Setting the global standard for investment professionals

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16 May 2007

Dear Jürgen,

CONSULTATION ON IMPLEMENTATION OF ARTICLES 45 – 47 OF THE DIRECTIVE ON STATUTORY AUDIT (2006/43/EC)

The CFA Institute Centre for Financial Market Integrity (the Centre)[1] appreciates the opportunity to comment on implementation of Articles 45 - 47 of Directive 2006/43/EC on Statutory Audit, regarding cooperation with non-EU jurisdictions on auditor oversight.

The Centre represents the views of investment professionals, including portfolio managers, investment analysts and advisors located in over 130 countries worldwide. A long-standing goal of the Centre is promote fair and transparent global capital markets and investor protection. An integral part of the goal is ensuring the quality of corporate financial reporting and disclosures provided to investors and other end users of this information. The Centre also develops, promulgates, and maintains the highest ethical standards for the global investment community through such standards as the CFA Institute Code of Ethics and Standards of Professional Conduct.

General Comments

Overall, the Centre supports the objectives of Directive 2006/43/EC on Statutory Audit, aimed at underpinning the overall quality of audit in the EU and, when properly implemented, sees the Directive as a significant step forward for investor protection in Europe.

[1] The CFA Institute Centre for Financial Market Integrity is part of CFA Institute. With headquarters in Charlottesville, VA and regional offices in New York, Hong Kong and London, CFA Institute, formerly the Association for Investment Management and Research®, is a global, non-profit professional association of more than 90,900 financial analysts, portfolio managers, and other investment professionals in more than 134 countries of which more than 78,200 are holders of the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 134 Member Societies and Chapters in 55 countries and territories.

In this context, we urge the Commission to strive to meet these objectives with the appropriate level of flexibility and pragmatism that may be needed in the process of implementing the Directive. Ensuring the credibility and reliability of companies' financial statements is upheld through high quality assurance and is consistent with the pursuit of Europe's long term competitiveness as one of the world's leading capital markets.

Furthermore, the Centre supports strongly Europe's efforts towards converging international standards and the equivalence of requirements for audit firms in order to foster fair and orderly markets. This effort, combined with the process of convergence and equivalence in the area of International Financial Reporting Standards, holds the promise of contributing significantly to fair, transparent and efficient global capital markets.

Specific comments

Regarding the specific questions raised in the Commission's consultation, the Centre will focus its comments on those areas addressing whether and under what terms transitional periods should be granted to third country auditors.

Question 1:

Do you have further comments, or concerns to share, on the equivalence?

The Centre supports a principle-based approach to the assessment of equivalence of third country public oversight systems. However, principles must be clearly stated and unambiguous to ensure a consistent assessment of third country's financial reporting system. We believe that the assessment should include an evaluation of the auditor's role in financial reporting and the audit oversight systems currently in place by (1) the publicly traded companies (audit committee and internal controls relating to financial reporting), (2) auditors (audit quality controls and approach to conducting audits) and (3) regulatory oversight of auditors (inspection and/or enforcement of audit standards).

Ultimately, these assessments should focus on the third country's public oversight systems and whether such systems meet objectives of the Directive 2006/43/EC. We believe it would be difficult to perform a line-by-line assessment of third country and European frameworks given their current diversity. As such, the horizontal assessment criteria set out in Directive 2006/43/EC appears to be an appropriate approach to evaluate the equivalence of the independent external quality assurance, effectiveness of domestic investigations and penalties, and a comprehensive set of responsibilities of the public oversight authority.

While supporting the approach that equivalent should not mean identical, the Centre would take this opportunity to caution the Commission against pressures to reach "equivalence findings" for convenience or political expediency. The overall quality of the audit of financial statements should not be compromised due to overly loose interpretation of "equivalent". To this end, we urge the Commission to assess clearly third country financial reporting/audit systems to avoid results which may be detrimental to investors and their overall confidence in the auditors' opinion and quality of financial reporting.

Question 2:

Do you have comments on the need for transitional measures?

The Centre recognizes the need for time-limited transitional solutions to be implemented under Article 46 of the Directive. This position reflects the need for pragmatism given the current situation in international auditor oversight and the encouraging process of convergence in these oversight arrangements being initiated by the International Federation of International Audit Regulators (IFIAR).

Transitional measures should be used to provide incentives for third countries to develop their own equivalent systems of audit regulation and oversight. To that end, granting such transitional measures should be *conditional* upon a commitment to establish an equivalent level of auditor oversight as outlined in the Directive, and should be *time-limited*. As such, we believe that a five-year period is adequate for establishing such oversight arrangements.

Furthermore, to uphold the objectives of Directive 2006/43/EC, the Centre believes strongly, and thus recommends, that such transitional measures should be transparent to investors and as such, disclosures should be required explaining the transitional measures and current status of equivalence. For example, the disclosure would detail those material entities within a company's financial statements which have not been audited by auditors subject to equivalent oversight to that exercised in the EU. The disclosure would not constitute a qualification of the accounts but rather ensure full transparency for investors regarding the quality of assurance applied to the financial statements.

Question 6:

Do you have comments on the use of International Standards on Auditing (ISAs) and US auditing standards (US GAAS)?

The Centre supports the principle of international convergence in auditing standards. Overall, such convergence should enhance international audit quality, maintain investors' confidence and lead to greater efficiency for auditors and their overseers. Although ISAs represent an international set of audit standards, we believe that further effort is needed to improve certain aspects of these standards. The IAASB is addressing areas of concern to us through several of its current projects whose objective is to improve the current ISAs.

In particular, we are interested in the outcome of the following projects:

- **Clarity Project** – review and amendment of the language used in IAASB standards to describe the responsibilities of the professional accountant, including use of the present tense in IAASB standards. In addition, it is to consider other aspects of the clarity and structure of IAASB standards.

We are particularly interested in this project since it addresses all the ISAs with an aim to ensure that these audit standards are applied consistently in a manner to produce high quality audits.

- ☐ **Auditing Accounting Estimates including Fair Value Measurements and Disclosures** – redraft existing standard in accordance with the clarity drafting conventions agreed by the IAASB to be applied to all ISAs, and to revise it to include auditing considerations relating to fair value accounting estimates and disclosures.

  We have a strong interest in this project because it addresses two very important areas to end users of financial statements – fair value and disclosures. The Centre recently conducted a survey of its membership on financial reporting and measurement. Respondents to the survey indicated a preference for fair value measurement and recognition of assets and liabilities on the balance sheet with historical cost disclosures as well as information about key assumptions, sensitivity analysis, and cash flows. The final copy of the survey is expected in early June 2007 and will be available at the Centre's website - **http://www.cfainstitute.org/centre/reporting/surveys.html**.

- ☐ **Audit of Group Financial Statements** - revise ISA 600, *Using the Work of Another Auditor* to deal with the special considerations in the audit of group financial statements and, in particular, the involvement of other auditors.

  We are interested in this project since it addresses the quality of audit work performed by other auditors for which the primary auditor relies on the work performed to opine on the consolidated financial statements and who are not the primary auditor (or signatory on the audit opinion).

We believe that these projects need to be completed in a satisfactory way to ensure that high quality audits of publicly-traded companies' financial statements are performed. Additionally, we believe that IAASB and the U.S. standard setter (Public Company Accounting Oversight Board) need to work together on converging audit standards with an ultimate goal of having "virtually" one set of high quality audit standards used for financial reporting within the global capital markets. In this regard, the Centre welcomes Directive 2006/43/EC assigning International Standards on Auditing (ISAs) as the reference point for auditing standards in Europe.

We support the Commission's proposal to allow, for a transitional period, the use of ISAs or US GAAS for third country audits of EU listed companies. Permitting such a transitional period may be needed to avoid unnecessary costs and difficulties for third country auditors without compromising Europe's standards of investor protection.

Conclusion

We thank the Commission for its consideration of these comments and CFA Institute Centre for Financial Market Integrity looks forward to contributing to the Commission's work in this area gong forward. If you should have any questions, please do not hesitate to contact me.

Sincerely,

/s/ Georgene B. Palacky

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Director, Financial Reporting Policy
CFA Institute Centre for Financial Market Integrity

Cc: Jeffrey Diermeier, CFA, Chief Executive Officer, CFA Institute
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