European Economic and Social Committee

INT/195
Statistory audit

Brussels, 10 December 2003

OPINION

of the European Economic and Social Committee

on the

Communication from the Commission to the Council and the European Parliament
Reinforcing the statutory audit in the EU

COM(2003) 286 final

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On 22 May 2003, the European Commission decided to consult the European Economic and Social Committee, under Article 262 of the Treaty establishing the European Community, on the

Communication from the Commission to the Council and the European Parliament Reinforcing the statutory audit in the EU
COM(2003) 286 final.

The Section for the Single Market, Production and Consumption, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 12 November 2003. The rapporteur was **Mr Byrne.**

At its 404th plenary session of 10 and 11 December 2003 (meeting of 10 December), the European Economic and Social Committee adopted the following opinion unanimously.

1. Introduction

1.1 The Commission's Communication *Reinforcing the Statutory Audit in the EU* should be seen both in the context of the Commission's Financial Services Action Plan and the Commission's reaction to the collapse of Enron and other financial scandals.

1.2 This Communication and the linked Communication on Modernising Company Law and Enhancing Corporate Governance in the EU are key steps in the essential task of restoring investor confidence in capital markets.

2. The Commission proposals

2.1 The Commission's vision for a modern regulatory framework for the statutory audit in the EU includes:

(a) a modernised and principles-based 8th Directive;
(b) creation of an Audit Regulatory Committee with representation for the Member States.

2.2 The Commission envisages that the EU should adopt International Standards on Auditing (ISAs) with effect from 2005.

2.3 The Commission proposes that public oversight should be a major element in the maintenance of confidence in the audit function. It also stresses other key requirements e.g. the importance of ethical guidelines for auditors, establishing an appropriate level of auditor independence, provision for quality assurance, education and training and a system of disciplinary sanctions.

2.4 The Commission indicates that it has considered the profession's concerns about the concept of joint and several liability. Its initial conclusion is that auditor liability is a key driver for audit quality, however it acknowledges there may be a need to examine the broader economic impact of present liability regimes.

2.5 The Commission details its negotiations to date with United States' regulators in relation to the implications of the Sarbanes-Oxley Act and records its disappointment that a satisfactory resolution has not yet been achieved.

2.6 The Commission summarises its proposed actions to achieve the Communication's objective of strengthening the statutory audit in the EU in a 10-point action plan.

3. **General comments**

3.1 The EESC welcomes the publication of this Communication. It recognises that it is vital to restore investor confidence and encourage the further development of the EU's capital markets and that a strengthened audit regime will be an important element in achieving this.

3.2 The EESC also acknowledges that this Communication is a continuation of a major programme of work in relation to the statutory audit undertaken by the Commission which commenced with the publication of the 1996 Green Paper "The Role, Position and Liability of the Statutory Auditor in the EU". Other more recent initiatives include the recommendations on "Quality Assurance for the Statutory Auditor in the EU" in November 2000 and "Statutory Auditors' Independence in the EU" in May 2002 both of which are being implemented by the Member States.

3.3 However recent events have fully justified the Commission in accelerating further steps to reinforce the quality of audits in the EU. The EESC therefore welcomes the 10-point action plan put forward by the Commission. In particular it supports the proposals for protecting the public interest by introducing independent oversight of the profession.

3.4 Once this framework, including the new 8th Directive, has been established at EU level the EESC believes that monitoring of compliance can best be implemented by Member States. Further it must be borne in mind that the issue here is a quality one – the quality of and therefore the reliance which can be placed on the statutory audit which in turn is based on the appropriateness of assumptions underlying accounts.

4. **Specific comments**

4.1 The Committee supports the Commission's proposal that the introduction of ISAs be a requirement for all EU statutory audits. This follows the precedent set in adopting International Accounting Standards (now renamed International Financial Reporting Standards) for all listed companies from 2005. However whereas the introduction of International Accounting Standards is initially limited to c.7000 listed companies, this Communication affects over a million statutory audits in the EU.

4.2 The Committee agrees that IFAC (The International Federation of Accountants) should be encouraged to look at ways of working with other bodies in the process of developing ISAs to secure proper public interest - as was done in the case of IAS via the International Accounting Standards Board.

4.3 The EESC accepts the need to validate ISAs for use in the EU. However it repeats its comments in the case of the Commission's power not to endorse IAS, that this is a provision which if actually used would undermine the international comparability of standards and be potentially damaging to investors.

4.4 The EESC believes therefore that the Commission should focus its efforts on strengthening the standard setting process and that a continuous dialogue should be maintained with the standard setter by the Audit Regulatory Committee to seek to iron out any problems in advance. The Committee is encouraged to learn that the Commission's work to date suggests a high degree of convergence with ISAs already exists in the EU.

4.5 The Committee believes that in a specialist area like auditing the expertise of the professionals must be available to the Audit Regulatory Committee. It welcomes therefore the proposal to retain the existing involvement of the auditing profession in the EU Committee on Auditing within the Audit Advisory Committee.

4.6 The Committee believes that the highest standards of auditor ethics are required. In this context the Committee supports the Commission's proposal to analyse the work of the IFAC Ethics Committee which develops principles-based global standards for auditor ethics including independence.

4.6.1 However regulations and codes of behaviour must be backed by appropriate sanctions if they are to be effective. As required by the existing 8th Directive the professional auditor bodies have systems of disciplinary sanctions for those who breach the codes. Best practice now dictates that this system of self-regulation (the ultimate sanction being exclusion from membership and therefore the ability to carry out audits) become more transparent and subject to external public oversight. The Committee notes the Commission intends that these requirements will be reinforced in the new Directive.

4.7 The Committee notes the Commission's view that auditor liability is an important driver for audit quality but believes that such liability should be proportionate. It therefore welcomes the Commission's recognition that it should examine the economic impact of present liability regimes.

4.7.1 It is vital that people of the right calibre are attracted into the auditing profession nor is it in the public interest that following the collapse of Andersen there should be any further reduction in the number of major firms which can undertake the audit of the largest international companies, and thus a reduction in competition. These considerations need to be borne in mind when assessing the urgency of reforming auditor-liability regimes.

4.8 The Committee is aware that IFAC is making it mandatory for auditors to undertake continuing education to maintain their professional skills and suggests that the Commission might consider including a similar requirement in the new 8th Directive.

5. **International aspects**

5.1 The Committee has noted the report of the Commission on the dialogue with the US authorities in relation to the Sarbanes-Oxley Act. The Act has introduced into the US a more restrictive and rules-based approach which is neither in line with the EU's principles-based, risks-safeguard approach also followed by IFAC (and which is recommended by IOSCO – the International Organisation for Securities Commission.)

5.2 Despite the representations made by the Commission the SEC in the US has refused so far to grant the exemption sought by the Commission from the unnecessary outreach effects of the Act for EU companies and EU auditors.

5.3 The Committee agrees that the present situation is unacceptable and urges the Commission to continue its dialogue with other major regulators including the US SEC and PCAOB with a view to achieving the acceptance by all parties of the equivalence of arrangements in terms of quality and related enforcement in both jurisdictions, for corporate governance, financial reporting and auditing.

6. **Conclusions**

6.1 The Commission has set out a ten-point action plan; as indicated in this opinion the Committee expresses its general support for the action plan and has set down specific comments and suggestions on various aspects of it. Overall the Committee believes the Commission's proposals are comprehensive and if fully executed will lead to a significant strengthening as well as greater harmonisation of statutory audits in the EU.

6.2 At this stage obviously the precise outcome of the work programme is not known nor for example the extent of the changes to the 8th Directive which will eventually be proposed. The EESC looks forward to giving its opinion on these when it will be possible to comment in more detail.

Brussels, 10 December 2003.

The President of the European Economic and Social Committee	The Secretary-General of the European Economic and Social Committee
Roger Briesch	**Patrick Venturini**