

Briefing Paper

Standing for trust and integrity

June 2011



European Passport for Auditors and Audit Firms

The creation of a true single European market for audit services is crucial as the rights of EU citizens to provide and buy services anywhere in the EU are one of the cornerstones of the Single Market.

The Statutory Audit Directive from 2006 provides for a more European approach to audit services by allowing cross-border participation in audit firms as well as cross-border management of audit firms. In addition, in its Green Paper on Audit Policy, the European Commission argues for "... a ("maximum") harmonisation and a "European passport for auditors". This would imply creating a European-wide registration with common professional qualification requirements and common governance, ownership and independence rules applicable across the European Union".

A European passport is understood to mean that an auditor registered in one Member State would be allowed to provide audit services in another Member State without further authorisation. This would enable smaller audit firms to grow and increase the choice of auditors for companies in national audit markets in the different EU Member States.

FEE considers the idea of a European passport for auditors and for audit firms to be attractive. Its effectiveness will largely depend on the further harmonisation of professional educational requirements, including the aptitude test, on adoption of international standards related to auditing and independence in the EU, the already adopted standards on accounting and a pan-EU supervisory authority on auditing. In addition, further harmonisation will be needed with regard to company law and taxation. Full harmonisation and a European passport for auditors is a longer term objective which can be achieved through harmonising step-by-step in all relevant areas.

A European passport could be relevant for individual auditors and also for audit firms. In both situations, increased cross border mobility would be beneficial and would contribute to the realisation of the European Single Market. Some audit firms have already moved towards a pan-

European structure and more may follow. Audit firms will therefore have an increasing need to move partners and staff cross-border.

In addition, certain specific requirements, not applicable to other regulated professions, are still impeding the opportunities for cross-border mobility for statutory auditors.

Currently, an auditor can provide audit services in more than one EU Member State, if qualified, approved and registered in one (home) Member State and has passed an aptitude test in another (host) Member State in accordance with the Statutory Audit Directive. This is aimed at ensuring that an auditor has gained sufficient knowledge of local aspects applicable in the host Member State. As audits of financial statements requires knowledge in various areas, such as financial reporting, auditing, tax and company law, the exams for auditors in each Member State are designed to test the knowledge level in all these areas from the national perspective.

The various areas in which knowledge is currently needed when an auditor provides services in more than one Member State can be illustrated as in Figure 1.

In order to have a European passport for auditors, more areas than those indicated above would need to be harmonised. This can be illustrated as in Figure 2.

As is apparent from the two diagrams, some harmonisation has already been achieved in certain areas, but much more is needed. Harmonisation through one set of (European and/or international) requirements for all audits could remove the unnecessary barriers of 'complexity', to provide for consistency in achieving higher quality audits, which would help reinforce confidence in the financial markets which are heavily dependent on uniformity. This will be the case irrespective of whether it are audits of large, small, public interest or private entities.

Although harmonisation in some areas may take longer than in other areas, European policymakers would be able to achieve significant improvements in many areas within a feasible timeframe.

Figure 1: Where are we on cross border mobility today?

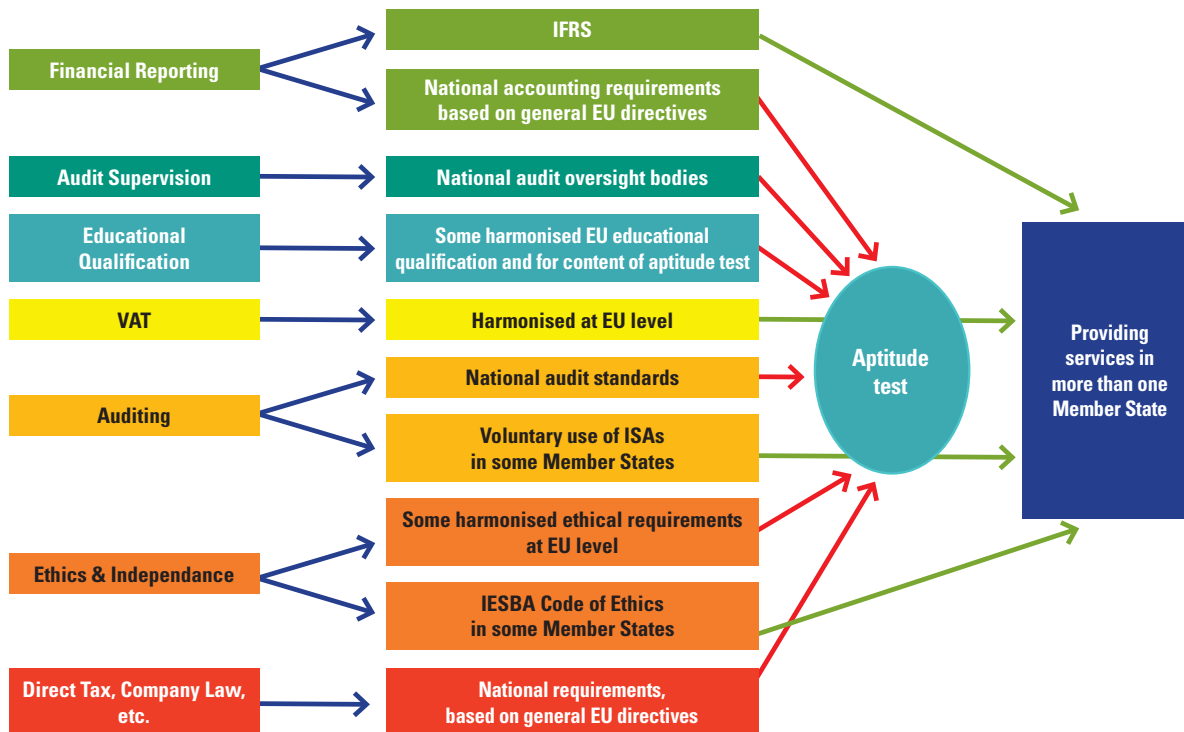
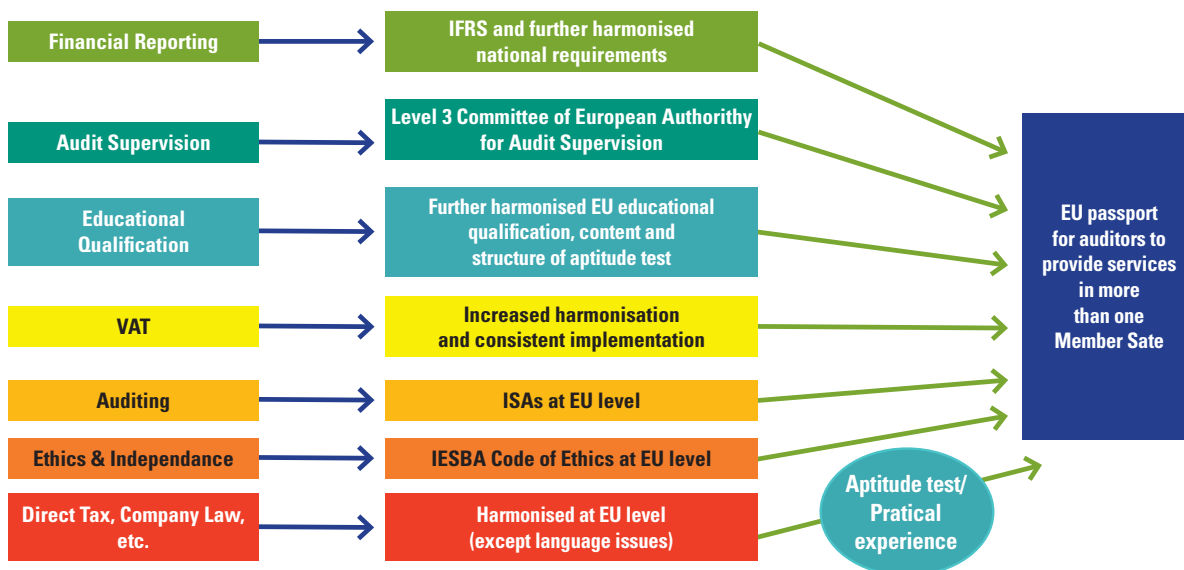


Figure 2: In the future cross border mobility should be enhanced through.



Financial Reporting

In financial reporting, much has already been achieved through the adoption of the IAS Regulation by the European Commission in 2002. This regulation requires listed companies to prepare their consolidated group financial statements in conformity with International Financial Reporting Standards (IFRSs). European companies and the furthering of the European internal market have clearly benefited from this initiative.

However, it has been left to the Member States to opt whether or not they apply IFRSs to other companies. Currently, national standards, in which an auditor needs to be knowledgeable, are still being applied widely. The current

European Commission initiative to recast the Fourth and Seventh Company Law Directives on financial statements would be a further step towards harmonisation.

Audit supervision

It is clear that the more integrated a market becomes, the more integrated the supervision of that market needs to be. Independent audit oversight is fundamental to the public interest and cooperation between national supervisors is needed and could be achieved by establishing a new level 3 committee or European Authority for audit supervision. We have set out our vision on audit supervision in the EU and beyond in more detail in the FEE

Briefing Paper on Audit Supervision which is available at http://www.fee.be/publications/default.asp?library_ref=4&category_ref=235.

Educational qualifications

For auditors, the Statutory Audit Directive has already enabled some harmonisation with regard to educational qualifications by requiring that auditors who want to provide audit services in more than one Member State:

- Obtain approval and registration in one Member State after passing an exam;
- Pass an aptitude test in any other Member State, proving sufficient skills and knowledge of the (local) regulatory environment in that Member State.

Qualifying in one Member State

Currently, educational qualification requirements in the Statutory Audit Directive are designed using an input-based approach and leave significant room for differences in implementation at national level.

It would be more appropriate if they were to be based on the competences expected from auditors to perform high quality audits. A relevant contribution to this could be the education standards for auditors issued by the International Accounting Education Standards Board (IAESB) which provide very relevant guidelines that support a harmonised approach in this area. Additionally, the Common Content Project, a project undertaken by some European professional accountancy bodies with the aim of harmonising the education of professional accountants and accountancy bodies¹ could contribute to harmonisation.

Qualifying in another Member State

The procedures, the structure and the depth of the aptitude test to permit an auditor from one Member State to provide audit services in a host Member State, differ significantly from one Member State to another. The aptitude test is often overly burdensome and time-consuming, and serves as a barrier preventing auditors from operating cross-border or moving within the EU. This is often a key issue for auditors in small and medium-sized audit firms (SMPs) in particular, as it is proportionately more onerous for such audit firms to go cross border.

In some countries, the aptitude test is written, in other countries it is oral or both and the topics tested vary, even though the principle is that fundamentals of accountancy and auditing tested in one Member State should not be re-tested in another Member State. However, as regulations at national level, such as tax law and company law, vary widely in the EU, in the short to medium term a mechanism to ensure that adequate national knowledge has been obtained does need to be retained. This is also true for local language skills which should be seen in connection with the general ethical requirements to have sufficient knowledge and competence, as further discussed below in the section on Ethics and Independence.

In the immediate term, the aptitude test needs to be further harmonised across the EU Member States to achieve a more consistent approach to its structure, depth and content, making sure that the aptitude test is proportionate to its objective of testing knowledge in areas that are not already tested in the home Member State.

Practical experience

Another way of achieving the goal of providing audit services cross-border in the EU through the EU passport would be to further encourage Member States to allow auditors to provide audit services through long-term practical experience after having passed the exam in their home Member State.

This option would allow an auditor who is qualified in one Member State and has acquired sufficient experience for the provision of audit services in the other Member State to become qualified in that other Member State without further exams or tests. In the short term, there is still a need to maintain a basic aptitude test in relation to the proficiency of local language skills and in matters concerning local company or taxation law.

Auditing

In accordance with the Statutory Audit Directive, Member States apply national auditing standards as long as the Commission has not adopted international auditing standards, generally believed to be the International Standards on Auditing (ISAs) as issued by the International Auditing and Assurance Standards Board (IAASB).

A significant number of countries in Europe already apply the ISAs. Full harmonisation through binding measures in the EU is needed to allow for the establishment of genuinely equal competitive conditions for audit firms that will, like for the harmonisation in financial reporting, aid the cross-border mobility for auditors.

Therefore, it is hoped that the European Commission in its legislative proposals will take note of the European Parliament support for ISA adoption and adopt them for all audits in the EU as being a significant contributor to audit quality and, at the same time, help provide a consistency of approach across jurisdictions. Therefore, the benefits of ISAs as well as the proportionality of ISAs for their use in audits of smaller entities are highlighted below.

The benefits of ISAs

The benefits of adopting ISAs for all statutory audits throughout the EU would be to:

- Ensure all auditors throughout the EU become conversant with one set of quality standards, which will also
 - ▷ Increase choice in the audit market for companies by avoiding the emergence of a two-tier auditing profession (i.e., between those with international competency and those with only national competency);
 - ▷ Provide consistent audit quality throughout the EU, enhancing the acceptance of audit reports across borders, and thus the reliability, comparability and credibility of European financial reporting;
 - ▷ Reduce costs and difficulties in conducting transnational audits if different standards are applied to different subsidiaries from not needing two sets of training, methodologies, tools, etc.;
 - ▷ Reinforce professional scepticism in the performance of audits;
- Cover all aspects of a group audit as desired by the European Commission through the strengthened requirements of the ISA on group audits²;
- Facilitate cross-border mobility of partners and staff to move between audit firms in the audit profession at national as well as at European level;

¹ <http://www.commoncontent.com/index.php>

² ISA 600 on Special Considerations - Audits of Group Financial Statements (Including the Work of Component Auditors)

- Enhance auditor communication to those charged with governance as ISAs require that the auditor reports to the supervisory board (or the audit committee in some entities) on key matters arising from the audit³, as desired by the European Commission in its Green Paper on Audit Policy;
- Be a prerequisite for closer cooperation and more integration of public audit oversight bodies on an EU and international level, which will also decrease regulatory costs in not having to maintain two sets of oversight and regulation for audit firms.

Proportionality of ISAs

Some have questioned whether the ISAs and the International Standard for Quality Control 1 (ISQC 1) work equally well for public interest entity audits as for audits of SMEs.

A parallel is sometimes drawn with IFRSs for which it is widely accepted that they are too complex for many small businesses. However, the comparison between ISAs and IFRSs is not appropriate.

ISAs are *objectives- or principles-based* and designed to be applicable for entities of all sizes in the way that the objectives of each audit are the same and the requirements to achieve the objectives are the same. There is however no requirement to apply an ISA or those individual requirements of an ISA which are not relevant to the audit, which is particularly relevant in a smaller entity environment.

The difference is in the application of the requirements as the specific audit procedures to be undertaken when applying the requirements may vary considerably in the audit of a small and simple entity compared to that of a large or complex one. This proportionate approach is based on the use of professional judgement by the auditor.

The proportionate approach is also relevant for the audit documentation. The ISAs do not require documentation of every matter considered or professional judgment made. The test is whether an experienced auditor can understand what has been done, not whether someone with no knowledge of auditing can.

Ethics and independence

For professional ethics and independence rules, further harmonisation would be a benefit in the same way as for auditing standards. Although

the Statutory Audit Directive enabled EU Member States to introduce relevant improvements to the independence requirements for auditors, major differences continue to exist. Further harmonisation, for instance through mandating the relevant parts of the international IESBA Code of Ethics, would be beneficial.

Such an initiative would mean that auditors are required to have sufficient knowledge and competence to carry out any audit within a Member State and also outside of the home Member State. This could be another contribution to the achievement of the European passport for auditors.

Tax and company law

The main obstacles for the European passport for auditors have been argued to be related to the difficulties in harmonising other areas at European level, such as direct and indirect taxation and company law.

However, in the area of VAT, although more harmonisation could still be achieved, for instance through the use of a regulation instead of a directive, other initiatives to reduce complexity, modernise and harmonise European legislation in the area of tax are still considered.

For European company law, recent initiatives of the European Commission to discuss the way forward have provided an analysis of current problems.

The way forward

For an EU passport for auditors to achieve its full potential, maximum harmonisation will be needed. Once achieved, a true European market for audit services will be beneficial for greater competition, more choice and higher quality audits.

A European passport for all auditors and all audit firms should be available to allow auditors and audit firms with cross-border ambitions to operate in another EU Member State without additional barriers to entry. However, it should not be mandated as some firms might not want to obtain it.

For those that have ambitions to grow their audit firms across national borders, regulation should encourage them, not discourage them and impede cross border mobility.

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 27 EU Member States. In representing the profession, FEE recognises the public interest. FEE has a combined membership of more than 500.000 professional accountants working in different capacities in public practice, small and larger firms, business, public sector and education, who all contribute to a more efficient, transparent, and sustainable European economy. Based on the practical experience gained in this daily involvement in all aspects of the economy and the set of values underpinning the profession's practice, FEE believes it has a contribution to make in this public policy debate.

³ This includes material weaknesses in internal controls in relation to the financial reporting process, auditor's independence, significant qualitative aspects of the entity's accounting practices and policies, accounting estimates and financial statement disclosures, significant difficulties encountered during the audit and/or other significant matters in the auditor's professional judgement.