Basic information

2011/2037(INI) INI - Own-initiative procedure	Procedure completed
Audit policy: lessons from the crisis **Subject** 2.50.08 Financial services, financial reporting and auditing 2.50.10 Financial supervision 3.45.03 Financial management of undertakings, business loans, accounting	

Key players

European Parliament

Committee responsible	Rapporteur	Appointed
JURI Legal Affairs	MASIP HIDALGO Antonio (S&D)	27/10/2010
	Shadow rapporteur BODU Sebastian Valentin (PPE) THEIN Alexandra (ALDE) LICHTENBERGER Eva (Verts/ALE) KARIM Sajjad (ECR)	

Committee for opinion	Rapporteur for opinion	Appointed
ECON Economic and Monetary Affairs (Associated committee)	SWINBURNE Kay (ECR)	23/11/2010

European Commission

Commission DG	Commissioner
Financial Stability, Financial Services and Capital Markets Union	BARNIER Michel

Key events

Date	Event	Reference	Summary
13/10/2010	Non-legislative basic document published	COM(2010)0561	Summary
17/02/2011	Committee referral announced in Parliament		

17/02/2011	Referral to associated committees announced in Parliament		
24/05/2011	Vote in committee		Summary
31/05/2011	Committee report tabled for plenary	A7-0200/2011	
12/09/2011	Debate in Parliament		
13/09/2011	Decision by Parliament	T7-0359/2011	Summary
13/09/2011	Results of vote in Parliament		
13/09/2011	End of procedure in Parliament		

Technical information

Procedure reference	2011/2037(INI)
Procedure type	INI - Own-initiative procedure
Procedure subtype	Initiative
Legal basis	Rules of Procedure EP 55
Other legal basis	Rules of Procedure EP 165
Stage reached in procedure	Procedure completed
Committee dossier	JURI/7/04983

Documentation gateway

European Parliament

Document type	Committee	Reference	Date	Summary
Committee draft report		PE460.675	02/03/2011	
Amendments tabled in committee		PE462.588	28/03/2011	
Committee opinion	ECON	PE460.922	11/05/2011	
Committee report tabled for plenary, single reading		A7-0200/2011	31/05/2011	
Text adopted by Parliament, single reading		T7-0359/2011	13/09/2011	Summary

European Commission

Document type	Reference	Date	Summary
Non-legislative basic document	COM(2010)0561	13/10/2010	Summary

National parliaments

Document type	Parliament /Chamber	Reference	Date	Summary
Contribution	SE_PARLIAMENT	COM(2010)0561	06/11/2010	

Contribution	DK_PARLIAMENT	COM(2010)0561	10/12/2010	
Contribution	IT_CHAMBER	COM(2010)0561	23/02/2011	

Audit policy: lessons from the crisis

2011/2037(INI) - 13/09/2011 - Text adopted by Parliament, single reading

The European Parliament adopted a resolution on audit policy: lessons from the crisis.

Parliament considers that an in-depth debate needs to be relaunched on the function of the auditor and the structure of the audit market given the high degree of market concentration of the Big Four audit firms.

Welcoming the Commission's Green Paper and its proposal, Parliament insists on the need for more use of regulations and a **wide-ranging, in-depth impact assessment which**: (i) looks at the various political options; (ii) focuses on practical issues in line with the principles of 'better lawmaking'; (iii) addresses the importance of accounting in providing accurate information about the sustainable economic development of companies, and (iv) includes an analysis of interest groups in order to clarify the segmentation of the impact assessment study for the various groups, such as SMEs, SIFIs and other listed and non-listed companies.

Parliament takes the view that the debate on the **role of the auditor** should go hand in hand with a strengthening of the role of the audit committee – now largely ineffective – and of the financial and risk reporting that companies are required to carry out.

The role of the auditor: Parliament takes the view that statutory auditing has a social function and is in the public interest, as it is an absolutely fundamental component of the democratic economic and political system. It welcomes the intention of the Green Paper to increase transparency and improve the **quality of audit reports** in order to contribute to the stability of the financial market and improve access to financing.

Parliament is in favour of any measures based on the evidence that costs and burdens to financial institutions, in particular, are outweighed by improving their quality significantly, as well as by regular external evaluation and appropriate regulatory oversight. It stresses the need for **specific legislation** in this area and also call for:

- the Commission to present its proposals on **corporate governance and audit**;
- financial institutions' audit reports to include enhanced disclosure requirements for the valuation of less liquid assets;
- the extension of the role of the auditor to include audits of risk reports provided by the entity being audited.

As regards the **form** that audit reports take, Parliament considers that these should be brief, with clear, concise conclusions,and should address all aspects of the auditors' statutory remit. Financial institutions' audit reports should include enhanced disclosure requirements for the valuation of less liquid assets, so as to allow a comparison of financial instrument valuations between institutions.

Other specific recommendations deal with the issue of **transparency**. Parliament believes that auditors have both a forward- and outward-looking responsibility. It takes the view that information available to auditors that is in the public interest and relates to risk, off-balance sheet operations or future potential future exposures should always be disclosed to regulators and in most circumstances made available to the public.

Members call for the role of the **audit committees** of all financial institutions to be strengthened by requiring them to approve a risk model assessment. This assessment should be presented on an annual basis to the executive and supervisory boards of financial institutions, along with the full audit report, for consideration and approval.

They take the view that **professional scepticism** is vital in auditing and has an impact on each and every stage of an audit. They point out that this scepticism comes about as a result of the objectivity and independence of the auditor**,** combined with professional judgement developed by experience for which box-ticking procedures cannot be a substitute. They believe that fluent, regular dialogue between the external auditor, the internal auditor and the audit committee is vital to allow effective auditing.

Parliament believes there is a need for the two facets of auditing – internal and external – to be clearly circumscribed in law. It suggests that the Commission urgently adopts the **International Standards on Auditing (ISA)**, clarified through a regulation, which would make it possible to harmonise audits at European level and facilitate the task of supervisory bodies.

Governance and independence of audit firms: Parliament is of the view that there is **an inevitable conflict in the auditor being appointed and paid by the audited entity**. It does not, however, currently see any justification for this appointment to be made by a third party and calls for the audit committee's role to be strengthened. Members take the view that the auditor, where that role is a statutory one, should be appointed by the audit committee and not by the management board of the company to be audited. They consider that the audit committee should take steps to ensure that the auditor is independent.

The resolution supports the **creation of an international code of good governance for auditing firms** that audit public-interest entities.

To strengthen **auditors' independence**, Members call on the Commission to deal with the following issues: (i) regular changes in internal auditors (preferable to external rotation); (ii) a clear demarcation between the audit services and non-audit services that an audit firm provides to a customer;

(iii) a list of conditions under which accountancy services would be deemed incompatible with audit services; (iv) external auditors should be banned from providing to the audited company services that could give rise to non-compliance with the applicable requirements regarding independence, or with other ethical requirements.

The resolution notes in particular that audit services which are deemed to give rise to a conflict of interest must not be carried out by the same company, including certain advisory services and evaluations of complex structured products. It recommends that the **audit committee, as an entity of the supervisory board, not the executive board, should decide whether to permit the provision of non-audit services** to a given financial company and should negotiate the tender and details of the mandate.

Other recommendations include:

- the fees an audit firm or a network of audit firms can charge a single client should be published when they exceed a given threshold ;
- supervisors should be able to intervene with checks, limits or other planning requirements when they exceed a certain percentage of its total income, so as to prevent a situation in which the audit firm loses its economic independence;
- firms that audit public-interest entities ought to publish their accounts.

Parliament considers that, where there is proof of abuse of the position of director of an undertaking or of a public-interest entity and/or of the audit firm, **it must be possible to prosecute all concerned**.

It calls on the Commission and the Member States to ensure that **audits of public bodies** are exemplary and to prevent any conflicts of interest from arising as a result of links between the auditor and decision-makers within the public body being audited.

Supervision: in this regard, Parliament calls:

- on the Commission to submit a proposal to improve communication between auditors of publicinterest entities and the regulatory authorities;
- for the harmonisation of audit supervisory practices ;
- for the integration of the European Group of Auditors' Oversight Bodies into the European System of Financial Supervision, possibly through the ESMA;
- for enhanced, two-way communication between auditors and financial supervisors of financial institutions, especially in relation to specific areas of concern;
- for the same communication to be established for cross-border entities by auditors and the European supervisory authorities;
- on the Commission and the Member States to ensure compliance with the findings published by national audit offices in pursuit of their audit remit.

Concentration and market structure: Parliament believes, in view of the current configuration of the audit market, that the collapse of one of the Big Four firms would undermine the credibility of the auditing profession as a whole. It takes the view that firms that are deemed 'too big to fail' could create the risk of moral hazard and that the **contingency plans** relating to the major auditing firms should be reinforced. Members believe, furthermore, that these plans should be designed to minimise the risk of an audit firm leaving the market without good reason and to reduce the uncertainty and disruption that would cause. These plans ought to include a mechanism via which the regulator is informed of any problems threatening an audit firm nationally or internationally, in order to allow the regulators to play their role and handle such situations with due care.

Members support the **introduction of living wills** for the Big Four audit firms and those auditors providing significant audit services to the financial sector, as well as the laying down of cross-border contingency plans for the orderly transfer of client contracts should a significant player withdraw from the market. They emphasise that one of the aims of every action undertaken in the field of auditing must be to develop competition among the various firms operating in the sector, while maintaining audit quality, accuracy and thoroughness. They therefore call on the Commission to establish **equal competitive conditions for all firms operating on the auditing market** and to simplify the rules governing auditing at European level. This easier access to the market and the removal of obstacles for firms wishing to enter the market are vital if a larger number of participants is to be attracted on to the auditing market. The Commission should explore ways that will allow public-interest entities, the public sector and European institutions better to judge the quality of audit services provided by audit firms, irrespective of their size.

Parliament also proposes: (i) the implementation of joint audits; (ii) an assessment of the potential benefits and the costs of mandatory introduction both for audit firms, in particular small audit firms, and for audited companies – in particular financial institutions – and how it might affect the concentration of the audit market and financial stability; (iii) **the introduction of a ban on including in contracts restrictive clauses that favour the Big Four firms**.

Members call for mergers between small and medium-sized audit firms to be encouraged. They urge the Commission to look into **creating a quality certificate and register for audit companies**, so that small and medium-sized audit firms can show that their work is of a satisfactory standard. Members consider that the public procurement sector should aim to use non-Big Four firms and that public bodies should set a benchmark percentage for use of such firms. They call on the Commission, in connection with tendering by public-interest entities, to stipulate that fair access to the tendering process must be provided for at least two non-Big Four audit firms alongside the Big Four firms. They call on the Commission (DG COMP) to conduct a detailed investigation of the audit market.

Creation of a European market: Parliament returns to the issue of the European audit market and calls on the Commission to:

- examine to what extent measures to facilitate the cross-border provision of audit services might serve to eliminate barriers to market access and capacity bottlenecks; examine to what extent a European market for audit services might serve to reduce procedural complexity and **costs for all market participants**, in particular small and medium-sized audit firms;
- take all appropriate steps to incorporate into EU law and enforce international auditing standards which can help to establish genuinely equal competitive conditions for audit firms;

- come forward with proposals to enhance harmonisation with a view to creating a **European passport for auditors**, placing particular emphasis on everything that guarantees the auditor's independence;
- develop a pan-European liability regime for the auditing profession.

Lastly, the Commission is called upon to step up its efforts to increase convergence as regards international cooperation.

Audit policy: lessons from the crisis

2011/2037(INI) - 13/10/2010 - Non-legislative basic document

PURPOSE: to present a Green Paper on international audit policy following the 2008 crisis.

BACKGROUND: the measures adopted both in Europe and elsewhere in the direct aftermath of the financial crisis have focussed on the urgent need to stabilise the financial system. While the role played by banks, hedge funds, rating agencies, supervisors or central banks has been questioned and analysed in depth in many instances, limited attention has been given so far to how the audit function could be enhanced in order to contribute to increased financial stability. The fact that numerous banks revealed huge losses from 2007 to 2009 on the positions they had held both on and off balance sheet raises not only the question of how auditors could give clean audit reports to their clients for those periods but also about the suitability and **adequacy of the current legislative framework**. It seems thus appropriate that both the role of the audit as well as the scope of audit are further discussed and scrutinised in the general context of financial market regulatory reform.

The Commission is keen to assume leadership at the international level on this debate and will seek close co-operation from its global partners within the Financial Stability Board and the G20.

Against this background, the Commission presents this Green Paper which aims to open a debate on the role of the auditor, the governance and the independence of audit firms, the supervision of auditors, the configuration of the audit market, the creation of a single market for the provision of audit services, the simplification of rules for Small and Medium Sized Enterprises (SMEs) and Practitioners (SMPs) and the international co-operation for the supervision of global audit networks.

The Commission is launching this Green Paper as part of its holistic approach that includes other initiatives within the context of financial stability. This Green Paper also builds on the results of earlier studies and consultations carried out by the Commission on these matters. In particular, the Green Paper of 2nd June 2010 on Corporate Governance in financial institutions and remuneration policies addresses a number of concerns regarding the audit of financial institutions.

CONTENT: audit, alongside supervision and corporate governance, should be a key contributor to financial stability as it provides assurance on the veracity of the financial health of all companies. This assurance should reduce the risks of misstatement, and in doing so, reduce the costs of failure that would otherwise be suffered by the company's stakeholders as well as by the broader society.

Robust audit is key to re-establishing trust and **market confidence**; it contributes to **investor protection** and reduces the cost of capital for companies.

In this context, it is important to stress that auditors have an important role to play and are entrusted by law to conduct statutory audits. This entrustment responds to the fulfilment of a societal role in offering an opinion on the truth and fairness of the financial statements of audited entities. **The independence of auditors should thus be the bedrock of the audit environment**. It is time to probe into the true fulfilment of this societal mandate.

Certain stakeholders have expressed concerns with regard to the relevance of audits in today's business environment. For other stakeholders it may be difficult to understand that an institution's financial statements may suggest "reasonableness" and "material soundness" even if the same institution was, in fact, distressed financially. Given that these stakeholders may be unaware of the limitations of an audit (materiality, sampling techniques, role of the auditor in the detection of fraud and the responsibility of management), this engenders an expectation gap. **The Commission therefore advocates the need for a comprehensive debate on what needs to be done to ensure that both audits of financial statements and auditor reports are "fit for purpose"**.

The Green Paper focuses on the following themes:

- a **limited offer of international audit firms**: after the demise of Arthur Andersen there are now a handful of such large, global firms, with an even lower number of firms being able to perform audits of large, complex institutions. The potential collapse of one of these firms could not only disrupt the availability of audited financial information on major companies, it would also be likely to damage investor trust and confidence and could impact the stability of the financial system as a whole. There is a need to explore further the ways to mitigate this risk;
- options such as the ramping up of the capacities of non systemic firms and exploring the pros and cons of "downsizing" or "restructuring" systemic firms should be further examined;
- the possibilities to **reduce existing barriers to entry into the audit market**, including a debate on existing ownership rules and the partnership model employed by most audit firms;
- a **genuine single market for the provision of audit services** based on enhanced harmonisation of rules and the creation of a "**European passport** " for auditors which would allow them to provide services on an EU wide basis.

The Commission stresses the need for a differentiated and calibrated approach which is adapted and proportionate to the size and characteristics of both the audited company and its auditor and will seek, in the case of any potential proposal that may emerge as a result of this Green Paper, to modulate any such proposals to take this into account. Any measures which the Commission would propose as a follow-up to the present consultation would be subject to better regulation principles, including cost-benefit analyses and impact assessments.

The Commission will be proactive in seeking comments from the broadest possible base of stakeholders such as investors, lenders, management, employees, government authorities, auditors, tax authorities, credit rating agencies, equity analysts, regulators, business counter-parties and SMEs.

A broad consultation will allow the Commission to assess the interplay of different policy options while maintaining a commitment to financial stability. This consultation will also assist the Commission in **calibrating the intensity of any future measures in a manner that is appropriate to the size and nature of the entities in question**.

Other issues dealt with in the Green Paper are as follows:

- the **role of the auditor**: in particular as regards the definition of what sort of information should be provided to stakeholders by the auditor as part of its opinion and findings;
- the governance and the **independence of audit firms**: in particular the question of possible conflicts of interest and the rules to be respected on the matter;
- the **supervision of auditors**: the Green Paper proposes that the supervision of audit firms in Europe must be performed on a more integrated basis, with closer cooperation between the national audit oversight systems
- the **configuration of the audit market**: the market for audits of listed companies is, in the main, covered by the so called Big Four audit firms (Deloitte & Touche, Ernest & Young, PricewaterhouseCoopers and KPMG). The market appears to be too concentrated in certain segments and deny clients sufficient choice when deciding on their auditors. Such concentration might entail an accumulation of systemic risk and the collapse of a "systemic firm" or a firm that has reached "systemic proportions"5 could disrupt the whole market;
- the **creation of a single market for the provision of audit services**: a single European market for the provision of audit services could be based on enhanced ("maximum") harmonisation and a "European passport for auditors". This would imply creating a European-wide registration with common professional qualification requirements and common governance, ownership and independence rules applicable across the European Union;
- the **simplification of rules for Small and Medium Sized Enterprises (SMEs) and Practitioners (SMPs);**
- the **international co-operation** for the supervision of global audit networks.

Next steps: this Green Paper will be open for public consultation until the 8th of December 2010. The Commission will host a high level Conference on 10th February 2011 which will aim at discussing the present Green Paper and the main findings of this consultation with all stakeholders and explore possible ways forward. Once this consultation phase is closed the **Commission will announce any appropriate follow up measures and proposals in 2011**.