

## **FEE Conference on Audit Regulation**

**Auditorium of the National Bank of Belgium, Brussels**

**Tuesday 27 November 2007**

### **MINUTES OF PANEL DISCUSSION ON QUALITY ASSURANCE SYSTEMS IN EUROPE**

**Jens Røder**, President of the Foreningen af Statsautoriserede Revisorer (FSR) in Denmark, Panel Chairman, introduced this session as a wrap up of all the discussions held at the conference. This panel will aim at demonstrating how the different critical aspects in relating to audit regulation can be brought together. Auditors, investors and regulators all have the same objective of achieving a true and fair view of financial information but might have different views on how to get there.

**Jürgen Tiedje**, Head of Unit, Auditing, DG Internal Market and Services of the European Commission, expressed his personal views and started the panel discussion by pleading for a smooth and correct implementation of the Statutory Audit Directive as the key for external quality assurance and audit inspections. The three main issues are public oversight, independence of the controller and public reporting.

For public oversight, there are two main models in Europe; one having an independent body (e.g. adopted in the UK or the Netherlands) and one having an independent committee delegating tasks to a Chamber of Auditors. The key question is the equivalence of these two models, and whether the role for public oversight is active (approving elements of the oversight such as the inspection, the methodology, the work program and reporting) or passive (having only the right to participate in the oversight process and accessing the working papers). The current public debate shows a move towards a more active role as a means to enhance the public interest.

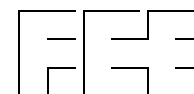
The independence and expertise of inspectors and peer-reviewers is another main issue to be addressed. While the audit profession has a preference for peer-reviewers, the trend is moving towards inspectors. It is necessary to find a balance between having the requisite integrity in terms of the independence of inspectors and the necessary level of expertise that is required in the practice of audit inspections. Shall we go for a more principles-based approach for independence rules rather than having only independent inspectors? The model currently debated includes having a mixed team of independent inspectors and experts in the audit field to achieve this compromise.

Confidentiality and whether it is worthwhile having a more public reporting on the outcome of the inspections is another element in this debate. Article 29 of the 8th Audit Directive focuses on aggregated annual reports, while the question raised by the European Commission is whether there should be reporting about individual audit firms, as there may be possible deficiencies in the internal quality control system of an audit firm.

The political answer to these questions is awaited but 'cultural diversity' in Europe would be the wrong answer.

**Prof. Kai-Uwe Marten**, Deputy Chairman of the Auditor Oversight Commission in Germany, offered the views on Quality Assurance systems from the perspective of a public oversight authority.

With the implementation of independent public oversight bodies, independent regular quality assurance inspection is seen as the key instrument to restoring public confidence.



The limitations of the peer-review system are addressed with the involvement of public oversight. The question of whether this should only involve public oversight bodies as opposed to the sole involvement of audit professionals ('peers') needs to be addressed. An aspect to consider is the availability of resources in terms of expertise that is required to perform the inspections.

Independent inspections are relevant as an element to restore public confidence in the concept of audits, to enhance the credibility of financial information through independent audits and to ensure that the capital markets function well. To achieve this, independent inspections of audit firms auditing public interest entities add public credibility and reliability, facilitate mutual recognition and offer a wider scope in quality assurance.

In Germany, the new inspections system effective from 6 September 2007 affects 150 auditors/audit firms of public interest entities. The new inspection cycle will ensure that the 25 largest public interest entity audits are inspected every year and smaller public interest entity audits inspected every three years. Under the new system, all inspections are organised by the Chamber of Public Accountants and performed by fulltime employees of the Chamber. The ultimate responsibility and decision-making power rests with the Auditors Oversight Commission (AOC). For this, the AOC has access to all documents, the right to participate in any inspections, receives the inspection reports and has the right to initiate inspections any time.

Regulators have an interest to protect local but also external investors. The existence of an equivalent quality assurance system for public interest entities auditors at a global level is core in the debate of mutual recognition.

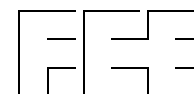
The International Forum of Independent Audit Regulators (IFIAR) has a role in the exchange of best practise in the area of audit inspections.

**Philippe Steing**, Secretary General of the Haut Conseil du Commissariat aux Comptes (H3C) in France, presented the principal recent changes to the French Quality Assurance system. The new expectations of the H3C turn around the reinforcement of independence and efficiency of the quality assurance system.

In France, the H3C is an independent administrative authority and the CNCC (chamber of auditors) assists the H3C in its general tasks. As such, inspections are carried out under the supervision of the H3C by the CNCC. Following a H3C decision, an independent body of inspectors was created, composed of non-practitioners (employees of the CNCC) performing the inspections for public interest entity auditors and practitioners for non-public interest entity auditors, but under the overall supervision of the H3C.

The overall responsibility of the H3C over the Quality Assurance System includes;

- The approval of the operational program for conduct of inspections and the budget;
- The oversight of the financial independence of the inspection system vis-à-vis the audit firms;
- The approval to the reviewer recruitment and assignment (including the withdrawal from professional duties if required);
- The disapproval of the reviewer appointments where competence and independence conditions are unfulfilled;
- The instruction of reviewers on conduct of inspections;
- The right to review all the documents held by the reviewers;
- The receiving of inspection reports; and
- The authorisation of adding practitioner-reviewers for inspections of certain PIE engagements as appropriate.



The effective implementation of this new system is still in progress and a Working Committee Group chaired by the President of the H3C has been created for this purpose. In particular, this Group will work on the budget, work program, the appointment of reviewers to this new inspection body and the decisions to be taken by the H3C Board on specific topics. The application of this system will take place next year and an assessment of its efficiency will be made before June 2008 on a sample of audit firms. This will be done with the ultimate goal being to ensure an efficient system in the best interests of the audit community and for the benefit of the capital markets.

**Katalin Fekete**, Vice-President of the Chamber of Hungarian Auditors (MKVK), presented the Quality Assurance System in Hungary with an introduction of the legal background in Hungary.

The monitored peer-review system was introduced in Hungary with the commencement of a quality assurance system in 2003. All statutory auditors and audit firms are currently subject to the quality review system. This includes the testing of selected files, the assessment of compliance with International Audit Standards (ISAs), the internal quality control of the firm and independence requirements. Except for the frequency of the review there is no difference in the treatment of public interest entities and other entities.

The main reaction to this introductory phase included some resistance from practitioners, while there was no reaction from stakeholders in terms of the quality of auditors. Now that the system is accepted in Hungary there is no criticism of the professional skills or the independence of the reviewers.

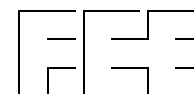
The implementation process of the Statutory Audit Directive will be completed in Hungary with the new law being effective from 2008. With the expected Quality Assurance system under Public Oversight from 2008, the quality assurance system in Hungary will be modified to introduce the control of resources including the audit fee, an extraordinary review initiated by the Public Oversight Committee and a separate fund for financing the system.

The Public Oversight Committee will have the right to conduct investigations and to take appropriate actions as necessary.

In Hungary, it is felt that there is no need for a new inspection system such as the new recommendation for the audit of public interest entities, particularly if this overrides the Statutory Audit Directive. While it is understood that equivalence with the US system forms part of the EU agenda, a separate inspection system of public interest entities seems unreasonable in Hungary, as there are no potential inspectors in Hungary and this could result in the wrong message to stakeholders.

**Rafael Cámara**, President of the Instituto de Censores Jurados de Cuentas de España (ICJCE) commented on the role of the audit profession highlighting some of the key aspects of the Statutory Audit Directive, emphasising the distinction between regulation and oversight and offering an overview of the current situation on quality assurance in Spain.

Article 32 of the Statutory Audit Directive dictates that Members States shall organise an effective system of public oversight for statutory auditors and audit firms. This should result in a clear view on who has the ultimate responsibility for and right to conduct the audit investigations as well as ensuring that these are transparent and adequately funded. Independence is the key element of such a process and this means the absence of any kind of influence and this is achieved by means of training and experience on the part of the members of the supervisory body, by means of a



transparent nomination process that takes place over a period that is long enough to avoid any political influence in the process.

Regulation and oversight have different meanings and thus different aims. While regulation relates to the institution that is responsible for the implementation of the legislative input, oversight implies an ultimate responsibility over the adoption of professional standards and the supervision of the professional behaviour of members in the audit profession.

The current situation on quality assurance in Spain includes two systems, one established by the ICJCE over its members and a second one established by ICAC but, in practice, carried out by the professional bodies. The Accounting and Auditing Institute (ICAC) is an agency dependent on the Ministry of Economy and Finance. The governing bodies of ICAC comprise of the president (a political position) and two advisory committees; the Accounting Committee and Audit Committee. All the decisions remain in the hands of the president of ICAC and there are no public programs or results of its quality assurance reviews. The audit profession funds the quality assurance system and ICAC is responsible for the disciplinary actions and sanctions. It is unclear whether ICAC acts as an oversight body or regulator and there is need for opening the debate on implementing a new system in Spain.

The overall view is that there is not a single solution to address the quality assurance and oversight system of the audit profession, while the oversight system should be independent. There is a belief that the aim of the Statutory Directive is not to exclude the audit profession from the oversight and quality assurance, given the inherent knowledge within the audit profession and the interest to maintain a strong, high quality, reliable and sustainable audit profession.

Unfortunately, there was no time available to invite questions from the audience.

**Jens Røder**, Chairman, closed this session and thanked all the participants.