

The setting of international standards on auditing and on accounting ethics.

Professor Irina Kuzmina (ICFM Eastern Europe) is interviewing David Damant, the chairman of the Consultative Advisory Group of the International Auditing and Assurance Standards Board [www.ifac.org/iaasb].

What is the Financial Reporting Chain?

The aim is to provide investors or the other users of the financial statements (which I will call accounts from now on) with accounts which they can rely upon. In the capital markets which is the most important place the analyst or investor can take from the accounts the financial information which is needed to make a judgment about the company or for any other decision they need to make. Now for that you need first of all within the company a good corporate governance, then you need good accounting standards, then you need good auditing standards, then you need good regulation of the various markets - or in other words how the financial reports are being presented to the investor - and finally when the figures are in hands of the investor the correct judgment has to be made about the pricing of shares and so on. Now of course if you have one weak link in that chain then the investor won't get what he wants. I think it is very important to bear that in mind, but the other view is this: just because some element in the reporting chain is weak (for example, let us say that in the particular country they are not very good at the corporate governance,) that is no excuse for not getting other links right (for example to get new accounting standards, or the auditing standards right). And eventually over time the other links will be put into place. So when you or anyone else is considering anything like the auditing standards which we shall be talking about, you have to remember that it is a part of that chain.

How are the International Standards for Auditing set?

It is very important here to look at the history. The International Federation of Accountants (IFAC) has been established for quite some time and until 2003 was really a representative ONLY of the accounting and auditing profession. Within IFAC a considerable amount of work has been done on behalf of the profession and in the setting the various standards. I think I should point out at this stage that before the IFAC was established, the International Accounting Standards Board (IASB) was established and has been independent ever since. And the IASB which is based in London is completely independent of IFAC. It is very important to remember that because in some places people tend to think that the accountants and auditors are the same. Everything is within the IFAC except the accounting standards. Now as I say there are many activities within IFAC and two of these relevant to our today's discussion are the International Standards on Auditing and International Standards on Ethics . We are mainly talking today about the International Standards on Auditing which are the ISAs. I would like to add one more thing about this: in 2003 there was considerable discussion as to whether the setting the standards for the accounting and

auditing profession should be set by the professionals themselves - which seemed not to be right. And various bodies like the World Bank, the International Organizations of Securities Commissions, the Basel Committee which sets the balance sheet ratios for banks and various others (including most recently the European Commission) - all these bodies set up a new system within the IFAC structure and I will mention two essential elements.

The first was the Public Interest Oversight Board (PIOB) established with representatives of all those bodies which I have just mentioned. The PIOB was set up to make sure that due process within IFAC has been followed and all processes are conducted in the public interest not just in the interest of the professional accountants. The second is that in certain cases including the setting the standards for ethics and the setting the standards for auditing Consultative Advisory Groups (CAGs) were established or developed, consisting of the people who were interested in the standards but were not themselves auditors. So that for setting standards the Boards are checked by the CAGs. And as you know I am the Chairman of the CAG of the Board which sets auditing standards. So that is where it gets technical input from people who know about auditing but are not auditors . Whereas the PIOB is set up to check due process for the production of standards, not the technical content.

What is the present state of the ISAs?

One of the other changes which was made as the results of reforms which I have just mentioned concerns the constitution of the International Auditing and Assurance Standards Board (IAASB). I should explain that the IAASB does not only set standards for audit - it also sets standards for other sorts of assurance because there are some activities like compilations and reviews which are less rigorous than the audit of the accounts and have a lower degree of assurance for the user. But of course the main activity of the IAASB is to establish standards for the full audit. Now, one of the changes which was introduced as part of the reform which I have already mentioned was that a number of non-practitioners were put on the IAASB and the Ethics Boards. That is up to 50% were not auditors but the people with the public interest at heart. Nevertheless they will all be experts in auditing which is not the case for the members of the CAGs who come from all sorts of background and who are interested in auditing but are not necessarily experts. I can give an example of the sort of person who comes onto the IAASB but not a practicing auditor in the usual sense of the word. You might have the Auditor General from a country - that is the head of the government body which audits the national accounts . We also have in another case a member who until recently was the head of the tax organization in one particular country. These people are on the board and there are 18 of them. They have to have a certain number of votes in order to pass a standard. So that is the present organization of the IAASB and I'll just make one or two further comments.

The former chairman of the IAASB John Kellas - who was before that a very senior partner of the KPMG - led the IAASB, through a complete revision of the all the ISAs, put them in much more clarified form. It was called "The Clarity Project" and if you look at the IAASB website

you will see the separate section explaining this project. ISAs are now better organized than the previous standards and state what the objective of each standard is, and what are the requirements which the auditors should ensure that he or she follows when looking at financial statements. So that was the big project which was finished last December.

The new Chair of the IAASB is not a former senior auditor although he does have auditing experience. Arnold Schilder was previously at the Central Bank of the Netherlands and at this stage, now that the Clarity Project is finished the IAASB is widening out the scope of the standards. For example we are implementing a standard for the auditing of Carbon Emissions now that we see the considerably interest in the environmental issues. Of course with his background Mr Schilder is devoting a very great deal of time to relationships with all sorts of bodies and all sorts of countries throughout the world and planning the next phase of work and also of course how the auditing standards are implemented.

What is the role of the CAGs in developing the standards on auditing and on ethics?"

As I explained earlier the membership of the CAGs, which essentially I built up over time, is people from around the world who are not auditors and nevertheless are very interested in assuring that the standards for auditing are correct. If you look at the IAASB and IESBA websites and click on CAG you will find the membership for my CAG on auditing and also for the Ethics CAG. We have several regulators such as the World Bank, the International Organization of Securities Commissions and we have many users such as the CFA institute, the International Corporate Governance Network, the World Federation of Exchanges and so on. In setting up the membership in the CAG we tried to find a spread of interested parties both by profession whether they are regulators or investors or whatever they could be, or the spread by geography so that we have representatives from all significant parts of the world. I think we are fairly near finishing the membership of the CAGs but have room for two or three more if somebody suitable appears. For example recently we brought in representatives of the regulators from the Gulf in the view of growing importance of that area

I think it is important to remember that my aim with the CAG is to take the views of my members on the topics which come from the IAASB. I suppose that the projects from the IAASB can last sometimes a very short time, but usually it takes two to three years to go through the various stages, first of all the project principles, then the exposure draft which is sent to the world for comment, then further discussion before the standard is issued together with the statement of why the Board came to these conclusions. During each of those stages the document come before the CAG - especially at the beginning when it is being developed and especially after we have had the world's response to an exposure draft. I should point out that I do not (usually) attempt to have a consensus or a vote on the views of the CAG. It is not my job, I believe, to try to get a decision out of my CAG, though it has happened sometimes. But it is important for the Board to get all possible significant views

from the CAG. In the vast majority of cases the relevant members of the Board attend my CAG meetings. As a result, when they next have the meeting of the Board there are several members of the Board who have listened to the discussion of the CAG, and in addition they have the minutes of the debate. After the draft has been discussed by the IAASB something called a Report Back is prepared which checks every point in the CAG minutes of the relevant discussion and puts down what actions have resulted. Of course the Board may not agree with the CAG but they have to put down why they are accepting and taking into account the CAG views - or disagree with them. So there is a rolling procedure which enables anybody looking through the minutes which are published to see how the arguments were handled.. It is all transparent and very clear. I would add just one thing - as I said to you earlier , the Public Interest Oversight Board is responsible for making sure that the whole process follows the acceptable due process in the public interest. From now on when a new document is reaching its last stage my CAG also has to decide whether in the view of the CAG the IAASB has followed the due process in talking to the CAG. That does not mean the IAASB has to agree with the CAG - the IAASB makes the decisions. But over the years they have taken significant note of what was said in the CAG. On two or three occasions the views of the CAG have resulted in the very considerable change to documentation.

Could you give your opinion on significance the question of ethics among the professionals?

As I mentioned to you earlier, there is a separate Board called the International Ethics Standards Board for Accountants (IESBA). That is completely separate from the IAASB. And for example there is also a Board dealing with educational matters. Commenting on ethics I would first of all say that the Board is concerned with ethics in general , that is the ethical behavior of an accountant in business which also will be covered by the Ethics Code. However for the purpose of this discussion we are really talking about the ethics of auditors. The work of the Ethics Board and therefore the work of the Ethics CAG is very much like the work of the IAASB and its CAG. In addition it is very important because it is the ethical questions which people are generally upset about. For example is the auditor completely independent from the company that the auditor is auditing? How far, for example, can the company or its directors provide entertainment for the auditor or pay for a dinner of the auditor? Obviously if the company tried to pay for the auditor to go on an expensive holiday, that would not be allowed under the Ethics Code. If you look on the IESBA website you will see the details of the work involved. What I tried to do when I was given a job of the Chair of the CAG for auditing is to have a very considerable overlap of membership between the two CAGs and this has been achieved with one or two exceptions, and we try to have our meetings back-to-back. Occasionally, the ethics people have a completely separate meetings altogether but usually, for example, my next meeting is in May 2010 and two days will be on auditing and the third day on ethics.

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He was a partner in Investment Research of Cambridge and in Quilter Goodison in London (Executive Committee). From 1977 onwards he pioneered the use of modern quantitative methods in investment management, including the indexation of equity portfolios in the United Kingdom and France. He was a founder and Treasurer of the Institute of Quantitative Investment Research.

Mr Damant is a member of the CFA (Chartered Financial Analyst) Institute and a Fellow and former Chairman of the predecessor body of the present CFA Society of the UK. He is Chairman of that Society's Sub-Committee on Headline Earnings (since 1994 this earnings number has been used in the Financial Times daily for the calculation of price/earnings ratios for UK companies, and for earnings announcements on the Johannesburg Stock Exchange). He was formerly President of the European Federation of Financial Analysts Societies, in which role he co-operated with other professions in establishing the European Financial Reporting Advisory Group (EFRAG) in Brussels, and was a Co-Chairman of the International Council of Investment Associations.

He was formerly a member of the Board and Executive Committee of the International Accounting Standards Committee, where he took responsibility for relationships with the former Soviet Union. Mr Damant has been a member of IASC Steering Committees on the Framework of Principles and on the Presentation of Financial Statements, and of the IASC's Standards Advisory Council.

Mr Damant was from 1992 the IASC member on the Russian International Advisory Board on Accounting and Auditing (together with representatives of the EU, IFAC, OECD, UN and the World Bank). He was Senior Advisor to the International Center for Accounting reform in Moscow and an Honorary Member of the Russian Institute of Professional Accountants.

Mr Damant has a degree in Logic and Scientific Method from the University of Cambridge.