

European Commission Summary of Responses to the Green Paper

From their summary dated

February 4, 2010



Information on Respondents

- **688 responses received**
 - 87% (599) from EU member states
 - 42% (252) from Germany (200 identical responses from German audit profession)
 - 2/3 from Germany, France, UK, Spain
 - 59% (407) from audit profession (largest group)
 - 285 from SMPs
 - 21% (144) from preparers (second largest group)
 - Other respondents included public authorities, users, audit committees, individuals

Issues dealt with in the summary

- Role of the auditor
- ISAs
- Governance and independence of audit firms
- Supervision
- Concentration and market structure
- Creation of European Market
- Simplification : SMEs/SMPs
- International co-operation

Appointment of auditors

- Professional bodies and associations
 - Code and audit committees adequate to address potential independence risk
 - Others acknowledge conflict in being appointed by the audited entity
 - Majority rejected appointment by third parties
 - Could be 3rd party involvement in limited cases
 - Right of supervisor to veto appointment
 - Government involvement if company receives public funds

Appointment of auditors

- **Big 4**

- Do not believe there is a conflict vis a vis appointment process
 - Rely on effective audit committees
 - EC has been asked to consider establishing independent body to work with audit committees
 - Ensure regular and open tendering
- Appointment by 3rd party would disenfranchise shareholders and audit committees
 - Some instances where regulator could be involved in appointment process
 - 3rd party appointment may be appropriate if previous auditor resigned due to a disagreement

Appointment of auditors

- **Mid-tier and SMPs**

- Main conflict – management having a role in appointing the auditor
 - May be a case for regulators to appoint auditor in case of large banks
- Role of audit committee in appointments could be strengthened
- Support regular tendering of audit
- However, some feel auditor should be appointed by the entity
 - 3rd party, maybe a regulator, could appoint for listed entity audits, if SMPs have access as well

Appointment of auditors

- **Investors**

- Believe there is a conflict in audited entity appointing the auditor; measure that can mitigate include
 - Shareholder approval
 - Audit committee engaged in audit process
 - Transparency of relationship between company and auditor
 - Transparency re: change of auditor/ views of outgoing
 - Regulator should be able to disagree with appointment
 - Remuneration of partners and staff should ensure high quality audits
- Most oppose appointment by 3rd party
 - Would undermine accountability of auditors and their relationship with shareholders

Appointment of auditors

- **Public authorities**

- Inherent conflict of interest when auditor is appointed and paid by the entity
 - In certain cases it should be forbidden
- Should be appointed and paid by the audit committee
- 3rd party appointment could be justified for certain PIEs
 - Certain EU member states regulators' have veto rights
 - Seen as an efficient way to control the appointment process

Rotation of Firms

- Professional bodies - generally rejected
 - Could be limitation, e.g., 10 years, for PIEs
- Big 4 - oppose
 - Studies show would harm audit quality
 - Statutory directive for partner rotation not yet implemented
- Mid-tier and SMP – do not support
 - Will increase costs, not audit quality

Rotation of Firms

- **Investors – some did not support**
 - But supported mandatory tendering after specified time period
 - More transparency on re-appointments, tendering, etc., needed
 - Greater involvement of shareholders
- **Public authorities – many did not support**
 - Others felt would be beneficial; could rotate firm at the same time as the partner rotates
 - Could allow audit committee to decide based on threats to independence

Rotation of Firms

- **Academics**

- Some supported rotation

- Rotation combined with fixed period (5-7 years) would decrease auditor bias to please management
 - Limit dismissal of auditor to material reasons and require Court approval - will reinforce independence
 - Should at least be for PIEs
 - Partner rotation does not contribute to independence

- Research suggests rotation may be beneficial in limited situations

- Cost to change is low, market is not competitive, reputation has limited effect on auditor performance

Non audit services

- **Professional bodies - generally rejected**
 - Audit committee should have more input on NAS
- **Big 4 - opposed**
 - Weakens the economic independence and skills
 - Should introduce some restrictions on systemic financial institutions
 - Increase role of audit committee
- **Mid-tier and SMP**
 - Prohibition for PIEs and systemic financial institutions
 - Safe harbor for SMEs

Non audit services

- **Investors – in favor of some limitations**
 - NAS with no connection with the audit at least discouraged
 - More transparency on the kind of NAS provided
 - Some suggest a list of NAS
 - Importance of uniform implementation of independence rules
 - Maximum % of NA fees : 25%
- **Public authorities – Not prohibited for all clients**
 - Some suggest a list of NAS
 - Audit committee responsible for the decision for PIEs and financial institutions

Non audit services

- **Academics – Broad support for prohibition**
 - At least, prohibition for audit clients
 - Pre-approval by audit committee
 - Improve third party perception of independence
- **Preparers – Not supportive of a wide prohibition**
 - Important to maintain diversity of skills
 - Some suggests to explore prohibition of NAS to audit client

Maximum level of fees

- Profession – agrees
- Academics
 - Propose a limit of 10%

Re -tendering

- **Profession**
 - Support for tendering on a regular basis (3 or 5 years)
- **Big 4**
 - Opposed to a limitation of continuous engagement
- **Mid tier and SMPs**
 - Opposed to firm rotation but more supportive on re -tendering

Re-tendering

- **Public Authorities**

- Broad Support for mandatory re-tendering
- Some support firm rotation

- **Preparers**

- In favor of tendering process with possible exemption if justified
- Process of tendering to be transparent and choice on a mix of parameters (audit fee should not be decisive)
- Mandatory rotation incompatible with joint audit