
(1) Do you have general remarks on the approach and purposes of this Green Paper

As the European Commission considers what lessons may be learnt from the crisis, we welcome the debate on the wide array of audit-related questions that different stakeholders have voiced in the past few years, but would like to comment that not all of the topics are connected to the crisis. We believe that many ideas in the Green Paper would help strengthen the role of audit, encourage financial stability and further enhance audit quality. In our view, a primary consideration in the assessment of any idea presented in the Green Paper should be whether or not it will enhance audit quality. In this respect, several topics raised in the Green Paper run the risk of negatively impacting audit quality, imposing disproportionate costs on business and weakening shareholder rights.

We note that the Commission is keen to assume leadership at the international level on this debate¹. Given the global nature of the capital markets and many networks of audit firms, it is important to consider the global implications, including potential unintended consequences, of any proposals made at the level of the European Union and to carefully consider views from stakeholders from outside as well as within the European Union.

The Green Paper opens by commenting that “the fact that numerous banks revealed huge losses from 2007 to 2009 on the positions they had held both on and off balance sheet raises not only the question of how auditors could give clean audit reports to their clients for those periods but also about the suitability and adequacy of the current legislative framework”² and adds that it is therefore appropriate to debate the role and scope of audit in the general context of financial market regulatory reform.

Statutory auditors are required to act in conformity with applicable laws which set out the accounting standards used to prepare financial statements. The auditor’s mandate is to issue an opinion as to whether the financial statements give a true and fair view in accordance with the relevant financial reporting framework. Under that framework, auditors have correctly issued ‘clean’ audit reports on the financial statements of banks which were then later on the verge of collapse, for the reasons that follow.

As a first point, during the crisis many banks faced an unpredicted and sudden collapse of liquidity, which significantly and negatively impacted their financial situation in a very short period of time. The high level of interconnectivity between many banks’ activities of course exacerbated the liquidity exposure of the whole banking system.

Secondly, the banks’ financial statements recognised incurred losses, as required by law, and not expected losses. Whether or not additional provisioning was made was a matter for prudential

¹ Green Paper, p. 3, second paragraph.
² Green Paper, p. 3, first paragraph.
regulators. Financial accounting is now changing through the standards setting process, so that loan loss provisions will be more prudent³.

Finally, in several countries the auditors worked with government and/or the regulators to ensure that the liquidity crisis did not result in a collapse of the banking system. Based on detailed information auditors obtained directly from government and/or public declarations by government on its commitments to banks, auditors were able to obtain the assurance needed under applicable standards to refrain from modifying or qualifying audit reports on going concern grounds. The actions of the auditors were in accordance with applicable professional standards, economically responsible and contributed to governments’ actions to avert a total financial collapse.

Notwithstanding these points, we nevertheless agree that the role of the auditor and the scope of audit should be examined in the light of the crisis, with a view to enhancing the audit function and its contribution to financial stability and to confidence in financial markets. Evidence-based analyses will be very important when examining the current audit function. Any suggestions for future changes to audit will need to be subject to careful and in-depth impact assessments, weighing up the costs and benefits for the different stakeholders, including investors and other users of financial statements, regulators, preparers and the audit profession as a whole, under the Commission’s “better regulation” processes⁴. As mentioned above, the impact of any suggested changes on audit quality in particular will need to be a determining factor.

(2) Do you believe that there is a need to better set out the societal role of the audit with regard to the veracity of financial statements?

The fact that auditors are subject to public oversight⁵ is a reflection of the societal role of audit. We believe that this societal role relates to the role audit plays in the transparency of financial statements and financial markets and as a contributor to financial stability. Audit’s contribution to ensuring that relevant accounting, company or other laws are respected can also be seen as part of a societal role, subject to existing differences under Member States’ laws. The extent of the societal role of the audit will depend on the characteristics of the audited entity (for example, whether it is a listed company or a bank or a privately held company).

Nevertheless, in the post-financial crisis era, we agree that there would be benefits in further discussions with stakeholders and particularly with regulators, as guardians of the public interest, on the societal role of the audit in providing an opinion as to whether the financial statements give a true and fair view in accordance with the relevant financial reporting framework.


(3) Do you believe that the general level of “audit quality” could be further enhanced?

Achieving high quality audits requires continuous improvements. Deloitte seeks to adapt and enhance its audit methodology as new auditing standards are issued and as results of practice reviews and external inspections warrant. Audit quality is a dynamic concept. We welcome further discussions between auditor oversight bodies, at the level of the European Group of Auditor Oversight Bodies (the “EGAOB”) and of the International Forum of Independent Auditor Regulators (“IFIAR”), as well as with stakeholders, on audit quality, with a view to agreeing on drivers of audit quality, promoting best practices and developing a suitable framework for judging audit quality.

We believe that audit quality has improved significantly over the years and that the audit process and reporting is valued by stakeholders. Recent research by Maastricht University, commissioned by six of the largest professional services networks, confirms that the auditor’s work is valuable for financial analysts as it increases their confidence in and reliance on financial statements and that audit committee members and CFOs value the audit and consider that the audit of financial statements meets their key expectations. The view the Commission expresses in the Green Paper that “robust audit is key to re-establishing trust and market confidence; it contributes to investor protection and reduces the costs of capital for companies” confirms the value of audit. We vigorously support efforts to enhance the quality of audits, recognising that public policy considerations should carefully address the costs and benefits of any changes that may be proposed.

(4) Do you believe that audits should provide comfort on the financial health of companies? Are audits fit for such purpose?

Audits currently consider “going concern”, but this relates only to whether there is a significant uncertainty as to the ability of an entity to continue in business. This does not provide a specific opinion on the likelihood of individual risks affecting an entity, nor to situations where a company survives but only with significantly curtailed operations.

We believe that auditors could perform some assurance work on the risk disclosures made by companies outside the financial statements, provided that (a) suitable criteria were developed to enable management to make such statements in a way which was objectively verifiable by auditors; (b) an appropriate standard for auditors would be put in place; and (c) appropriate “safe harbours” would be implemented, recognising that information about the future is inherently uncertain.

6 ‘The Value of Audit’, Maastricht Accounting, Auditing and Information Management Research Center (MARC), Maastricht University, 1 March 2010, research project commissioned by the Global Public Policy Committee, the global forum of representatives of BDO, Deloitte, Ernst & Young, Grant Thornton, KPMG and PwC., p. 4, see http://www.maastrichtuniversity.nl/web/Main/Sitewide/News1/NewReportFromMARCValueOfAudit.htm.

7 Green Paper, p. 3, 2nd paragraph.
(5) To bridge the expectation gap and in order to clarify the role of audits, should the audit methodology employed be better explained to users?

We believe that the adoption of a single set of auditing standards across Europe will help clarify the role of audits and result in the use of consistent standards throughout the EU. We suggest that it may be helpful to provide an explanation for the public as to what an audit entails, what it is and what it is not. This would increase public understanding as the objectives in International Standards on Auditing (“ISA”) are often described in technical language and may not be clear to non auditors. This could be prepared by the EGAOB, working with IFIAR and the International Auditing and Assurance Standards Board (“IAASB”). Ideally, the information would be brief and concise and could either be included alongside the audit report or be published on a website with a link provided in the annual report.

The Green Paper also questions whether the audit methodology should return to a more “substantive audit” approach, focussing on a balance sheet audit. We do not believe this is appropriate because:

- In the modern business world, many businesses have a large volume of small transactions. Whilst substantive tests of details may appear appealing in testing the year-end balance sheet, it is of less use in auditing financial performance throughout the year.
- There is no evidence of failure in the audits of balance sheets of banks arising from the use of modern risk-based auditing techniques which use a mixture of control and substantive assurance.
- The increased use of computerised accounting systems generally means that there are reduced levels of error in systematically processed information. Controls-based auditing techniques provide efficient and effective assurance that such systems are processing information accurately; additional substantive tests of details may not therefore identify errors. Where the current risk-based approach of ISA will focus effort is in areas where computerised information systems have failed, or where items are processed non-systematically and where there is heightened potential for error and fraud. For example, ISA require explicit consideration of the risks of misstatement arising from the use of journals, which are non-systematic and hence susceptible to management override (for example, over or understatement of a provision) or processing error (for example, entry of a journal the wrong way round).

(6) Should “professional scepticism” be reinforced? How could this be achieved?

We believe that the profession already demonstrates a high level of professional scepticism; however, we agree that there is scope to achieve more consistency in the level of scepticism applied. We believe that the requirements of the new clarified ISA on professional scepticism will be helpful in developing a consistently high level of scepticism throughout the EU. We also believe that the new, clarified ISA 260 will provide for enhanced communications with those charged with governance, giving audit committees greater insight into the scepticism exercised by auditors and the challenges made to management’s assumptions.
(7) Should the negative perception attached to qualifications in audit reports be reconsidered? If so, how?

No. A qualified audit report sends a clear and important message to the marketplace. Whilst enhanced dialogue between auditors and regulators could help address the issue of the negative perception of qualified audit reports, ultimately nothing will avoid shareholders perceiving that a report saying that something is wrong, or that there is something an auditor cannot do, indicates a significant problem.

The position on modified reports that include an emphasis of matter or other matter paragraph, without being qualified may, however, be different. Emphases of matter in audit reports have traditionally been used to draw attention to a going concern problem or another fundamental uncertainty in the accounts which has been properly accounted for and adequately disclosed. Currently, management and shareholders perceive an emphasis of matter in an audit report as indicating, in most cases, a significant uncertainty; it may be worthwhile for auditing standard setters and others to consider whether the range of matters which could be emphasised be expanded, with the role of such emphases being more clearly explained to users of audit reports.

(8) What additional information should be provided to external stakeholders and how?

We agree that it is worth considering further explanation in management’s disclosure, audit committee reports and audit reports of the issues and judgments taken by management, audit committees and auditors respectively, particularly for public interest entities. However, the results of IAASB/AICPA (American Institute of Certified Public Accountants) research seem to indicate that a longer form audit report has little impact on financial statements users’ understanding of the messages conveyed in the report. In many cases, the information which users perceive is “missing” is there in accounting disclosure within the audited financial statements already. For example, in considering the risk of further impairment of an entity’s assets, IFRS already requires extensive disclosure of the assumptions used in an impairment review and of the effect of estimation uncertainty. We believe that it may be helpful for further research to be carried out with investors and other users to consider what additional information is needed and who is best placed to provide it – management, audit committees or auditors. We support the work currently being done by the IAASB on this topic.

This research will be important in deciding next steps and may lead to consideration of enhanced audit reporting and disclosure for all public interest entities. For instance, the audit committee could report on management disclosures as to the risks of the business model, key assumptions and sensitivities of estimates and judgments, accounting policies and going concern evaluations. Subject to cost/benefit analysis, it may be appropriate for auditors to provide assurance on the audit committee’s reporting, as well as disclosure of key aspects of the audit process such as materiality, and a summary of scope of the audit.

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In order for this to be workable, there are three essential elements: 1) any such reporting should be based on commentary on management disclosures, with an appropriate framework for management to use in preparing such disclosures; 2) an appropriate standard for auditors would need to be in place; and 3) appropriate safe harbours would need to be implemented, recognising that information about the future is inherently uncertain.

(9) Is there adequate and regular dialogue between the external auditors, internal auditors and the Audit Committee? If not, how can this communication be improved?

Yes. We believe that the new clarified ISA provide for extensive discussion between external auditors and the audit committee on all the significant matters arising from the external auditors’ work. Many Member States already have standards that go further than the pre-clarity ISA. The new clarified ISA 260 standard will provide a high standard for all audits and help improve this communication.

We have also welcomed the IAASB’s proposals to revise ISA 610 which deals with the interaction with internal audit and believe that this will further enhance the flow of information, particularly in clients where the auditor does not normally rely on the work of internal audit and such interaction has historically been more one-way. However, care will be needed to avoid perceptions of a lack of independence by either external or internal audit.

(10) Do you think auditors should play a role in ensuring the reliability of the information companies are reporting in the field of CSR?

This depends on stakeholder needs. The amount and range of reporting by companies is expanding each year, often as a result of stakeholder pressure. Where appropriate, it should be open either to companies to ask their auditors to provide independent assurance of the information that is objectively verifiable, or for stakeholders to ask companies to obtain such assurance. We support the work of the International Integrated Reporting Committee\(^9\) and suggest that the Commission may want to take the results of this work into consideration.

As the provision of information, and assurance, becomes more widespread, it will be important for standards to be developed for both preparers and auditors to enhance the comparability of CSR information across companies. Several bodies are preparing standards for the disclosure of carbon footprint information, and the IAASB is developing a corresponding standard for greenhouse gas emissions assurance.

(11) Should there be more regular communication by the auditor to stakeholders? Also, should the time gap between the year end and the date of the audit opinion be reduced?

At the time the Transparency Directive was implemented, it was not considered appropriate to mandate auditor involvement in half-yearly reports or interim management statements. Many listed companies voluntarily ask for a review of such half-yearly reports, seeing it as an important step in enhancing

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confidence in the information they are releasing to the market. Before mandating a review of half-yearly reports there is a need for a cost/benefit analysis and discussion with users of such reports as to whether they would welcome such auditor reporting. Generally, we believe that reviews of interim financial information do add value for the users of this information.

We believe the same considerations should apply as to any judgments made about quarterly reporting obligations on companies, with or without any audit or review requirement, recognizing that regulators and stakeholders must assess the cost/benefit of any additional reporting. There is a danger that mandating quarterly reporting would further encourage short-termism by investors focussing on quarter-by-quarter results, rather than the long term success of companies, harming the stability of the economy, and resulting in a disproportionate cost on business without a commensurate benefit to stakeholders.

We do not support reduction of the time gap between the year end and the date of the audit opinion. The current deadlines for listed companies, introduced as part of the Transparency Directive, reflect an appropriate balance between providing information that is fresh enough to be relevant but with enough time to produce it reliably. For unlisted companies, there are currently longer deadlines.

(12) What other measures could be envisaged to enhance the value of audits?

We believe that enhanced reporting by management, the audit committee and the auditor (please see above our response to question 8) would represent the most appropriate way of enhancing the value of audit. However, any such measures would need to be clearly defined and tested as to meeting stakeholder needs and cost/benefit considerations. In some Member States, there are additional requirements such as the German long form report issued to the supervisory board, as mentioned in the Green Paper\textsuperscript{10} which we agree are worthy of study. However, it will be important that any such initiatives provide useful information that stakeholders value and not simply more boilerplate information common to all audits.

(13) What are your views on the introduction of ISAs in the EU?

As mentioned in our response to the Commission’s 2009 consultation on the adoption of International Standards on Auditing\textsuperscript{11}, we support the adoption of ISA for all statutory audits carried out in the European Union. We believe that the application of ISA would enhance audit quality and the consistency and comparability of annual and consolidated accounts and so increase confidence in the reliability of financial reporting. This should benefit the European capital markets on the global stage. It would also reduce the current costs and inefficiencies of having multiple sets of standards. One set of high quality auditing standards for the European Union will also serve to allow greater cooperation and consistency.

\textsuperscript{10} Green Paper, p. 8.
\textsuperscript{11} See \url{http://circa.europa.eu/Public/irc/markt/markt_consultations/library?l=/abschlussprfung/international_standards/deloitte_tohmatsu/_EN_1.0 &a=d}
among EU auditor oversight bodies and to help facilitate the internal market for audit services and cross-border mobility of auditors.

In our view, the new clarified ISA are more robust, particularly in the areas of fair value and other accounting estimates made by management and related party transactions\(^\text{12}\) that have proved to be focus points in the financial crisis. Moreover, we are unaware of any other set of auditing standards of higher quality or of any other standard setting process that is more transparent or focused on the public interest.

We also support EU adoption of the International Standard on Quality Control ("ISQC") \(^1\), the international quality control standard for firms that perform audits and review of financial statements, as also mentioned in our response to the Commission’s 2009 consultation on ISA adoption and believe this would contribute to enhancing audit quality throughout the European Union\(^\text{13}\).

(14) Should ISAs be made legally binding throughout the EU? If so, should a similar endorsement approach be chosen to the one existing for the endorsement of International Financial Reporting Standards (IFRS)? Alternatively, and given the current widespread use of ISAs in the EU, should the use of ISAs be further encouraged through non-binding legal instruments (Recommendation, Code of Conduct?)

Yes - in our view ISA should be made legally binding throughout the EU, for all statutory audits, preferably via a Regulation to favour consistency of audits throughout the EU.

An endorsement process is of course required in the EU as ISA are developed by a private body, the IAASB. However, the standard setting processes of the IAASB are designed to encourage participation by representatives of the public interest from different geographical areas\(^\text{14}\):

- The IAASB itself, half of the members of which are non practitioners, has members from each of six geographical areas and three members which must be individuals who are, and will be seen to be, capable of representing the broad public interest\(^\text{15}\).


\(^{13}\) As concluded in the recent study carried out by the University of Duisburg-Essen for the European Commission: ‘Evaluation of the Possible Adoption of ISAs in the EU’, University of Duisburg-Essen, 2009, Executive Summary, p. 9, see [http://ec.europa.eu/internal_market/auditing/docs/ias/study2009/summary_en.pdf](http://ec.europa.eu/internal_market/auditing/docs/ias/study2009/summary_en.pdf).


\(^{15}\) The IAASB has had public members and has opened its meetings to public observers since 2002 (see [http://web.ifac.org/download/IAASB_Brief_History.pdf](http://web.ifac.org/download/IAASB_Brief_History.pdf), p. 3).
IAASB meetings are attended by non-voting observers, including from the European Commission, who have the right of the floor and provide assurance that regulatory organisations are closely involved in the standard setting process.

The involvement of the IAASB Consultative Advisory Group (“CAG”) whose members represent a balance of geographical representation and regulators, international organizations (including the European Commission), users and preparers, allows the IAASB to receive advice on technical and other issues from an international regulatory perspective, as well as from private sector institutions.

Finally and importantly, the Public Interest Oversight Board (“PIOB”) (made up of ten members, including two members nominated by the European Commission, four members nominated by IOSCO and others by the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors and the World Bank) which has its mandate from the Monitoring Group\(^\text{16}\) has oversight over the IAASB and the standard setting processes.

The IAASB consults widely on draft standards. The Commission, in cooperation with the Member States has been actively involved in consultations, via the ISA sub-group of the EGAOB.

Given the different scope of IFRS and ISA (i.e. the former set out how different transactions must be reflected in financial statements accounts, leading to complex and varied standards for different transactions and businesses and keen involvement of preparers and users of financial statements; the latter describe what an audit is and its requirements for “universal” application subject to specific relevance and scalability), we believe that the endorsement process for ISA can be less onerous than that for IFRS. In particular, we would support:

- Endorsement of the clarified ISA as a comprehensive ensemble, not standard by standard;
- Involvement of the Member State standard-setters and audit oversight bodies in the identification of add-ons required by Member State law, which should then be specifically mentioned in the audit report;
- Involvement of the audit profession in discussions with the Commission and other stakeholders on the evaluation of ISA;
- No Member State carve-outs to ISA, as this would undermine audit quality and consistency in application across the EU, as well as globally.

\(^{16}\) The Monitoring Group is a group of international regulatory bodies and organisations committed to advancing the public interest in areas related to international audit quality. The Monitoring Group’s members are IOSCO, the Basel Committee on Banking Supervision, the European Commission, the International Association of Insurance Supervisors, the World Bank and the Financial Stability Board, and the International Forum of Independent Audit Regulators attends meetings as an observer.
The likely process would seem to be for the Commission to obtain Audit Regulatory Committee approval of a draft Regulation adopting ISA before proposing it to the European Parliament and the Council. Given the due process used to establish ISA, the overall support for ISA adoption at EU level shown in the Commission’s 2009 consultation\(^\text{17}\) and the technical and general nature of auditing standards, we assume that the European Parliament and Council scrutiny would focus on ensuring that the criteria for adoption of international standards set by the Statutory Audit Directive (development with proper due process, public oversight and transparency and international acceptance; contributing a high level of credibility and quality to annual or consolidated accounts and being conducive to the European public good) are met rather than seeking to make any changes that would reflect any specific interest groups.

(15) Should ISAs be further adapted to meet the needs of SMEs and SMPs?

No, we do not think that ISA need to be further adapted to meet the needs of SMEs and SMPs. ISA can be scaled to fit the needs of audits of smaller companies and a number of ISA are unlikely to be applicable to smaller companies\(^\text{18}\). It is true that audits of smaller companies have specificities but we believe that the standards themselves and recently issued guidance take these into account:

- ISA contain “Considerations Specific to Smaller Entities”;
- The IFAC SMP Committee has produced guidance to using ISA in the audit of SMEs\(^\text{19}\);
- The IAASB Staff has issued a Q&A publication which highlights how ISA can be applied proportionately to audits of small and medium-sized entities\(^\text{20}\);
- The Auditing Practices Board in the UK issued “Guidance on Smaller Entity Audit Documentation”\(^\text{21}\).

(16) Is there a conflict in the auditor being appointed and remunerated by the audited entity? What alternative arrangements would you recommend in this context?

No, we do not believe there is a conflict. We believe there are adequate safeguards to deal with any potential threats. Statutory auditors are generally appointed by the general meeting of shareholders\(^\text{22}\) of

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\(^\text{17}\) See Green Paper, p. 10, 2nd paragraph.

\(^\text{18}\) FEE has issued a policy statement covering the implementation of ISA for small and medium-sized companies, citing as an example that in the simple audit of a small or medium-sized company, up to one-third of the 36 ISA may not be relevant so their requirements would not need to be met, see [http://www.fee.be/fileupload/upload/Auditing%20and%20Assurance%20PS%20International%20Standards%20on%20Auditing%20%28ISAs%29%20%20090430145200923149.pdf](http://www.fee.be/fileupload/upload/Auditing%20and%20Assurance%20PS%20International%20Standards%20on%20Auditing%20%28ISAs%29%20%20090430145200923149.pdf).


\(^\text{22}\) Except for the first appointment of an auditor when a company is incorporated which is done by the board of directors in certain Member States (for example, the UK).
the audited entity\(^{23}\). The statutory auditor reports to the general meeting of shareholders, the owners of the company, and is remunerated by the audited entity on behalf of the shareholders.

For public interest entities, the board or supervisory body proposal to the shareholders to appoint an auditor is based upon a recommendation by the audit committee\(^{24}\). The role and composition of the audit committee serve to dissipate or neutralise any potential conflicts of interest the statutory auditor may have in its interactions with management. The audit committee of a public-interest entity is effectively entrusted with reviewing and monitoring the independence\(^{25}\) of the auditor and the provision of additional services to the audited entity\(^{26}\).

Once appointed, the auditor’s independence from management of the audited entity is protected through the fact that the duration of an audit engagement is set by law and dismissing an auditor during the course of the engagement also generally requires a decision by the general meeting of shareholders and may only be decided on proper grounds\(^{27}\).

Taking into consideration the different constituents that take part in the auditor appointment process, we do not believe that there is a conflict. However, we agree that management (and particularly the CFO) should not choose the auditor. We would support strengthening the role of the audit committee (and particularly its independent members) in appointing and determining the remuneration of the auditor, although we believe that the final decision to appoint an auditor should remain with the general meeting of shareholders, as owners of the company and the first line of users of the audited financial statements.

(17) Would the appointment by a third party be justified in certain cases?

We would not support the audit function becoming an inspection-type function carried out on behalf of the regulator as mentioned in the Green Paper and believe that this would raise questions regarding the regulator’s role and responsibilities. Arguably, a more pertinent consideration is how the removal of these important rights and responsibilities of the shareholders and audit committee could disenfranchise both groups. The audit committee in particular has valuable insights into the audit needs of an entity. The appointment of an auditor by a regulator could also create inherent conflicts in the regulator’s relationship with the audited entity.

We would also not support granting special rights regarding the auditor’s appointment to any one group among the shareholders, as this would impinge upon the principle of shareholders’ equal rights.

However, for banks and other financial institutions, we would support the relevant regulator being advised of the details of the proposed auditor appointment in advance\(^{28}\).

\(^{23}\) Article 37 of the Statutory Audit Directive sets the principle of appointment of the statutory auditor by the general meeting of shareholders, specifying that Member States may allow alternative systems providing that they are designed to ensure independence of the statutory audit from the audited company’s management.

\(^{24}\) As set out in article 41.3 of the Statutory Audit Directive.

\(^{25}\) Independence is a wider notion than that of conflict of interest, see Article 22 of the Statutory Audit Directive.

\(^{26}\) Article 41.2 (d) of the Statutory Audit Directive.

\(^{27}\) Article 38.1 of the Statutory Audit Directive.

\(^{28}\) This is already the case in many EU Member States, such as Austria, Belgium and France.
Should the continuous engagement of audit firms be limited in time? If so, what should be the maximum length of an audit firm engagement?

No, we do not believe that the continuous engagement of audit firms should be limited in time, nor are we aware of any evidence that supports the position that this would enhance audit quality.

Auditors are appointed by the general meeting of shareholders for set periods of time that vary among the EU Member States\(^\text{29}\) and we believe that the general meeting of shareholders should keep the right to appoint the auditor of its choice, including the possibility of re-appointing the same auditor.

The existing requirement under the Statutory Audit Directive for key audit partner rotation at least every seven years for audits of public interest entities\(^\text{30}\) adequately addresses the risk of familiarity which this measure seeks to address. A second partner engagement quality review (as mandated by ISQC1) also has an impact in mitigating any potential risk, as does the natural turnover of key client personnel. Moreover, independent oversight over auditors and audit committee monitoring of the auditor’s independence\(^\text{31}\) provide additional safeguards against the risk of familiarity. As the Statutory Audit Directive has only been implemented in the different Member States for at most a couple of years, we believe that before proposing any additional restrictions, time is needed to judge the effectiveness of the existing measures. It may be helpful for auditor oversight authorities to consider providing guidance on key audit partner rotation.

A mandatory requirement for a company to change auditor increases costs for business (internal costs explaining its business and processes to the new audit team) and risks reducing audit quality as the knowledge of the audited entity acquired in the past is lost. A study carried out by Bocconi University in Italy, where audit firm rotation after a period of nine years is imposed by law for public interest entities, indicates that audit quality is lower in the first year of an audit mandate and that there are higher costs after rotation for both the audit clients and the auditors due to the new auditor’s lack of knowledge of the business\(^\text{32}\). Similarly, a study carried out by the US General Accountability Office concluded against mandatory audit firm rotation\(^\text{33}\).

Mandatory audit firm rotation is also very difficult for multi-national companies to implement in practice. Multi-national companies select auditors that have the relevant capabilities to implement consistent quality audits in the markets in which they operate. From a practical perspective, a multi-national company would either have to change audit firms on a global basis every time rotation is

\(^{29}\) For example, one year in the UK, three years in Belgium, six years in France and nine years in Italy (for public interest entities).

\(^{30}\) Article 42.2 of the Statutory Audit Directive.

\(^{31}\) Articles 29, 43 and 41.2 (d) of the Statutory Audit Directive.


required in any given jurisdiction, or to use a variety of different audit firms in those jurisdictions that require rotation, which is very expensive, inefficient and impractical.

In summary, we believe that any potential, theoretical benefit of an enhanced appearance of independence would not come close to outweighing the enhanced risks of reduced audit quality through adopting such an approach, not to mention the limitations on the shareholders’ rights to select an audit firm of their choice.

(19) Should the provision of non-audit services by audit firms be prohibited? Should any such prohibition be applied to all firms and their clients or should this be the case for certain types of institutions, such as systemic financial institutions?

No – legislation is already in place limiting strictly the type of non-audit services that can be provided by the statutory audit firm to its audit clients to preserve independence in fact and in appearance, in implementation of Articles 22 and 24 of the Statutory Audit Directive. In addition, for audits of public interest entities, auditors must annually confirm their independence from the audited entity, disclose annually to the audit committee any additional services provided to the audited entity and discuss threats to their independence and the safeguards they have applied, under Article 42 of the Statutory Audit Directive. However, this legislation is inconsistent in the European Union; to remedy this and to encourage adoption of a single set of high quality global standards on auditor independence we support consideration of an EU-wide implementation of the independence standards included in the recently enhanced IESBA Code of Ethics for Professional Accountants.¹⁴

To further enhance the effectiveness of measures aimed at ensuring auditor independence for public interest entities, we would also support audit committee approval of non-audit services (per categories of services and amounts of fees). We would suggest that categories of non-audit services be defined carefully (for example, any special work or reports required by prudential authorities that are best provided by the auditor would be disclosed as audit related services).

Complex audits require the expertise and competencies of multi-disciplinary teams (including, for example, actuaries and information system specialists) who are up-to-date with market techniques. These teams can simply not be maintained through audit-only experience. We believe that any general prohibition for audit firms to carry out any services other than audit services is not necessary to achieve independence and the negative effects would be clearly disproportionate to the aim this prohibition would be seeking to achieve. Any such prohibition would weaken the general economic independence of audit firms and the range of skills they can house by impacting their ability to recruit and retain people by providing a varied career and the possibility to evolve. In addition to specific audit

¹⁴ The International Ethics Standards Board for Accountants (IESBA), which is overseen by the Public Interest Oversight Board, has issued a new Code of Ethics, after an extensive public consultation process. See http://web.ifac.org/publications/international-ethics-standards-board-for-accountants.

³⁵ In many EU Member States, audit firms are separate legal entities from the other legal entities that are part of the same network of firms and that others services such as tax or consultancy services. However, we understand the question to concern the set of different companies that operate under a same corporate or brand name.
needs, complex businesses frequently require the services of a multi-disciplinary team and appreciate the efficiencies and effectiveness of this being provided by one firm. Any such measure would also seriously impact smaller audit firms and their ability to grow. We believe that adding new limits to the provision of professional services runs counter to the Commission’s aims to remove administrative and legal burdens to encourage the services sector, which is seen as an area of growth for Europe.

(20) Should the maximum level of fees an audit firm can receive from a single client be regulated?

Yes. For reasons of auditor economic independence, we would support setting a maximum level of fees that an audit firm can receive from a single public interest entity audit client and its related entities, in the form of a percentage of the total audit firm revenues. We would recommend that the EU adopt the same restrictions included in the revised IESBA Code of Ethics which provides that if total fees from any one public interest client exceed 15% of total fees of the audit firm for two consecutive years, a special review of the second year’s audit by an auditor from outside the firm (but not the network of firms to which the audit belongs) is needed.

(21) Should new rules be introduced regarding the transparency of the financial statements of audit firms?

In the majority of Member States audit firms already file firm financial statements and the majority of these are audited. Importantly, there should be financial transparency towards the relevant public oversight authority, including provision of information not in the public domain which may be useful for the oversight body’s oversight processes. Information about financial risk which may be relevant to their oversight role in ensuring continued supply of audits in the relevant market is an example of such information.

We believe that the most important information which should be published is information regarding how firms deliver audit quality. Audit firms of public interest entities in the European Union already prepare transparency reports; however, the cost of producing such reports by audit firms that do not audit public interest entities might outweigh the benefits. Since Article 40 of the Statutory Audit Directive is relatively new, and many firms have only produced one or two statutory reports, we would recommend that the Commission consider whether this measure has achieved its aims before creating new requirements. At the global network level, we believe that it would be appropriate for the major networks to prepare a report in accordance with Article 40.

(22) What further measures could be envisaged in the governance of audit firms to enhance the independence of auditors?

There are already rigorous auditor independence requirements in Europe arising from the national standards, the IESBA Code of Ethics and the Statutory Audit Directive. These ensure that auditors remain independent from their clients. As mentioned in our response to question 13, we support EU adoption of ISQC1, which we believe would help enhance the quality control systems of many audit firms and the independence of auditors in such firms.
We are not sure that changes to audit firm governance will contribute to improved independence. The appointment of an independent non executive by an audit firm serving a public interest entity (for example, as envisaged by the UK Audit Firm Governance Code) might improve its risk management, including potentially risks relating to arrangements put in place within the firm to monitor independence. However, independence is not the primary aim of this provision in the UK Code and it would be worthwhile reviewing whether the adoption of this code in the UK has contributed to improved independence or the perception thereof before considering adoption at a European level.

As an alternative, consideration could be given to mandating audit committee approval for non audit services as discussed in question 19 above.

(23) Should alternative structures be explored to allow audit firms to raise capital from external sources?

Yes. We agree that alternative structures should be explored, providing they are voluntary. These could potentially help new entrants to the market and smaller firms to expand, enhancing competition and choice. However, care will be needed to ensure that there are effective safeguards aimed at protecting audit quality and auditor independence. Liability reform might also encourage the availability of capital to support expansion by smaller firms.

(24) Do you support the suggestions regarding Group Auditors? Do you have any further ideas on the matter?

We believe that the new clarified ISA 600 represents a major step forward in reinforcing the role of the group auditor. However, we recognise that the ability of group auditors to have unfettered access to the working papers of component auditors, particularly outside the EEA, is often restricted by local privacy, professional secrecy and audit laws. Within Europe, the changes brought about by the Statutory Audit Directive help. The greatest barriers are those outside the EEA. We suggest that EGAOB, working with IFIAR, can play a key role in identifying legal and other obstacles and in encouraging steps needed to work through these matters. This could also involve working with the Forum of Firms of IFAC to address implementation issues and best practices with ISA 600, using issues reported by the networks to the IAASB. Encouraging adoption of a single set of high quality global standards for audits, independence and quality control would also help this process.

(25) Which measures should be envisaged to improve further the integration and cooperation on audit firm supervision at EU level?

We support closer cooperation between Member State audit oversight systems to foster consistency in the application of EU law. We also support a common approach to oversight and inspections throughout the EU, including a common approach to third country oversight authorities and auditors. Adopting a single set of high quality auditing standards, quality control standards and independence standards for the EU is a fundamental building block that is essential to achieving greater cooperation, efficiencies and synergies on audit firm supervision.
The EU auditor oversight authorities should debate the type of structure they would need to best achieve this closer cooperation. In the event auditors or audit firms have activities in more than one Member State, specific Colleges of relevant Member State auditor oversight authorities could together carry out oversight on these auditors or audit firms.

We do not support integrating audit oversight (including over the cross-border management entities of firms covering various Member States) into one of the three new European Supervisory Authorities as this could lead to divisions within the audit profession and variation in oversight practices and ultimately audits. We believe that a European group of dedicated auditor oversight authorities will be better placed to contribute to improved audit quality than the New European Supervisory Authorities which focus on other market areas.

We believe that the EGAOB will need to have regular communication both with the three new EU supervisory authorities and with the new European Systemic Risk Board.

(26) How could increased consultation and communication between the auditor of large listed companies and the regulator be achieved?

We support increased communication between financial services regulators and the auditors of financial institutions, including both direct dialogue between auditors and regulators and trilateral discussion including the financial institution itself. We believe such dialogue could help address systemic risk and current industry specific reporting and audit issues and the application of applicable standards in those areas.

The Green Paper suggests that there may be scope to expand this duty to involve communication with the relevant securities regulator by the auditors of all large or listed companies. In practice, given the auditors’ role, there are already some mechanisms in place. It may be worth considering expanding the model whereby in some countries regulators of listed companies and/or financial institutions are warned in advance about potential qualifications and emphases of matter.

Two-way communication is also important, and there is a need for communication by regulators to auditors on areas of concern. For instance, CESR currently publishes a database of decisions taken by national accounting enforcement authorities. However, these are focussed on specific cases. Some, but not all, of these national authorities publish details of general areas of concern in the current reporting and economic environment which may be of help in improving the quality of risk assessment by auditors. Similarly, it would be helpful if auditor oversight bodies not only provided a summary of the quality of auditing in their Member State following completion of their annual inspection cycle, but also published suggestions of areas where they will focus their activity and believe that auditors as a whole need to be vigilant.

(27) Could the current configuration of the audit market present a systemic risk?

Failure of one or more of the largest audit firms could under certain rare circumstances (i.e. if the reputation of the network and/or one of its member firms suffers seriously as a result) cause a
temporary disruption in capital markets, and result in a lack of choice of auditor in the upper segment of the public interest entity audit market, but would not cause a financial or economic crisis. We do not believe that audit firms can be considered to present a systemic risk in the same way as banks. Banks are providers of finance and holders of funds and have interconnected activities such that there is a risk of contagion if one important bank fails; this had led governments to provide financing to save certain banks.

We do however believe that even though the configuration of the audit market does not present a systemic risk similar to that of the largest or most interconnected banks, the present level of concentration in the audit market for listed companies presents a certain level of risk to the continuity of audit services and to choice of auditor in that market. To counter this risk, we believe that the Member States that have not yet introduced reasonable and effective liability limitations for statutory audit work into law, as recommended in the Commission Recommendation, should do so. We would add that in our view the biggest risk in terms of failure of large audit firms currently stems from the litigation environment, coupled with the lack of effective liability limitations for statutory audit work, in the UK and the US.  

(28) Do you believe that the mandatory formation of an audit firm consortium with the inclusion of at least one smaller, non systemic audit firm could act as a catalyst for dynamising the audit market and allowing small and medium-sized firms to participate more substantially in the segment of larger audits?

We believe that audit committees and shareholders need to remain free to choose the type of auditor that is appropriate for their needs. Currently, shareholders can appoint joint auditors if they so wish. We do not believe, however, that mandating such an approach is either prudent or effective as a solution to the question posed.

Although this suggested measure would mean that a larger number of auditors would be involved in larger audits, it would increase costs for companies and risks negatively impacting audit quality. Joint audit or a consortium of audit firms makes it more difficult to gain an overall understanding of the entity and to supervise audit work. The use of different audit methodologies by the auditors can lead to inconsistent approaches and to inefficiencies. Each firm involved would also have additional coordination costs.

It is not clear to us how the concept of a consortium of audit firms would work but if the idea is that the larger audit firm would carry out the main part of the audit and the smaller firm a small part of the audit, it is not clear that this will have much impact on allowing the smaller firms market access, other than for small parts of an audit. Key partner rotation may also be an issue for the smaller firm, which will have a smaller pool of partners with the required technical expertise. A consortium of audit firms would be likely to be difficult to implement in practice and to be a source of uncertainty for

shareholders and other stakeholders (i.e. which audit firm would be responsible for which part of the audit). The risks of an audit firm facing liability for the actions or omission of another audit firm are also introduced.

Finally, this artificial attribution to smaller firms of a share in the market for larger audits could risk becoming a disincentive to them to grow.

(29) From the viewpoint of enhancing the structure of audit markets, do you agree to mandatory rotation and tendering after a fixed period? What should be the length of such a period?

No. As mentioned above in answer to question 18, mandatory audit firm rotation increases costs for business (internal costs explaining its business and processes to the new audit team) and risks reducing audit quality as the knowledge of the audited entity acquired in the past is lost. It is also very difficult for multi-national companies to implement in practice.

Regarding the impact that mandatory audit firm rotation can have on the audit market, the Bocconi study on the topic suggests that mandatory audit firm rotation has not decreased concentration and may even have increased it.\(^{37}\)

Given the increased cost to business and risks to audit quality that mandatory audit rotation presents and that it is unclear that it would decrease concentration, we do not believe that limiting the right of shareholders to appoint the auditor of their choice can be justified.

We also do not support mandatory tendering of audits and believe that the audit committee and the shareholders should decide on any tendering process. If tendering takes place, we agree with the Green Paper view that there should be transparency as to the criteria for appointment and that quality should be a key criterion (independence is of course a necessary requirement). We would support inclusion of at least one suitably qualified non “Big 4” firm in any tendering process as a possible measure aimed at decreasing concentration. The inclusion of a non “Big 4” firm in any tendering process could perhaps be included by securities or other regulators in their market or governance rules that listed or regulated companies undertake to apply.

(30) How should the “Big Four bias” be addressed?

As an initial point, the London Economics’ study referred to in the Green Paper\(^{38}\) concludes that smaller audit firms face a number of barriers to entry into the market for audits of the largest (listed) companies: reputation, capacity and breadth of their networks and the exposure to unlimited liability in

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\(^{38}\) Green Paper, p. 15, 5, first paragraph.
most Member States combined with very little professional insurance availability\(^{39}\). Reputation is not therefore the only factor. Importantly, reputation is built-up over a long period of time, through consistent high quality performance, which implies huge investments in human resources and enabling technology, and lack of circumstances that endanger a reputation.

We believe that any “Big-4”-only clauses, as mentioned in the Green Paper\(^ {40}\), should be discouraged. This may perhaps be achieved via Corporate Governance Codes or be included by securities or other regulators in their market or governance rules that listed or regulated companies undertake to apply.

The role of audit committees, acting as a proxy for the shareholders, in recommending auditor appointments and monitoring the work of the auditor could be strengthened and made more effective. For instance, audit committees could provide information on the determining factors for their recommendations for auditor appointments and consideration could be given to an EU-wide form of audit committee or supervisory board assessment of the auditor.

As mentioned above in response to question 29, although we do not support mandatory tendering, if tendering takes place, we would support inclusion of at least one suitably qualified non “Big 4” firm in any tendering process as a possible measure aimed at decreasing concentration. The inclusion of a non “Big 4” firm in any tendering process could perhaps be included by securities or other regulators in their market or governance rules that listed or regulated companies undertake to apply.

Regarding the Commission’s idea of exploring the creation of a European quality certification for audit firms apt to perform audits of large listed companies, if smaller firms believe this is helpful, we would agree this is something the Commission should consider further, with the EGAOB and subject to a cost/benefit analysis.

(31) Do you agree that contingency plans, including living wills, could be key in addressing systemic risks and the risks of firm failure?

We support reflection with regulators on contingency plans for auditors of large public interest entities, aimed at ensuring the continuity of audit services regardless of the continuity of the audit firm. The scale and scope of any contingency plans could depend on the market structure and position of the audit firm and its network and would need to take into consideration requirements under bankruptcy and insolvency laws. Based upon a general framework of principles, contingency planning could then be discussed with regulators on an individual firm basis.

In our view, the “living wills” that are being debated for banks to arrange orderly resolution of a failing bank without government bail-outs are not appropriate for audit firms as government bail-outs are not an option that has been considered and are not necessary due to the non-systemic risk posed. As


\(^{40}\) Green Paper, p. 16, 5\(^{th}\) paragraph.
mentioned above in our response to question 27, audit firms are in a very different position from banks which are providers of finance and holders of funds and have interconnected activities such that there is a risk of contagion if one bank fails.

(32) Is the broader rationale for consolidation of large audit firms over the past two decades (i.e. global offer, synergies) still valid? In which circumstances could a reversal be envisaged?

Yes. Firms have grown to their current size over a long period of time, in response to market needs (reputation in the financial markets, geographic coverage and resources, including specific sector experience, required to audit large, complex companies). We believe these market needs still exist and may even have increased, given the increased globalisation of business and size of multinationals and the increased complexity of certain business sectors.

Most recently, the European Commission approved the 1998 merger between Price Waterhouse and Coopers & Lybrand. In 2002, the European Commission cleared the arrangements whereby Deloitte and Ernst & Young firms respectively took over partners and activities from Andersen in Europe and some other transactions involving national Andersen firms were looked at by national competition authorities.

Even assuming there would be a benefit in simply having more, smaller firms, breaking up existing large firms risks negatively impacting the overall level of audit quality a firm can offer (i.e. its range of expertise and sector knowledge), reducing the audit firm’s economic independence and ability to invest, as well as potentially reducing the breadth of geographic reach – all of which are demanded by the current global business environment.

(33) What in your view is the best manner to enhance cross border mobility of audit professionals?

Closer alignment of professional training and the adoption in the EU of international standards (IFRS for further segments of the market, ISA and the IESBA Code of Ethics) will help the cross border mobility of auditors within the EU. Making company law and, to a certain extent, tax systems, of the EU Member States more similar would also help.

The knowledge of local languages, legal regimes and the business and socio-cultural and political environment do, of course, also remain key factors for audit work. We believe that the aptitude test on the laws and regulations of a host Member State that an auditor qualified in another Member State has to pass to be approved to carry out statutory audits in that host Member does currently still appear to be a necessary requirement for providing high quality audits. It may perhaps be worthwhile for the


43 Under Article 14 of the Statutory Audit Directive.
Commission to further explore the contents of these aptitude tests and how they are carried out in practice across the European Union\(^4\).

\((34)\) Do you agree with “maximum harmonisation” combined with a single European passport for auditors and audit firms? Do you believe this should also apply for smaller firms?

As mentioned above in response to question 33, we support closer alignment of professional training and the adoption in the EU of international standards (IFRS, ISA and the IESBA Code of Ethics), as well as closer alignment of quality assurance practices. We believe it would be worthwhile for the Commission to examine, with Member State auditor oversight authorities, further harmonisation of audit firm governance and ownership rules and possibly also confidentiality and professional secrecy rules, with a view to furthering the single market for audit services and reducing the costs of diverging legislation for audit firms that wish to operate cross-border.

We also support the idea of a European passport and further work by the Commission on this topic but would add that, as mentioned in our answer to question 33 above, at this stage we believe that the current Member State aptitude test for auditors qualified in other Member States is still needed for audit quality. It is not clear to us if this European passport system would replace “home” Member State approval to carry out statutory audits in that Member State or be in addition to that approval.

As mentioned above in our response to question 25, we would not support auditors being brought under the supervision of one or more of the new European Supervisory Authorities, as this would risk being divisive for the profession and we believe that an oversight authority dedicated to audit would be preferable for audit quality.

We do not see any reason why the benefits of harmonisation and a European passport would not also apply to smaller firms.

\((35)\) Would you favour a lower level of service than an audit, a so called “limited audit” or “statutory review” for the financial statements of SMEs instead of a statutory audit? Should such a service be conditional depending on whether a suitably qualified (internal or external) accountant prepared the accounts?

The development of a modern, internationally acceptable review standard could provide Member States with an alternative option between audit and no assurance for entities where full exemption is not appropriate.

The IAASB is developing a revised standard, ISRE 2400, for a review service (which would be clearly distinguished from an audit) in order to satisfy demand for such a service in those instances where an audit is not required and is deemed to be too expensive compared to the needs of users in the particular circumstances.

\(^4\) For instance, in some Member States, this is an oral exam only and in others a written exam, which may have impact on the type of questions covered and the possibility of being informed of past questions etc.
We do not agree that the availability of having a review should be conditional upon the accounts being prepared by a qualified accountant. Such a requirement is not imposed in the case of audited financial statements and its introduction might well remove the cost benefit of switching to a review.

(36) Should there be a "safe harbour" regarding any potential future prohibition of non-audit services when servicing SME clients?

The IESBA Code of Ethics provides significant prohibitions on certain non-audit services and for other services adopts a threats and safeguards approach. The restrictions in the Code apply to both audits and reviews.

The restrictions in the Code already acknowledge that the degree of public interest is greater for some audited entities than others, with the restrictions for SMEs being less than those for listed companies. This means that, for listed companies and other public interest entities, the balance between the economic benefit in appointing the auditor as a trusted advisor to carry out certain non-audit services is less likely to outweigh the perceived or actual threat to the auditor’s independence.

We believe that this Code already provides a tough but proportionate regime for non-audit services and do not believe that there should be further restrictions, over and above those in the Code, for audits or reviews of both public interest and SME clients. We would once again support the EU adopting the provisions of the IESBA Code, which were developed with a public interest focus.

(37) Should a “limited audit” or “statutory review” be accompanied by less burdensome internal quality control rules and oversight by supervisors? Could you suggest examples of how this could be done in practice?

We would not support the development of less stringent internal quality control standards as we believe ISQC1 is scalable to audits and reviews. However, we suggest that the oversight for firms carrying out reviews of private companies could be performed by local professional bodies under the supervision of the relevant national public oversight body. The professional body will already have knowledge of their members’ operations, thereby reducing costs, whilst oversight of the professional body’s activities in this area by the national oversight body will maintain public confidence.

As a final note, we would not support the use of the term “limited audit”, but rather “review” as defined in the IAASB’s standards.

(38) What measures could in your view enhance the quality of the oversight of global audit players through international cooperation?

We strongly support the efforts of the Commission and the EGAOB to work towards mutual recognition as envisaged by the Statutory Audit Directive. We believe this would be the single most effective way to deliver robust, cost effective regulation of transnational networks of auditors. As mentioned above in our reply to question 25, adoption of one set of high quality auditing, quality control (ISQC1) and independence standards would be a key step to facilitating enhanced oversight cooperation.
EGAOB and IFIAR have an important role to play in bringing about consistency and quality in audit oversight. Development of a common oversight framework, to the extent possible, would reduce costs (for example, by standardising the registration information required from firms), encourage harmonisation of inspection practices and related reporting, and facilitate co-operation in the case of cross border oversight.

Whilst there is scope for closer cooperation between Member State audit oversight bodies, there needs to be proper consideration as to whether the creation of a single EU regulator might result in an additional layer of cost, since there would still need to be an inspection presence in every country. Where an auditor has activities in more than one Member State, specific colleges of the relevant auditor oversight authorities could carry out such oversight together.