

# Policy Statement

*Standing for trust and integrity*

July 2012



## FEE Policy Statement on Public Oversight of Statutory Auditors and Audit Firms auditing Public Interest Entities and non-Public Interest Entities

In the context of the European Commission audit reform proposals, this Policy Statement seeks to provide input from the accountancy profession's viewpoint regarding public oversight governance and activities while highlighting the different risk profile and visibility of Public Interest Entities and non-Public Interest Entities audit engagements.

### Public Oversight and its Governance

Over the last ten years, one of the most important innovations in audit practice was the move from a self-regulated profession to a regulated profession which is under the supervision of a public oversight system<sup>1</sup>. Currently, all 27 European Union (EU) Member States have established a public audit oversight body which takes at least ultimate responsibility for the education, qualification, quality assurance and disciplinary procedures relating to statutory auditors and audit firms as well as for relevant standard setting. **Cooperation** between **national** public oversight bodies on a European and where possible on an **international** level, is essential to advance the internal market objective and further enhance credibility.

#### Public Oversight should not be dealt with by Regulation

As the representative organisation of the European accountancy profession, FEE is committed to advancing audit policy across the EU and globally. This would require striking a proper balance between the need to provide consistent common principles and requirements while acknowledging the (sometimes significant) differences in size, structure, complexity and type of economies of EU Member States. While we recognise the importance of fostering harmonisation in accordance with the EU legal competences, we believe that EU intervention in these matters and especially as regards company law need to continue complying with the principles of subsidiarity and especially proportionality.

Therefore, FEE recommends the European Institutions to reassess the choice of a European regulation as the legal instrument to change statutory audit of public interest entities. In line with the choice made regarding the current Statutory Audit Directive (2006/43/EC), it would be more appropriate and proportionate to continue dealing with the provision of statutory audit services to companies which are public interest entities

in a European Directive. Furthermore, in view of the objective – that FEE supports – of enabling new entrants on the market of statutory audit services for public interest entities, it does not appear opportune to split the legislation of statutory audit in two different instruments, a Directive and a Regulation, as this may increase barriers to entry on the public interest entities audit market.

Our recommendations below are therefore not aimed at endorsing the legal instrument of a Regulation, but intend to encourage a common approach on public oversight by other legislative means.

#### Public Oversight on national level

The European Commission audit reform proposals published on 30 November 2011<sup>2</sup> aim to enhance the role of the existing public oversight bodies as an independent supervisor of the audit profession. FEE strongly supports public oversight of the profession.

However, an appropriate balance between independence from the audit profession and competence required for the task of supervising the audit profession should be sought. Therefore, FEE recommends that the proposed Directive<sup>3</sup> requires that **Member States ensure** competent authorities have an appropriate **mechanism** to identify, assess and use relevant **up to date expertise and experience** from practitioners, regarding the workings of the audit profession and the conduct of statutory audit.

Regarding the overall **composition of competent authorities**, FEE supports that an oversight system should reflect a necessary wide range of stakeholders, including representatives of business, regulators, shareholders and **not only government officials**. Public Oversight

<sup>1</sup> For further details see: <http://www.fee.be/fileupload/upload/Backg%20P%20120327%20EP303201238850.pdf>

<sup>2</sup> See [http://ec.europa.eu/internal\\_market/auditing/reform/index\\_en.htm](http://ec.europa.eu/internal_market/auditing/reform/index_en.htm)

<sup>3</sup> See [http://ec.europa.eu/internal\\_market/auditing/docs/reform/directive\\_en.pdf](http://ec.europa.eu/internal_market/auditing/docs/reform/directive_en.pdf), Art 32

systems consisting purely of government officials currently exist in a number of EU Member States. Therefore, FEE recommends that the Directive proposed by the European Commission<sup>4</sup> clarifies that a competent authority should reflect a **wider range of stakeholders** than just government officials. We also support the position that competent authorities should have adequate funding and resources to undertake their activities.

## Public Oversight on European level

On a European level, FEE supports the improvement of the cooperation and coordination of audit oversight.

Confidence in a system of oversight is dependent on the involvement of all relevant stakeholders. In order to be successful, European coordination of oversight within ESMA would necessitate the creation of a dedicated and representative **Stakeholder Consultative Group in ESMA**. FEE recommends that this is clarified in the legislation proposed by the European Commission<sup>5</sup>. This Group could consist of all relevant stakeholders including investors and other users of financial statements, regulators, audit regulators, business representatives, national audit standard setters, the European Commission as well as the audit profession itself in all its diversity.

This EU Stakeholders Consultative Group could have the following tasks:

- Exchange views and contribute to the debate regarding the qualification of auditors, their independence, the application of auditing standards and auditor reporting as well as audit market structure matters;
- Make suggestions to improve harmonisation and coordination within areas of competence, for instance audit oversight; and
- Provide input into the work programme at EU level.

FEE strongly supports public oversight of the profession as it is crucial to enhance audit quality and the long-term sustainability of auditors and audit firms.

Nevertheless, an appropriate balance between independence and competence within supervision should be sought. Therefore, the proposed Directive should require that Member States ensure that an appropriate mechanism is set up to identify, assess and use relevant and up to date expertise and experience from practitioners regarding auditing.

FEE recommends that the proposed Directive clarifies that the composition of competent authorities reflects a necessary wide range of stakeholders, including representatives of business, regulators, shareholders and not only be composed of government officials. Furthermore, the proposed European legislation should clarify the need for ESMA to create a dedicated and representative Stakeholder Consultative Group to involve all relevant stakeholders.

## Delegation of oversight activities to professional accountancy bodies

In line with the 2006 Statutory Audit Directive (2006/43/EC)<sup>6</sup>, competent authorities are ultimately responsible for the oversight of the profession but they may delegate certain tasks related to statutory audits, such as for example, the approval and registration or investigative and disciplinary activities to the professional accountancy bodies. Such **flexibility** was provided as each Member State's competent authorities are **best placed and sufficiently competent** to judge about the level of delegation that is appropriate according to their own specific market conditions.

Irrespective of the public oversight system, a professional institute instils in its members the values and expertise that underpin the development of the profession while enhancing its quality and independence and therefore, it is essential that the professional accountancy bodies have greater involvement in the activities of the profession than those currently envisaged in the European Commission proposals.

### Approval and Registration including auditor's education and qualification

In accordance with the European Commission audit reform proposals, EU Member States may allow the competent authorities to delegate tasks

as regards to the approval and registration of statutory auditors and audit firms. FEE strongly supports such allowance for delegation to the profession by the **competent authorities** at EU Member State level but the extent of delegation needs to be increased.

Auditor's competence relies on the proper education and training, both leading up to his or her approval as an auditor and also during his or her entire career as an auditor. Therefore, FEE recommends that greater **clarity** is provided in the Directive proposed by the European Commission<sup>7</sup> that the approval and registration activity **incorporates the whole process of education and qualification** of the auditors as it is closely related to his or her qualitative and up to date education and training. Professional accountancy bodies have a long and tested experience in developing the competences to undertake such activities based on their **existing know-how and high-quality standards**. Education and qualification matters were regulated by the Eight Council Directive of 1984 regarding the approval of persons responsible for carrying out the statutory audits of accounting documents. The Statutory Audit Directive of 2006 updated and refined the qualification of statutory auditors and audit firms to incorporate best practice which was then already applied in the majority of EU Member States.

<sup>4</sup> See [http://ec.europa.eu/internal\\_market/auditing/docs/reform/directive\\_en.pdf](http://ec.europa.eu/internal_market/auditing/docs/reform/directive_en.pdf), Art 32

<sup>5</sup> See [http://ec.europa.eu/internal\\_market/auditing/docs/reform/directive\\_en.pdf](http://ec.europa.eu/internal_market/auditing/docs/reform/directive_en.pdf), Art 32(a)

<sup>6</sup> See <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2006L0043:20080321:EN:PDF>

<sup>7</sup> See [http://ec.europa.eu/internal\\_market/auditing/docs/reform/directive\\_en.pdf](http://ec.europa.eu/internal_market/auditing/docs/reform/directive_en.pdf), Art 32(a)

## Standard-setting for the audit profession

As far as standard-setting is concerned, professional accountancy bodies should **continue to provide their constructive guidance** which is needed in the national environment, thus assisting the profession in the implementation of the international standards.

## Quality Assurance Reviews of statutory auditors and audit firms of non-Public Interest Entities (non-PIEs)

Regarding quality assurance reviews, the objective of the European Commission proposals is to ensure an overall minimum level of quality for all statutory audits while promoting the application of the principle of proportionality on public oversight.

Considering the need to foster public confidence in Public Interest Entities (PIEs), **quality assurance reviews** or inspections of statutory auditors or audit firms of **PIE engagements** should be performed by the **competent authorities**.

This should not necessarily be the case for **quality assurance reviews of** statutory auditors or audit firms of **non-PIEs** as existing systems for such reviews by professional accountancy bodies - **under the oversight of the competent authority - add value to these engagements** and are sufficient and appropriate to ensure that audit quality is maintained and enhanced.

A quality assurance review consists at least of an assessment of the design of the internal quality control system of the audit firm and an adequate compliance testing of procedures and review of audit files in order to verify the effectiveness of this internal quality control system. For the purposes of this assessment, at least the following internal control policies and procedures should be reviewed:

- Compliance with applicable auditing and quality control standards as well as ethical and independence requirements;

## Extending the Public Interest Entities definition

The extension of the definition of PIEs might appear sensible for supervisory purposes and for protecting the interests of investors.

However, some of the entities added in the extended definition of Public Interest Entities (PIEs) in the proposed Directive<sup>9</sup> may in reality be **low risk or low complexity entities** with limited effect to the public interest. In terms of size, many of these are likely to be **Small or Medium-sized Entities (SMEs)**<sup>10</sup>. Thus, such extended definition introduces another layer of Regulation on these entities which are often **already extensively regulated** both on a national level and/or in other jurisdictions (such as for instance the US Securities and Exchange Commission (SEC), Public Company Accounting Oversight Board (PCAOB) or banking authorities in

- Quantity and quality of resources used, including compliance with continuing professional development requirements.

Quality assurance reviews are currently delegated to professional accountancy bodies in many EU Member States. These professional accountancy bodies have the experience and expertise to perform such reviews for non-PIEs in a cost effective way whilst contributing to the constant improvement in audit quality. They ensure that an appropriate **balance** is achieved between a sufficient **quantity** of reviews being undertaken and at the same time ensuring that the depth of their reviews enhances audit **quality** as relevant **expertise and infrastructure** has been established to support these areas. Furthermore, in cases where deficiencies are identified, they offer remedial action to address them. Therefore, under the Directive proposed by the European Commission<sup>8</sup> the competent authority should continue to be able to delegate - **under the oversight of the competent authority and appropriately reported to these authorities** - quality assurance reviews for non-PIEs to professional accountancy bodies in order to ensure that there is **real value added** for these engagements and no unnecessary burden to non-PIEs.

FEE supports the possibility for delegation of approval and registration of statutory auditors and audit firms to professional accountancy bodies. It would be helpful to clarify in the proposed Directive that this includes the whole process of education and qualification of the auditors.

Regarding non-PIEs audits, we believe that existing mechanisms such as quality assurance reviews performed by professional accountancy bodies have proven effective and useful in adding value to non-PIEs audits. Therefore, FEE recommends that under the proposed Directive the competent authority continues to be able to delegate - under the oversight of the competent authority and appropriately reported to them - quality assurance reviews for non-PIEs to professional accountancy bodies.

case of a subsidiary of a US bank).

As all those entities, regardless of their complexity, risk and size, would fall within the scope of the Proposed European Commission Regulation<sup>11</sup> regarding statutory audit of PIEs, they face **considerably increased costs** as well as **limited available infrastructure or expertise** to handle their extended obligations. Therefore, the proposed definition may not be the right way forward, not only for smaller EU Member States but for the market as a whole.

Additionally, every statutory auditor of any such entity, even the lowest risk and simple one, would need to comply with all requirements of the

<sup>8</sup> See [http://ec.europa.eu/internal\\_market/auditing/docs/reform/directive\\_en.pdf](http://ec.europa.eu/internal_market/auditing/docs/reform/directive_en.pdf), Art 32(a)

<sup>9</sup> See [http://ec.europa.eu/internal\\_market/auditing/docs/reform/directive\\_en.pdf](http://ec.europa.eu/internal_market/auditing/docs/reform/directive_en.pdf), Art 2 par 13

<sup>10</sup> As defined in the EU Fourth Directive

<sup>11</sup> See [http://ec.europa.eu/internal\\_market/auditing/docs/reform/regulation\\_en.pdf](http://ec.europa.eu/internal_market/auditing/docs/reform/regulation_en.pdf)

proposed Regulation. These **increased obligations and overheads** for auditors would be expected to lead to increased audit fees and thus, more limited supply of statutory auditors. This may actually **restrict audit clients' choice** and would thus not aid in creating a more open and vibrant market, one of the objectives of the European Commission's proposals.

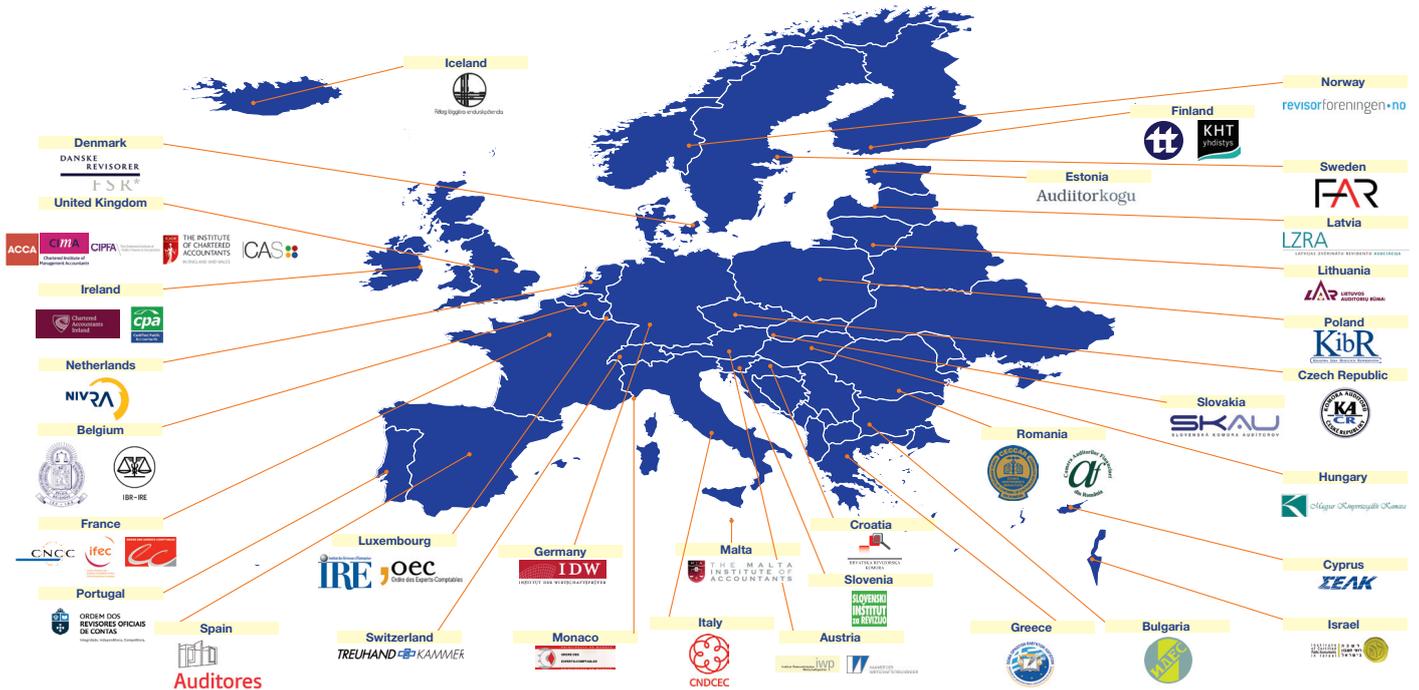
Therefore, FEE recommends introducing a **Member State option to exclude certain entities from the proposed EU definition of PIEs under the condition** that Member States ensure that:

- There is sufficient national regulation of these entities;
- Such entities are not significant to the economy of their jurisdiction; and
- The exemption of such entities would not result in any cross-border effect.

All entities meeting the PIE definition under the proposed Directive, regardless of their complexity, risk and size, as well as their statutory auditors would fall under the scope of the proposed Regulation thus, increasing audit fees while restricting the supply of statutory auditors for audit clients.

Therefore, FEE recommends that the proposed Directive introduces a Member State option to exclude certain entities from the proposed PIE definition on condition that Member States ensure that there is sufficient national regulation, that these entities are not significant to the economy of their jurisdiction and that the exemption of such entities would not result in any cross-border effect. Consequently, this would enhance competition and choice in the audit market and promote the European Commission objective towards a more open and vibrant economy.

## FEE and its Members



FEE is a Regional Organisation of IFAC, the International Federation of Accountants

## About FEE

FEE (Fédération des Experts-comptables Européens – Federation of European Accountants) represents 45 professional institutes of accountants and auditors from 33 European countries, including all of the 27 European Union (EU) Member States. In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 700.000 professional accountants, working in different capacities in public practice, small and big firms, government and education, who all contribute to a more efficient, transparent and sustainable European economy.