BUSINESSEUROPE

SPEAKING POINTS

16 December 2010

FEE CONFERENCE
STAKEHOLDERS' EXPECTATIONS FROM STATUTORY AUDITORS
STANHOPE HOTEL
BRUSSELS
16 DECEMBER 2010

PANEL DISCUSSION – PRIVATE SECTOR'S PERSPECTIVES
10.00 – 11.15 HOURS

PHILIPPE DE BUCK, DIRECTOR GENERAL

Some facts:

A. Audit reports are key for confidence and access to finance

- Audit is an integral part of the financial environment. It should provide an accurate opinion of whether a company's financial statements are true. It is thus central to confidence in the marketplace and key for companies' access to finance.

B. There is no single market for audit services

- Currently there is no single market for the provision of audit services. There are many barriers to integration of the European audit market and cross-border mobility of audit professionals is low. We should try to resolve that.

- Statutory audits of financial statements of limited liability companies are required by Community law (4th and 7th EU Directives). Community law also states that statutory audits shall be carried out on the basis of International Standards on Auditing (ISAs) to ensure high quality. And yet, the Commission has not adopted these standards. It should do so as soon as possible to create more harmonisation across the EU.

C. Clean audit reports did not avoid the financial crisis

- Although audits of some large financial institutions just before or during the crisis resulted in 'clean' audit reports, there were serious problems with the financial health of these institutions.

D. Strong concentration in the market

- The audit market is dominated by only four accountancy firms. If one of these firms would get into trouble the consequences for competition will be significant.

AV. DE CORTENBERGH 168
BE-1000 BRUSSELS
BELGIUM
VAT BE 863 418 279

BUSINESSEUROPE a.i.s.b.l

TEL +32(0)2 237 65 11
FAX +32(0)2 231 14 45
E-MAIL: MAIN@BUSINESSEUROPE.EU
WWW.BUSINESSEUROPE.EU

E. Audit services are often mixed with consultancy services

- Often an audit firm also offers non audit services to the same company. It is important that this does not jeopardise the independence of the audit.

Why is this and what can we do about it:

The role of the auditor

- Examining the role of auditors in the financial crisis is certainly justified. And there is absolutely a need for better regulators of systemic risk. The question is whether and to what extent auditors should be expected to take this responsibility.

- The crisis was caused by a combination of factors which were all highly interlinked involving a large variety of market players. Central banks and national supervisory authorities are now much better equipped to regulate and overview this. That is why we strongly supported the setting up of a European System of Financial Supervisors and the creation of a European Systemic Risk Board which will start working soon at the beginning of next year.

- The fact that companies' financial statements are audited means that the auditors provide "reasonable assurance" that the financial statements as a whole are free from material misstatement, whether due to fraud or error. Through various procedures, such as identification of a company's risks, assessment of internal controls, discussion with management, auditors seek to minimise the risk that financial information is materially misstated.

- This does not mean that the accounts are entirely free from misstatements. "Reasonable assurance" does not mean "absolute" assurance.

- Based on this assurance and the financial statements themselves, the market will and should form their own opinion on the financial health of the company. They will be guided by rating agencies and other professionals in this assessment.

Expectation gap

- If there are any misunderstandings about what may be expected from an auditor and what the auditor actually delivers, it would be first up to the profession and regulators to make it more clear what an audit means and what users can expect from them.

Broadening the scope of audits

- We are not in favour of larger audit opinions describing for instance business risks, etc. If business risks are material, then management should provide this information in the financial statements. If the auditor finds that information should have been included, then the auditor has to consider whether to qualify the opinion.

- The Commission should also not make proposals that force auditors to give assurance on forward looking information. Auditors cannot control management decisions, new strategic initiatives, mergers etc. It is thus nearly impossible to gather sufficient audit evidence to issue any form assurance on forward looking information.

- Assessing the forward looking information provided by management is one of the core businesses (if not the core business) of credit rating agencies and analysts. When they apply their methodology to give external estimates on the value or prospect of a business, this is based on information both from the company and from other sources.

- Proposals to ask the auditor to provide forward looking information will simply add an extra layer of uncertainty and it could endanger the independence of the auditor as the auditor would have the incentive to meet the estimates expressed earlier by choosing appropriate accounting treatment.

- We are also not in favour of proposals to broaden the scope of audits. For example, narrative reporting, such as CSR, should be the sole responsibility of the company. CSR reporting is a voluntary reporting adapted to the specific entity on the areas that are important to the business concerned.

- Proposals to broaden the scope of an audit should also consider potential liability issues with EU recommendations to limit liability still not being uniformly implemented in the EU. The vanishing of another major audit firm would certainly not help to reduce concentration on the market.

Governance and independence of audit firms

- Regarding the governance and independence of audit firms, the shareholders are ultimately responsible for the selection of the auditors at the general assembly. The auditor acts thus on behalf of the shareholders.

- We believe that this is appropriate. The company is best able to determine which auditor has the necessary knowledge of the industry and the adequate international network. The company must remain responsible for that choice and not a third party such as a regulator.

- We should also not forget that important steps have been taken to ensure that the provision of consultative services does not endanger the independence of the auditors, such as partner rotation and the requirement to allow other audit firms to make competing bids for the audit contract (tendering).

- In addition to these safeguards, we do believe that there should be a maximum level of fees an audit firm can receive from a single client. Currently, different rules regarding limitations on the total fees (audit and non audit) arising from one client

are already in place across the EU. It would thus be useful to have a common threshold throughout the EU.

- I want to underline that the provision of non-audit services by a company's auditor is very useful. It is essential for the audit quality in general as it is the most efficient way to maintain all necessary skills in a same structure. Analyses of international activities of the companies are ever more complex and it is of the utmost importance to maintain the diversity of skills in the audit firms to adapt to this growing technical nature. "Pure audit firms" would lead to a poorer quality audit and less service to the companies concerned. We are thus against an EU-wide ban prohibiting auditors from delivering non audit services.

- We could also support increased transparency with regard to the audit firm's own financial statements. These should cover global networks audit firms.

- Audit firms should also strengthen their corporate governance and organisational requirements to further mitigate conflicts of interest and reinforce their independence.

- However, primarily it is the task of supervisors to control whether independence requirements are met. They have the power to determine that an auditor should not perform an audit in case there is a problem.

Audit inspections

- Regarding supervision, we are in favour of audit inspections of multinational audit networks. We support a more formalized integration of the European audit inspection units in order to achieve more identical practices. A model where a centralized audit inspection unit is integrated into an existing framework similar to what has recently been agreed in the area of financial supervision would be the best solution. We do not see the need for a pan-European inspection unit.

- Apart from better European integration of control, we also need better international cooperation between audit regulators as this is the only way to conduct audit inspections of large global networks.

- However, better international cooperation should not endanger the confidentiality of business sensitive information that is in the hands of an audit firm.

Increasing competition

- Given the strong concentration on the audit market, the emergence of new entrants is certainly desirable. However, proposals to require joint audits or the mandatory formation of an audit firm consortium with the inclusion of at least one smaller firm are not the right solution. They would burden companies without resolving limited choice in a very concentrated market.

- We also cannot support a mandatory rotation of audit firms as this would lead in fact to less competition in the audit market considering that other audit networks will be able to calculate when an audit network is going to rotate. Better is partner rotation since if it is only the partner who is going to rotate then the competition will be stronger.

- We should try to understand why there is a "Big Four bias". The difference between the Big Four and other firms is their widespread international presence and their particular reactivity on any topic, in almost any country. Large multinational entities require such large, global networks. This also has to do with the use of the International Financial Reporting Standards (IFRSs) as only the Big Four audit firms today may be able to maintain a sufficient knowledge of these standards, and even in these networks the local offices struggle to maintain sufficient knowledge.

- It is important to first thoroughly investigate what the causes of the Big Four dominance are before creating new legislative measures that could create more administrative burden or uncertainty in the market. In any case, we are against a forced reversal of the consolidation that has taken place in the last years.

Adoption of International Standards on Auditing (ISAs)

- As stated before, BUSINESSEUROPE is in favour of more harmonisation for audits. We support the adoption of International Standards on Auditing in the EU for the statutory audit of all companies except for the audits of small companies as the standards are inappropriate and too burdensome for these small entities.

- The standards should be made legally binding for auditors throughout the EU. We are convinced that this will contribute to more consistent and comparable audits in the EU which in turn will enhance the value of the financial statements of European companies and bring us closer to a truly single market for audit services.