BUSINESSEUROPE

SPEAKING POINTS

31 January 2012

INSTITUT DER WIRTSCHAFTSPRÜFER IN DEUTSCHLAND (IDW) SYMPOSIUM "THE FUTURE OF THE AUDIT"
31 JANUARY 2012
REPRESENTATION OF NORTH RHINE-WESTPHALIA TO THE EUROPEAN UNION IN BRUSSELS, RUE MONTOYER 47, BRUSSELS

PANEL DISCUSSION – SESSION 3 – ALTERNATIVE APPROACHES TO ENHANCE THE AUDIT OF FINANCIAL STATEMENTS AND ACCOMPANYING MEASURES
14.45 – 15.45 HOURS

PHILIPPE DE BUCK, DIRECTOR GENERAL

Audit reports are key for confidence and access to finance

- Audit is 1) an integral part of the financial environment. It should 2) provide an accurate opinion of whether a company's financial statements are true. It is thus 3) central to confidence in the marketplace and 4) key for companies' access to finance.

- BUSINESSEUROPE is therefore strongly in favour of enhancing the quality of audits. We support efforts to ensure that European companies have access to high quality audits and that auditors operate independently.

- I would like to address four important issues that are central to the debate about the future of audit policy:

  1. The role of the auditor
  2. The scope of audits
  3. Governance and independence of audit firms
  4. How to increase competition

1. The role of the auditor

- 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 exclude 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 although it should be close to that**.

- 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 for those companies that have ratings and other professionals in this assessment.

- Providing comfort on the financial health of companies is very difficult for auditors. It is unlikely that audit can provide a high level of assurance on forward looking information. **The long-term health of a company is the responsibility of the management** and when the audit is assumed to provide assurance on this there is an expectation gap.

- Generally, audit procedures will uncover common errors and normal managerial misstatements. In collapsing systems or fraudulent firms where there is significant collusion by management, **it is more difficult for audit to detect the fraud or systemic risk even though an auditor should be able to identify major risks and check procedures with a view to avoiding fraud.**

- The best way to bridge an expectation gap is to **provide clear information about the limits of the audit**. An audit is not a marketing study or activity.

- This does not exclude that one should always strive at **improving the quality of the audit**, for example, through audit inspections, better education, better auditing standards, and better interaction with regulators if they are there.

2. Broadening the scope of audits

- We are not in favour of larger audit opinions describing for instance **business risks**, for example related to the competition situation, technological developments, or socio-political events. 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 of assurance on forward looking information.

- We are also not in favour of proposals to broaden the scope of audits to include **narrative reporting, such as CSR**. CSR reporting is a voluntary reporting adapted to the specific entity on the areas that are important to the business concerned. This does not exclude of course that companies which want to have this information audited can request their auditors to do so.

- We should also not forget that **users of audit reports, such as investors, have other sources of information** such as rating agencies, sector reports, regulatory and supervisory bodies, insurance markets, investment analysts and often additional disclosures above those required by law such as disclosure by directors of discussions that they have had with auditors, reports from internal risk management committees, or information from the audit committee of a company.

3. 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 on behalf of the shareholders**. We should also not underestimate the role of **a strong audit committee** in preserving auditor independence.

- The provision of **non-audit services** by a company's auditor is very useful provided that **effective safeguards** are put in place **to not endanger the independence of the auditor**.

- The provision of non-audit services by audit firms – both to their own audit clients and to other companies - is also important 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 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.

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

- 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.

4. Increasing competition

- Given the strong concentration on the audit market, the emergence of new entrants is certainly desirable. Companies should be able to choose from a variety of firms and we **favour competition and new entry** in the market.

- Currently there is **no single market for the provision of audit services**. Audit services are excluded from the Services Directive and there are many barriers to integration of the European audit market. Consequently, cross-border mobility of

audit professionals is low. We should try to resolve that and therefore **support proposals for a pan-European passport for auditors**.

- Requiring **joint audits** is not the right solution and should not be re-introduced in the debate. 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 to a **loss in knowledge and quality** especially when the rotation period is very short. When a new auditor is appointed, it takes time to understand a business. Audit quality could also suffer in the last years when rotation is imminent. It would also not increase 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 are four big audit companies**.** 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. **Some large multinational entities require large, global networks whilst other entities are well-serviced by other firms**.

* * *