conclusions of this work. ISA 700 already acknowledges mandatory departures from the draft audit opinion in ISA 700.

Question 8: Do you support adoption of ISAs at EU level?

We still find that the benefits should be presented more clearly. For the listed companies we do support a EU-adoption of ISAs as this would increase the transparency. We have noted that there is a significant cost increase on audits performed under the latest ISAs, and that the cost increases are highest (in percent) for smaller audits. In this light, we find that more emphasis should be put on removing the mandatory audit requirement for smaller businesses and to differentiate in the audit of large, listed companies and smaller, unlisted companies.

Question 9: If yes, which of the following options do 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 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 – ISAs should be adopted for the statutory audit of all companies, including small companies for which an audit is required.**

We would support option 2, as the audits of small entities should be out of scope of the Directives. Further, with option 2 the Member States will be able to find solutions that matches the requirements of the specific Member State, taking into account the stakeholders at a national level and the costs associated with a full blown ISA audit for a small entity. BUSINESSEUROPE would at the same time ask the Commission to find a way to reduce the costs of audits for medium and large unlisted companies (or consolidated accounts).

Question 10: Do you have comments on the timing in case of an adoption of the ISAs?

We would suggest that the adaption of the ISAs is started as quickly as possible in order for the adaption to be in place for audits starting on 1 January 2011 at the latest.

BUSINESSEUROPE would welcome a timetable for the further deliberations regarding a possible adoption of the ISAs.

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