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Individual Initiatives, Collective Solutions: Recent Developments in the International Auditing and Assurance Standards Board's (IAASB) Agenda

It is my pleasure to be here today at this important initiative of ESMA. It brings together international and European leaders responsible for standard setting, supervision and enforcement for today's capital markets.

The International Auditing and Assurance Standards Board (IAASB) is a global independent standard-setting body. It serves the public interest by setting high-quality standards for auditing, review, other assurance, quality control, and related services. Through its standards, the IAASB seeks to enhance the quality and consistency of practice throughout the world and strengthen public confidence in the auditing and assurance profession at the global and local levels.

I was appointed IAASB Chairman in 2009, when work to establish the clarified International Standards on Auditing (clarified ISAs) was just completed. Many had thought the IAASB program would be much more subdued than it had been. Of course, that has not been the case.

And so I found it very interesting listening to Mr. Hans Hoogervorst, International Accounting Standards Board (IASB) Chairman, in his speech before me today. We heard how much commonality there is in the issues and challenges we face in leading our respective international bodies; indeed, challenges we all face in serving the public interest.

What are these challenges? There are many, and I describe only a few.

Firstly: eroding public confidence in financial reporting. The global financial crisis and continuing discovery of failures in financial reporting have done much to justify a loss of faith by the investing public.

Secondly, from this: an outcry for full transparency about risks and judgments, with users demanding more relevant and more meaningful information. For me, this echoes what I heard from discussions with investors nearly two years ago: “we care more about the soft stuff.”

Finally: the nature and pace of change in financial reporting. This stretches and challenges all of us who are involved in the financial reporting supply chain.

So we have to look forward and to continue to challenge the status quo if financial reporting, audit and the profession are to continue to be relevant.

Importance of Audit Quality

These challenges immediately make me think about audit quality. There are inputs to audit quality, like education, auditing standards, audit methodology, and quality controls, which are all important. There are also important context factors such as sound corporate governance regimes and laws and regulations. But equally important to audit quality are outputs. If you ask an investor, user or audit committee member what they think about audit quality they will not talk about inputs; these are largely inaccessible to them. Rather, they will talk about outputs: what have they received, seen, and understood. These outputs influence perceptions of audit quality and therefore are important determinants to these users’ assessments of audit quality. In the context of an audit, investors and other outside stakeholders often only see the standard auditor’s report. But that is very much boilerplate, so how do they see quality if relevant information is not being provided? Importantly, they understand there is more information available and they want to know it too.

Audit quality is equally influenced by effective relationships. Think about the dynamic amongst regulators, preparers, investors and auditors, and how actions – or inaction – of one can affect the others. Progress and change can be made even more substantively when all stakeholders move towards thinking how collectively they can make improvements, and stimulate – even demand – others to improve. Consider the example of an active, engaged audit committee that is probing, challenging, and stimulating in its discussions with the external auditor. Consider then how that compares to the case where an audit committee is only focused on having the audit completed soon and receiving the auditor’s report.

With that general introduction, let me turn to three themes central to the work of the IAASB: enhancing a robust auditing platform; responding to the global financial crisis; and promoting transparent, relevant reporting.

Robust Auditing Platform

I am encouraged by the recent European Commission (EC) proposals that now make explicit reference to the use of the clarified ISAs in Europe. For me, this is clear recognition of the importance of the ISAs as part of audit reform. It also certainly is a positive acknowledgement of the many years of hard work of my predecessor John Kellas and the IAASB then.

But why ISAs? Let me highlight a few important attributes of the clarified ISAs.

Firstly, they focus on the appropriate and sound use of professional judgment and explicitly address the importance of professional skepticism. They stimulate a “thinking audit”, not a mechanistic one, focusing on: what are the risks of misstatement and what evidence does the auditor need, what does that evidence tell the auditor, what does the auditor need to discuss with those charged with governance, and what needs to be told in the auditor’s report?

Secondly, they include more robust requirements in relation to, for example, risk assessment, materiality, evidence gathering, and communications. Nearly half of the ISAs had been substantively revised as part of the Clarity project. A particularly important ISA is the revised standard on accounting and fair value estimates and related disclosures.

When we engage in dialogue with audit regulators and inspectors, we learn that a number of their concerns are observed in the context of the application of national standards or the pre-clarified ISAs. We believe that the adoption and effective implementation of the clarified ISAs, including adequate training on them, will lead to added rigor in audits. Of course it is not possible to say that the clarified ISAs will address all issues, but we believe they go a long way to enhancing audit quality.

Now, as Mr. Hoogervorst did in relation to International Financial Reporting Standards (IFRS), let me turn to the question of how far the world is moving towards global adoption and use of the clarified ISAs.

There are now more than 75 countries around the world that use or are committed to using the clarified ISAs in 2011 and beyond. In Europe, already 20 of 27 European Union (EU) Member States and a number of others are in this position. And countries like Germany and France have done much already to align their national standards with the ISAs, and when the draft EC Regulation and Directive come into effect we will see them and others become fully aligned.

Beyond Europe there is also much progress: Canada; Brazil, with their speedy translation of the ISAs into Portuguese; many Latin American countries, now there is one global Spanish translation; US, for private companies through its own Clarity project; Asia-Pacific, for example Australia, New Zealand, China, and Japan very soon; and many countries in Africa. Also, the 24 major audit firm networks already have their methodologies aligned with the clarified ISAs. I should add to that the adoption by INTOSAI, the global organization of Supreme Audit Institutions, of ISSAIs, the public sector version of the clarified ISAs. So, this is very much telling of the demand for and acceptance of a common auditing language on a global basis, both for the private and the public sector.

While this is all very encouraging, it is important that we also take a broader view and think about how we can further assist, especially in relation to effective implementation. In this regard, leadership and staff of IAASB, IASB and IFAC jointly hosted two days of meetings this week with representatives from 12 Commonwealth of Independent States (CIS) and Baltic countries. Delegates included representatives from ministries of finance, regulators, national banks, and professional bodies. There were a lot of important questions asked, for example: how best to organize and structure public oversight; what are best practices for quality and inspection regimes; and what can we learn from those before us? This signals the importance for the IAASB and IASB, and indeed ESMA and others, to have a dialogue with emerging economies to help them move forward on ISA and IFRS adoption and implementation in a focused and quality way.

In this regard, also like the IASB, the IAASB is committed to ongoing improvement. We have initiated a post-implementation review of the clarified ISAs to better understand how well the standards are being understood and consistently applied, and whether the objectives the IAASB had in mind when developing the standards are being achieved.

In this respect, our dialogue with audit regulators becomes essential. With much thanks to Mr. Maijoor in his former capacity as chairman of the International Forum of Independent Audit

Regulators (IFIAR), there is a solid foundation for ongoing dialogue between the IAASB and IFIAR. Equally, we encourage – and listen – to input from such groups as the International Organization of Securities Commissions (IOSCO), ESMA, IASB and from other important stakeholders represented on our Consultative Advisory Group.

The Global Financial Crisis

Now, let me speak a little bit about IAASB's initiative to help respond to lessons learned from the global financial crisis.

One cannot think about the crisis without also thinking about financial instruments. Relevant, therefore, is our recently approved (subject to necessary approval by the Public Interest Oversight Board) new International Auditing Practice Note (IAPN) 1000, *Special Considerations in Auditing Financial Instruments*. This IAPN provides important material that will assist auditors in understanding the nature of, and risks associated with, financial instruments, and the different valuation techniques and types of controls that may be used by entities in relation to them. The IAPN then highlights important audit considerations that may be relevant throughout the audit process. The IAASB understands that the quality and consistency of audit practice is helped not only through new standards but by other tools that can be used in developing training programs, internal guidance or corresponding national material. New IAPN 1000 helps serve this aim.

The IAASB also recognizes that there might be need for further guidance in the ISAs themselves relating to financial instruments in the future. This doesn't mean the ISAs are not high-quality or in some way deficient. But the world continues to evolve, for example in terms of industry practice for third-party pricing sources. Accordingly, we will actively explore whether, and if so how, the ISAs should be enhanced in respect of developments in this important and complex area.

Not unrelated, the IAASB also sees that more needs to be done in relation to addressing matters relevant to the banking sector. It therefore intends to work closely with Basel Committee on Banking Supervision, and others as appropriate, in exploring guidance on the relationship between auditors and banking supervisors.

Taking a broader view, the IAASB sees the critical importance of effective dialogue with the IASB on the auditability, or verifiability, of IFRS. The IAASB doesn't comment on the technical

accounting merits of the financial reporting standards proposals; rather we focus on suggesting, where appropriate, ways that the same objectives of the proposal could be achieved but perhaps in a different way so as to help ensure auditability. I look forward to meeting again with Mr. Hoogervorst and his team in January to further discuss IASB and IAASB liaison efforts.

Transparent, Relevant Reporting

Finally, the topic of promoting transparent, relevant reporting.

I mentioned at the outset of my speech that there are many calls for more informative reporting. We've been proactive in this respect by commissioning a few years ago research on user perceptions of the standard auditor's report. This effort was immediately followed by our May 2011 consultation paper on exploring options for change to auditor reporting. The US Public Company Accounting Oversight Board (PCAOB) followed a month later with its own concept release, and we see striking similarities in the comments by stakeholders on both consultations, showing how global the issue is. And we see now initial thinking by the EC also around how to help enhance the transparency and relevance of auditor reporting.

What is at issue? Users and regulators alike are demanding to know more about individual audits and to gain further insights into the audited entity. While the audit is valued, many perceive that the auditor's report lacks communicative value. So, can auditors do more? That is the question, but the answer is not straightforward. There are many complex issues, for example: who should report any such additional information – the entity, in the first instance, or auditor? Management is ordinarily seen as the first source of information about an entity, but some believe auditors should contribute by telling their independent view about matters such as key risks. Also: can auditors comment more about key aspects of their audit and draw users' attention to areas of the financial statements where attention should be placed?

Interestingly, the UK is placing greater priority on reporting by audit committees, as part of the solution to the information gap. And in France, they use the so-called "justification of assessments", which has been implemented successfully, though it is not without room for further improvement.

At its upcoming meeting next week, the IAASB will be asked to consider a project to revise its reporting standards, and as appropriate its other communication standards. I expect there will

be broad support for the IAASB to make changes to ISA 700, *Forming an Opinion and Reporting on Financial Statements*, and related ISAs on a priority basis. But we will also be mindful of doing this in a way that can accommodate different national reporting regimes while at the same time ensuring that common and essential content is addressed. An active dialogue with the EC, PCAOB and other standard setters will be important.

Taking a broader view, I should also mention IAASB's recent Discussion Paper on disclosures. This publication is aimed at stimulating thinking about audit implications of disclosure reporting trends and to learn about perspectives of preparers, regulators, investors, auditors and others. From stakeholder comment letters on consultation, we heard broad support for this IAASB initiative but also the overwhelming view that improving disclosures will require cooperation and collaboration with many such as the IASB and others that are exploring disclosure frameworks. This cooperative and collaborative spirit will be at the forefront of our minds as we further explore the topic of disclosures. As an immediate step in this respect, the IAASB plans to release a feedback statement by the end of the year to share what we heard on consultation, and help stimulate further thinking and dialogue on this important topic.

Taking an even broader view on transparent, relevant reporting, one cannot overlook what the future may hold. Consider emerging areas such as integrated reporting, XBRL, and reporting on corporate governance, to name a few. In developing its future strategy and work program the IAASB intends to establish a special group focused on actively monitoring these and other developments, and to start thinking now about issues, from an assurance perspective, that are likely on the horizon as reporting practices evolve.

Moving Forward

Let me close my remarks by citing two stimulating quotes. Firstly, from ESMA's comment letter on IAASB's Auditor Reporting consultation paper:

“Auditor reporting is only one element of the broader corporate reporting process...In broadest terms it is important to explore ways for enhanced corporate reporting models.”

Secondly, from IAASB's January 2011 Audit Quality publication:

“The continued enhancement of audit quality depends not only on the IAASB’s efforts but also on the active engagement of all stakeholders in the debate.”

For me, these demonstrate how important it is to take a broader perspective when thinking about how we move forward, and that only through collective efforts can all of us be successful in implementing fundamental and meaningful change. Together I am confident we can make the future a success. Thank you for the opportunity to engage with important stakeholders such as yourselves.