



8 December 2010

Commissioner Michel Barnier  
European Commissioner for Internal Market and  
Services  
European Commission  
BERL 10/034  
B - 1049 Brussels

[markt-greenpaper-audit@ec.europa.eu](mailto:markt-greenpaper-audit@ec.europa.eu)

Re: GPA/HB/LA/PW/GC/SH

Dear Commissioner,

**Re: European Commission Green Paper on Audit Policy**

FEE is pleased to provide you below with its comments on the European Commission (EC) Green Paper on Audit Policy: Lesson from the Crisis (the Green Paper).

We have considered your general and specific questions in the Green Paper with great interest and provide you with our responses to your questions attached in the Appendix. These responses include both the main point(s) answering the questions raised along with our more detailed explanations. In addition, we would like to outline below the key elements based on which we believe a way forward could be developed to enhance the auditors' contribution to the economy and the public interest.

**Responding to the crisis**

While it might take a number of years before the causes of the financial and subsequent economic crisis are fully understood, most agree that the sub-prime lending and a dramatic fall in property prices in the USA originated the financial crisis. This triggered a sudden collapse in confidence across capital markets because of doubts about the viability of financial institutions holding significant assets dependent on property lending or wholesale market funding with a subsequent and dramatic meltdown in liquidity available. The sharp and sudden contraction of funds available to the banking system generally and the ability of banks to provide credit to consumers and businesses in particular impacted the real economy.

With the unfolding of a crisis involving a combination of interdependent factors, and considering various players in the market, all the elements of our financial system deserve to be scrutinised. All national, European and global market participants involved need to think hard about the lessons of the past two years and be prepared to take the necessary steps to ensure enhanced economic stability and long term sustainability.

As an integral part of the effective operation of markets where financial institutions, public interest entities, large businesses and Small and Medium-sized Entities (SMEs) are active, the audit profession is prepared to reassess how it can enhance its contribution to the economy and to society. In our market economy, an important role of the audit profession is to bring transparency and reliability in corporate reporting.

FEE commends the EU's smart regulation initiative to which the EU and its Member States are committed. Legislative reviews and fact-based ex-post impact assessments are good practices that we fully support. In this respect, we appreciate the expected EC study on the effects of the 'acquis' on statutory audits of annual and consolidated accounts including the consequences on the audit market.

As the Statutory Audit Directive was only transposed in a number of EU Member States in the current year, it is too early for the benefits of these reforms to have fully materialised throughout the EU since such legislative and regulatory changes do not immediately induce behavioural change and impact market structures. Similarly, the clarified International Standards on Auditing (ISAs), which address a number of the concerns raised in the Green Paper and arising from the crisis, are still to be used in practice as their implementation is normally due for audits of financial statements for periods commencing on or after 15 December 2009. A few audit cycles will need to be completed and inspected before the real impact of the implementation of the clarified ISAs becomes tangible. It is therefore important to adopt them without further delay as it is this impact that should be taken into account before new adjustments to existing legislation and standards are contemplated.

We believe that a well-founded discussion with all stakeholders involved in audit policy will only be achievable if such discussion is based on a careful analysis of the current audit model and its integration within the entire regulatory, financial reporting and corporate governance system. We fully understand that such an in-depth analysis is not within the scope of the Green Paper which is intended to legitimately stimulate a public discussion, although such analysis is, however, vital for determining further measures.

FEE also stresses that the majority of matters related to the audit market and the audit process have to be considered at a global level. There is a need for enhancing global convergence in relation to audit regulation, audit standards and ethical standards.

Although evidence to date suggests that, despite very challenging economic circumstances and the financial market crisis, auditors have, overall, been performing their role as requested with diligence, FEE welcomes the opportunity to discuss with all stakeholders how in the future the value of an audit for users of annual reports and audited financial statements might be further enhanced.

We share the Commission's objective of reassessing and enhancing the value of the audit. In today's rapidly changing world, the role of the audit should not be considered in a static but in a dynamic way. As Europe becomes less central in this world of constant innovation in products and services and technological change, for instance with the expanding use of XBRL in Asia and the Americas, there is a need to take full account of the further integration of markets, the growing globalisation and multi-polarisation of the world economy. Stakeholders' initiatives, more than regulators' requests, are reshaping reporting to the needs of tomorrow's sustainable economy. In this respect, the growing trend towards 'integrated reporting', bringing financial, governance, environmental and social reporting as well as management reporting into a consistent framework carries considerable promise and is likely to result in significant changes. These changes in reporting will also impact on the provision of audit and other assurance services in the future.

The preparation, reporting and presentation of financial and other information is a responsibility of management and the board(s) of the company. The auditor's responsibility consists of the provision of assurance services, including audit, in respect of financial and other information produced by management and board(s). It follows that the auditor's responsibility must be seen as 'secondary' to management's and board(s)', without consequently exceeding the responsibilities assumed by those who originate the information. This is why it is crucial that business is also closely involved in how the audit process can evolve to meet to changing market expectations of investors and others.

An entity's management and board(s) are responsible for the preparation of financial statements and other financial information in accordance with the applicable financial reporting framework, being it national or international accounting standards. An auditor's responsibility is to express an opinion on such financial statements. When the European Commission suggests that financial statements and auditor reports may not be "fit for purpose" it should be noted that any discussion about the auditor's role needs to start with the underlying financial reporting framework and its ability to meet the needs of users and other stakeholders. FEE therefore believes that a comprehensive evaluation of the whole financial reporting system may be needed.

### **The future role of the auditor**

FEE is of the view that the role of the auditor can be expanded in the future, as explained hereafter. However, audit is but one part of the financial reporting system and therefore auditors should only assume responsibility for their own role and actions without excessive and disproportionate liability attaching to them.

FEE represents qualified accountants from all sectors and all audit firms and cares particularly about the needs of SMEs and Small and Medium-sized Practitioners (SMPs). Many of the issues raised in the Green Paper seem almost exclusively focused on the top end of the audit market relating to financial institutions, listed entities and other public interest entities. Consequently, the issues and responses to questions for which we have indicated the application to be limited to such entities, should not be extrapolated to other entities without in-depth analysis and an appropriate impact assessment of the implications this would have on SMEs and SMPs.

To improve communication for entities, if the investor community is interested, management or the board(s) could, in a proportionate way, report on the assumptions on which the entity's ability to continue as a going concern is based. Management and the board(s) could also disclose additional information on key risks associated with the entity's business model and its longer term sustainability. The auditor is well positioned to provide assurance on this additional information. The involvement of the auditor in relation to management's or the board(s)' reporting on Corporate Social Responsibility (CSR) and other environmental, social and governance (ESG) information could also be further enhanced to respond to today's market needs and the expectations of an enlarging number of stakeholders.

In relation to public interest entities, the balance between auditor's reporting on key matters arising from the audit to the public at large and private reporting to the supervisory board or audit committee should be carefully considered. Additionally, whether key matters arising from the audit should be reported by the external auditor or by the audit committee or supervisory board also depends on users' demand and should be debated further with all relevant stakeholders, bearing in mind the primary responsibility of entities' governing bodies to report financial and other information.

We are also supportive of more open and regular dialogue between external auditors, internal auditors and the audit committee or supervisory board, if available. In regulated industries, we believe more regular mutual sharing of information could be achieved by better three-way communication between external auditors, regulators or supervisors and entities.

In the debate on such communications, a proper balance needs to be struck and two main shortcomings avoided: first, the creation of an information overload that would reduce the accessibility to and relevance of key information, and second, the production of self-fulfilling prophecies that would have counterproductive effects threatening entities' existence.

This need to enhance auditors' communication, reinforce professional scepticism and the requirements for group auditors as well as many other issues are already addressed in the ISAs whereas improving the standard on the audit report is being considered. Therefore, FEE fully supports the adoption of ISAs for all statutory audits in the EU through a legally binding instrument at EU level. ISAs would also help enable the EC to fulfil a number of its objectives by contributing to the improvement in cross border mobility and improve coordination between audit oversight bodies, both at EU and international level.

We believe that European auditors' oversight will be best performed by a new specialised Level 3 Committee in which colleges of audit oversight bodies should be responsible for the common inspections of pan-EU audit firms. Other solutions – particularly integrating audit oversight into an existing Level 3 Committee – may have serious shortcomings, especially when covering conflicting areas of supervision like financial reporting and auditing. Given that audit oversight mainly requires high-quality human resources with appropriate audit expertise, the possibilities for achievement of significant synergies between the various areas of supervisory responsibilities do not seem achievable.

## Creating better framework conditions

FEE also recommends the adoption of the Independence Section of the International Ethics Standards Board of Accountants (IESBA) Code of Ethics for both public interest and other entities as it includes a robust approach to the provision of non-audit services and remuneration of auditors as well as many other independence-related issues.

Multi-disciplinary audit firms, as opposed to 'pure audit firms', are the best way forward to advise businesses and public authorities, as they bring together the expertise needed in different areas relevant in doing business. Such audit firms are also conducive to continue maintaining and creating highly qualified jobs for young talent.

FEE also believes that the adoption of the International Standard on Quality Control ISQC 1 (or equivalent system at least as demanding) throughout the EU would further encourage fundamental governance principles in audit firms. For audit firms auditing public interest entities, additional financial transparency and enhanced internal governance could be envisaged.

ISAs, the IESBA Code of Ethics and ISQC 1 are proportionate and can be adapted to perform audits of smaller entities and be applied by smaller audit firms. In this respect, an introduction of differing requirements for differing types of assurance engagement and relief from independence requirements for small and medium-sized audit firms could carry the risk that the audit profession would be split into 'first' and 'second' class auditors, resulting in additional barriers to enter the 'first' class and further strains on the supply of audit services.

Adoption of these international standards would put the EU back on the map as a global leader in regulatory, reporting and auditing matters. It could also create goodwill from other international players for some of the initiatives the EC is considering, most of which can only work in a global context.

As far as the appointment of auditors is concerned, we believe shareholders are best placed to continue to find the most suitable auditor for their entity from an independence and competence point of view. This is one of the fundamental rights of the owners or shareholders of an entity. Improvements can be envisioned, for instance in relation to transparency of auditors' appointment and reappointment.

In general, there is a large number of participants on both the supply and the demand sides of the audit market. However, in the audit market of large multinational entities, the number of suppliers is perceived as too limited. Policy responses to this issue are much debated. As FEE is a body covering all sectors of the profession, our approach focuses on contributing to this debate from a public interest perspective. In this respect, we look forward to the outcome of the planned EC study, as initiatives in this field have to be carefully assessed.

Continued progress in audit policy will require the engagement and cooperation of all stakeholders at national, European and global level. Therefore FEE is at the full disposal of the European Commission to discuss any of our comments in further detail in order to contribute to the important work of striking the right balance in audit policy, including enhancing audit quality. This also includes further discussions related to any issues raised in our responses to the detailed questions included in the appendix to this letter.

### **About FEE and the process to develop this paper**

FEE's ID number on the European Commission's Register of Interest Representatives is 4713568401-18.

FEE represents 43 professional institutes of accountants and auditors from 32 European countries, including all 27 EU Member States. The membership of FEE is composed exclusively of professional bodies recognised either by law or general consensus as being substantial organisations of good standing within the accountancy profession. FEE's membership does not directly include firms or individual accountants. Through its member bodies, FEE has a combined membership of more than 500.000 professional accountants working in different capacities in:

- Public practice, i.e. in accountancy firms of all sizes as well as sole practitioners;
- Enterprises of all types and sectors, multinationals and SMEs, as employees or self-employed in financial departments, operational divisions or management e.g. as CFOs or CEOs;
- The public sector, including in Courts of Auditors, internal audit functions or others, and;
- Education.

A majority of the members of FEE Member Bodies are active in small and medium-sized practices (SMPs) and/or servicing the SME sector. SMEs-SMPs are therefore an important strategic priority of FEE and are involved in all relevant FEE groups and decisions-making mechanisms. In representing the profession FEE recognises the public interest.

To respond to this specific European Commission consultation, FEE has set up a dedicated process ensuring a holistic and inclusive approach, including consultation of all FEE Working Parties (more particularly Auditing and Qualification and Market Access, as well as Ethics, SME-SMP, Company Law and Corporate Governance, Sustainability, Banks, Insurance and Public Sector) and Member Bodies, webinars and conference calls, warranting the inclusion of the more remote or smaller jurisdictions, and dialogues with the leaders of the profession all across Europe and beyond.

The views put forward by FEE take the perspective of the broad European accountancy profession and are not specific to particular jurisdictions or particular audit firms. Responses by FEE Member Bodies might differ because of specific local circumstances.

For further information on this letter, please contact Hilde Blomme, FEE Director of Practice Regulation, at +32 2 285 40 77 or via email at [hilde.blomme@fee.be](mailto:hilde.blomme@fee.be).

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Hans van Damme', with a long horizontal stroke extending to the right.

Hans van Damme  
FEE President

A handwritten signature in black ink, appearing to be 'Philip Johnson', with a long horizontal stroke extending to the right.

Philip Johnson  
FEE Deputy President