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To European Commission
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THE GREEN PAPER – AUDIT POLICY: LESSONS FROM THE CRISIS

1 General

The approach taken in the Green Paper is based on the thinking that auditors would have had a central role in the emergence and aftercare of the financial crisis. As stated in the introduction, auditing, alongside supervision and corporate governance, should be a key contributor to financial stability. However, no facts or analyses to support these arguments are presented in the Green Paper.

Any changes in the legislative framework applicable to the audit industry would require accurate cost-benefit analyses to be carried out. Even if a change would, from a certain viewpoint, be motivated for some parties, it could be too expensive to implement. A change made based on the needs of one player may be adverse for another. When taking decisions about possible changes, total community benefits should be considered.

1 INTRODUCTION

Questions 1 – Do you have general remarks on the approach and purposes of this Green Paper?

The Green Paper fails to clearly distinguish the roles and factual tasks of corporate management, auditors and oversight bodies, but is more inclined to present a view not supported by current legislation and reality. As a result of such inaccuracy, the thinking presented in the Green Paper with regard to change options is mainly not convincing or well-reasoned. The role and tasks of auditors cannot be reviewed as a separate issue, but as a part of an entity involving handling, review and communication of financial information, where each party must have its respective sufficiently defined obligations. Each party shall be responsible for taking proper care of its own obligations.

On the other hand, many important matters have been correctly presented in the Green Paper. It also contains well-reasoned and sustainable thinking with regard to possible changes.

The Green Paper includes matters approached from different angles. Readers can easily apprehend that the Green Paper is a summary of views of a large number of persons representing different areas of expertise.

The matters contained and proposals presented in the Green Paper can be divided into three categories:

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- 1) Truthful descriptions supported by well-reasoned change options. These would include e.g. statements concerning the major importance of audit quality and independence or the need to develop auditor's reports and international cooperation between auditor oversight bodies. Most issues fitting into this category included in the Green Paper have long been the subject of discussion in different forums and there is nothing new involved. Changes are, however, needed.
- 2) The second category comprises matters which are relevant as such, but have already been implemented. These would include e.g. introducing the principle of content emphasis in auditing (substance over form), developing international auditing standards (Clarity Project) as well as observing SME sector needs in implementation.
- 3) The third category includes matters partly relating to central issues in terms of auditing development, but the descriptions of these matters also include cases of incorrect understanding and errors. The thoughts and change options relating to this category are most surprising, partly provocative and far-reaching. Political purposes and an attempt to arise active discussion can be seen in the background of these change options. Examples include requirements relating to auditor rotation, options for payment of auditor remuneration and involvement of two auditors.

Question 2 - Do you believe that there is a need to better set out the societal role of the audit with regard to the veracity of financial statements?

No. The term "societal role of the audit" is unclear and it is open to various interpretations. The main task of the auditor is to give an objective statement (assurance) on financial statements. The Green Paper fails to clearly distinguish the roles and factual tasks of corporate management, auditors and oversight bodies, but is more inclined to present a view not supported by current legislation and reality.

The role and tasks of auditors cannot be reviewed as a separate issue, but as a part of an entity involving handling, review and communication of financial information, where each party must have its respective sufficiently defined obligations. Each party shall be responsible for taking proper care of its own obligations.

Question 3 – Do you believe that the general level of "audit quality" could be further enhanced?

The quality of audit is one of the most central issues. Recently a lot of emphasis has been put in order to define audit quality, to examine it and to enhance it further. Various means can be used to improve audit quality. Regulation can be improved too. Audit oversight must follow the international development. Professional skills of auditors require continuing education. Code of ethics must be developed further and auditors' skills to apply ethics can be improved.

2 ROLE OF THE AUDITOR

Question 4 – Do you believe that audits should provide comfort on the financial health of companies? Are audits fit for such a purpose?

The description of the auditor's role should more clearly have pinpointed the accurate tasks of persons in charge of preparing the financial statements, auditors and oversight bodies. The Green Paper is describing the audit expectation gap, but the text merely displays this expectation gap as it is and is even inclined to deepen it.

Auditor's report readability must be continually developed, but improvement is also needed in terms of readers' ability of understanding statements of accounts and auditor's reports. Obligations not based on valid norms must be placed neither on auditors nor on other parties. Auditor activities may be criticized only in case auditors have failed to act in accordance with such norms.

Contrary to what is said in the Green Paper, the role of an auditor is not to provide "a true and fair view" – this is the task of the person in charge of preparing the financial statements. For a long time already, the principle of content emphasis (substance over form) has been applied in auditing. The task of external corporate communications should not be imposed on auditors, since this is typically the responsibility of the corporate management. Roles and obligations should rather be clarified in order to elucidate responsibilities and narrow the expectation gap.

The Green Paper also gives an incorrect comprehension of auditor competences and possible abilities to foresee the future better than their client's corporate management. This would bring profound changes to the present auditor tasks. Implementation of this line of thinking would bring significant changes in professional competence of auditors which relate to required training and experience.

Question 10 – Do you think auditors should play a role ensuring the reliability of the information companies are reporting in the field of CSR?

No. The idea of introducing mandatory reviews of information concerning social and environmental responsibilities included in the Green Paper and extending the auditor's tasks would be typical actions to significantly increase corporate administration burden, which would not be well-reasoned. The Green Paper does not discuss or present any benefits to be gained from such a major change. The auditors are not specialists in the field of CSR.

Companies can already agree on several non-audit services with their auditors. It will probably not even be possible to transform these into obligations. Implementation of these thoughts would also bring significant changes in the professional competence of auditors.

3 GOVERNANCE AND INDEPENDENCE OF AUDIT FIRMS

Question 16 – Is there conflict in the auditor being appointed and remunerated by the audited entity? What alternative arrangements would you recommend in this context?

In a free market economy, the fact that companies select their auditors and pay their auditors' fee is considered natural and essential by the Central Chamber of Commerce.

The question is related to the independence of the auditor. The need to safeguard the independence of auditors and audit firms is important. Independence can be promoted by way of legislation as well as by taking practical measures.

The Green Paper does not distinguish independence in fact and independence in appearance, which are the central dimensions in view of independence. Matters relating to external independence are essential in business life. Guarantees relating to external independence may help convince interest

groups of independence in auditing. Profound consideration is needed when setting independence requirements.

Independence in fact relating to auditors' mindset cannot easily be influenced using legislative means. In terms of independence in fact, an auditor's professional competence and will to observe ethical principles are essential. Independence in appearance can, however, be influenced in many ways by imposing statutory obligations on auditors. Several obligations of this type are already in use. Independence obligations have been harmonized in Europe in the Directive on Statutory Audit (2006/43/EC) passed by the Commission and in the Commission Recommendation on Statutory Auditors' Independence (2002/590/EC). Today, the need to safeguard independence in a situation of conflict of interest may even require an auditor to resign from his or her duties.

In the Green Paper, the Commission is presenting three issues which it wishes to address in order to control situations of conflict of interest: 1) the company to be audited selects its auditor, 2) the company to be audited pays its auditor's fee, 3) audit firms are rarely replaced, and 4) audit firms offer non-audit services. These issues presented by the Commission have always been taken up in discussions about auditors' independence.

Obligations, the focus of which are to enhance independence (i.e. independence in appearance) are often exhibitional. Obligations which efficiently increase trust in auditors' independence without causing unreasonable costs to companies or auditors may be well-reasoned. The possible new obligations presented by the Commission are not efficient and would, upon materialisation, cause unreasonable costs to companies and auditors. They would also change some basic modes of operation which are part of a market economy.

Question 17 – Would the appointment by a third party be justified in certain cases?

No. A procedure where a specific auditor is appointed by a public authority can be reasoned only in exceptional cases. Such exceptional procedures are already in use. For example in Finland, as provided for in Section 9 of the Auditing Act, a regional state administrative agency is, based on notification received, obliged to appoint an auditor for a company if the company has not appointed a qualified auditor or the auditor appointed is not independent.

Question 18 – Should the continuous engagement of audit firm be limited in time? If so, what should be the maximum length of an audit firm engagement?

No. Requirements for key audit partner rotation have already been introduced. Extending rotation to include audit firms as well as key partners would be a very expensive obligation for companies to be audited and no reasons can be presented to show that cost-efficient benefits would be obtained in terms of improved independence.

The requirement for independence relevant in terms of auditing is focused on the relation of the person acting as auditor in view of matters to be audited and people involved. Treats to independence are not caused by audit firms and replacing an audit firm selected does not really promote independence.

Question 19 – Should the provision of non-audit services by audit firms be prohibited? Should any such prohibition be applied to all firms and their clients or should this be the case for certain types of institutions, such as systemic financial institutions?

No, an overall prohibition of the provision of non-audit services by audit firms is not well-reasoned. Safeguards may be applied to non-audit services offered by audit firms to their audit clients. The approach taken in the Green Paper to prohibit non-audit services has often been discussed and has been applied in some countries. In most cases, however, unambiguous prohibition is normally an excessively steep measure and it also has a harmful impact on market activities.

Question 20 – Should the maximum level of fees an audit firm can receive from a single client be regulated?

No. Statutory limitation of auditors' fees is not applicable to a market economy. No facts or analyses to support the idea are presented in the Green Paper.

Question 22 – What further measures could be envisaged in the governance of audit firms to enhance the independence of auditors?

As already provided by applicable legislation, an obligation to adopt safeguards in case of threats affecting independence is already in place. The use of safeguards can be developed and enhanced further.

Any situations endangering independence can already be efficiently addressed in Europe by way of oversight body actions, since auditor oversight activities have been harmonised by the Directive on Statutory Audit.

We also find it necessary to emphasise in regulation that all member states have really independent organizations, which are responsible for pre-emptive oversight and that the oversight bodies have independent resources and that the effectiveness of the oversight can be measured by its openness and transparency.

4 SUPERVISION

Question 25 – Which measures should be envisaged to improve further the integration and cooperation on audit firm supervision at EU level?

The need to further develop oversight activities within the audit industry as presented in the Green Paper is well-reasoned. Efforts taken to enhance cooperation in international oversight activities are important in this development work. This work has been ongoing for years.

In terms of development and implementation of cooperation in oversight activities on an EU level, the EGAOB group mentioned in the Green Paper is a central forum. In order to secure efficient and concrete operation, EGAOB's structure must be changed in the near future. This could best be done by transforming EGAOB into an independent agency having its own office and a permanent full-time secretariat employing sufficient resources.

The need for cooperation in oversight activities also extends to third party countries outside the EU. For several years, EGAOB has been working to create prerequisites for cooperation oversight activities towards oversight bodies in central third party countries. Concrete results have been reached in this work along with the so-called equivalence decisions as provided for in Article 46 of the Directive on Statutory Audit and the adequacy decisions provided for in Article 47 of the same. EGAOB has also carried out investigations and created agreements to promote cooperation oversight activities.

Question 26 – How could increased consultation and communication between the auditor of large listed companies and the regulator be achieved?

There must be a functioning dialogue between the auditor and the regulator at all levels. Also regulators and oversight bodies can facilitate this dialogue and provide for forums for this.

At global level, the IFIAR (Independent Forum of Independent Audit Regulators) is an important organization in order to facilitate dialogue between the oversight bodies, large international audit networks and other stakeholders. Dialogue will proceed as the activities of central actors such as IFIAR are developed and extended. IFIAR and other organizations must maintain an ongoing dialogue with stakeholder groups, especially international audit networks, investors, international organisations and institutions of public law.

5 CONCENTRATION AND MARKET STRUCTURE

Question 27 – Could the configuration of the audit market present a systemic risk?

Centralisation involves some risks which may jeopardise the stability of the market and these must be controlled. Centralisation may result in reduced competition and increase company costs. Competition forces audit firms to effectuate their operations which serves to promote auditing quality.

This centralisation has taken place under free market conditions based on materialised development without public authority influence. Structural factors, too, have apparently promoted centralisation and these must be critically reviewed. These factors especially include matters relating to audit firm ownership, constitution of administrative bodies and license conditions. Deliberate deregulation may also be used to affect market functionality. In addition, possible risks related to deregulation must be controlled.

Centralisation has served to harmonise modes of operation and service offerings of the large Big Four audit firms, which is why the disadvantage of reduced freedom of choice for audit clients should not be exaggerated.

Question 28 – Do you believe that the mandatory formation of an audit firm consortium with the inclusion of at least one smaller, non systemic audit firm could act as a catalyst for dynamising the audit market and allowing small and medium-sized firms to participate more substantially in the segment of larger audits?

No. As a topic, centralisation within the audit industry has been of interest to audit clients, auditors, oversight bodies and audit industry interest groups in the last few years.

Several options to address centralisation presented in the Green Paper are exaggerated, unreasoned and unsuited for use in a market economy. These would especially include the mandatory formation of an audit firm consortium.

Auditing costs could be doubled if companies were required to appoint two audit firms instead of one. This would be an unreasonable requirement in terms of administrative burden imposed on companies. In several markets, finding a competent audit firm for a large company outside the Big Four constellation would also be questionable and serve to jeopardise auditing quality and confidence in auditing.

Question 29 – From the viewpoint of enhancing the structure of audit markets, do you agree to mandatory rotation and tendering after a fixed period? What should be the length of such a period?

No. Extending rotation requirements from key partner rotation to audit firm rotation would be a very expensive obligation for companies to be audited and no reasons can be presented to show that cost-equivalent benefits would be obtained in terms of improved structure of the audit market.

Question 30 – How should the “Big Four bias” be addressed?

The idea of limiting the freedom of choice of the auditor would be an expensive obligation for companies to be audited. The possible new limitations as presented by the Commission are not efficient and would, upon materialisation, cause unreasonable costs to companies and auditors. They would also change some basic modes of operation which are part of a market economy. Contractual freedom must be respected.

Structural and regulatory factors, too, have apparently promoted centralisation. They must be critically reviewed. These factors especially include matters relating to audit firm ownership, constitution of administrative bodies and license conditions. Deliberate deregulation may also be used to affect market functionality.

Centralisation has served to harmonise modes of operation and service offerings of the large Big Four audit firms, which is why the disadvantage of reduced freedom of choice for audit clients should not be exaggerated.

The idea of an European quality certification system for audit firms presented in the Green Paper, the purpose of which would be to identify an audit firm’s qualifications to audit large public listed companies would result in unreasoned increase of regulation. In Europe, all countries presently have their own qualification procedures for auditors and audit firms, which is sufficient. Responsibility must be given to persons in charge of appointing auditors, who should be qualified to select an auditor.

Question 32 – Is the broader rationale for consolidation of large audit firms over the past two decades (i.e. global offer, synergies) still valid? In which circumstances, could a reversal be envisaged?

Yes. We find the rationale for consolidation of large audit firms still valid. Revisal of the consolidation by regulators would be exaggerated, unreasoned and unsuited for use in a market economy. These would especially include extension of rotation obligations, mandatory tenders, restrictions in terms of contractual freedom (Big Four only clauses) and cancellation of M&A transactions among audit groups.

6 CREATION OF A EUROPEAN MARKET

Question 33 - What in your view is the best manner to enhance cross border mobility of audit professionals?

The concerns regarding free cross-border mobility of auditors and audit firms presented in the Green Paper are well-reasoned. Free cross-border mobility must be promoted in order to secure efficient operation of the internal market.

Free cross-border mobility can be promoted by way of national deregulation. Possible risks related to such deregulation must be controlled here as well. The work to promote free cross-border mobility should continue. Care must also be taken to ensure that international cooperation between oversight bodies is kept up to date.

Question 34 – Do you agree with maximum harmonisation combined with a single European passport for auditors and audit firms? Do you believe this should also apply for smaller firms?

These questions should be further examined and analyzed. The quality of audit varies in member states within the EU. Further integration and harmonisation are desirable.

The idea presented in the Green Paper to create licenses and auditor registers covering the entire EU could be a long-term target. This target cannot be an independent objective, but development must follow EU integration.

7 SIMPLIFICATION: SMALL AND MEDIUM-SIZED ENTERPRISES AND PRACTITIONERS

Question 35 - Would you favour a lower level of service than an audit, a so called “limited audit” or “statutory review” for the financial statements of SMEs instead of a statutory audit? Should such a service be conditional depending on whether a suitably qualified (internal or external) accountant prepared the accounts?

No. The Central Chamber of Commerce takes an adverse standpoint towards statutory limited audits or reviews. However, reviews can be conducted on voluntary basis.

Removal of administrative burden imposed on companies is an important target. Especially small and medium-sized companies suffer from administrative burden. The work to investigate administrative burden should continue and burden should be removed where they are not well-reasoned and necessary.

The limited audits or statutory reviews would require new additional regulation. There would be a need to regulate audit extent, objects, reporting, responsibilities and several other issues. Introduction of new concepts and learning the respective meaning of these would be a burden for companies and their interest groups. New statutory services could blur the purpose of audit.

The new requirements would cause unreasonable costs to companies and auditors and thus they are not well-reasoned. Auditors can already nowadays offer their audit clients review (ISRE 2400) and assurance services.

In many countries small companies have been exempted from audit obligations. EU corporate law directives already provide quite extensive options for granting statutory exemptions with regard to accounting and auditing obligations to small companies. This is the right way to go. Possible changes in auditing obligations require cost benefit analyses to be conducted and total community benefits to be observed.

The Green Paper contains no proposal on how instructions or oversight to be provided by statutory authorities could be applied to limited audits. This thinking is not worth being further developed.

8 INTERNATIONAL COOPERATION

Question 38 – What measures could in your view enhance the quality of the oversight of global audit players through international co-operation?

The need to further develop international cooperation between auditor oversight bodies presented in the Green Paper is well-reasoned indeed. As we have stated above in section 4, such work has been ongoing for years.

IFIAR (Independent Forum of Independent Audit Regulators) is the central organization in this respect. A central challenge to be faced when organizing global oversight cooperation is the lack of applicable legislation and legal agreements. Much work is needed in order to remove the obstacles hindering cooperation between oversight bodies.

International oversight cooperation will proceed as the activities of central actors such as IFIAR are developed and extended. Contacts to oversight bodies in other countries and people working within these will be of key importance in this work as well. IFIAR and other organizations must maintain an ongoing dialogue with stakeholder groups, especially international audit groups, investors, international organisations and institutions of public law.

THE CENTRAL CHAMBER OF COMMERCE

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