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Committee on Legal Affairs

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DRAFT REPORT

on audit policy: lessons from the crisis
(2011/2037(INI))

Committee on Legal Affairs

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Rapporteur (*):

Kay Swinburne, Committee on Economic and Monetary Affairs

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MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION

on audit policy: lessons from the crisis (2011/2037(INI))

The European Parliament,

- Having regard to the Commission Green Paper of 13 October 2010 on audit policy: lessons from the crisis (COM(2010)0561),
- Having regard to its resolution of ... on corporate governance in financial institutions (2010/2303(INI))¹,
- Having regard to its resolution of 10 March 2009 on implementation of Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts (2008/2247(INI))²,
- having regard to Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts³,
- having regard to Rule 48 of its Rules of Procedure,
- having regard to the report of the Committee on Legal Affairs and the opinion of the Committee on Economic and Monetary Affairs (A7-0000/2011),

General issues

1. Welcomes the Commission's Green Paper and salutes its holistic approach;
2. Takes the view that the debate on the role of the auditor should take place alongside a review of the role of the audit committee – now largely ineffective – and of the financial and risk reporting that companies are required to carry out;
3. Reminds the Commission that a wide-ranging, in-depth impact assessment is needed, looking at the various political options and focusing on practical issues in line with the principles of 'better lawmaking';

The role of the auditor

4. 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;
5. Agrees with the Commission on the principle that an audit report's conclusions should focus on substance over form;

¹ ...

² OJ C 87E, 1.4.2010, p. 23.

³ OJ L 157, 9.6.2006, p. 87.

6. Calls on the Commission to look into how the role of the auditor might be extended to include audits of risk reports provided by the entity being audited, in addition to verification of the information supplied in the main financial statements;
7. Takes the view that auditors should be subject to an obligation to alert supervisors or the relevant authorities when they spot problems that might jeopardise the future of the entity being audited;
8. Takes the view that audit reports should be brief, with clear, concise conclusions, and that they should include an annex containing additional explanations on general issues such as the methodology used, and specific issues such as key indicators, materiality figures, assessments of the risk involved in the material accounting estimates or materiality judgements made, and any particular problems encountered whilst carrying out the audit;
9. Takes the view that professional scepticism is vital in auditing and has an impact on each and every stage of an audit; points out that this scepticism comes about as a result of the objectivity and independence of the auditor;
10. Believes that fluent, regular dialogue between the external auditor, the internal auditor and the audit committee is vital to allow effective auditing, as the shareholders need to be kept informed, for example as to why an auditor is appointed, reappointed or withdrawn, or by means of specific clarifications relating to the audit report;

Governance and independence of audit firms

11. Agrees that there is an inevitable conflict in the auditor being appointed and paid by the audited entity; nevertheless, does not currently see any justification for this appointment to be made by a third party; with this in mind, calls for the audit committee's role to be strengthened;
12. Believes that, in order to guarantee the independence of audits, auditing contracts should run for no longer than eight years; takes the view that an initial contract should be concluded for four years, renewable only once for a further period of four years, followed by a period of at least four years – eight years for public interest entities – during which the audit firm concerned cannot audit the same company again; considers that there would be a need, at the end of the initial four-year period, for a new team to be appointed from within the audit firm;
13. Considers it vital that steps be taken to prevent attempts to get round the mandatory rotation rule by appointing another audit firm from within the same group or by using the same auditors working for a different company;
14. Takes the view that there should be a ban on services other than auditing being provided to the audited company, as this would pose a risk to the auditor's independence; takes the view, furthermore, that under no circumstances should internal and external auditing services be provided simultaneously; points out that this would restrict 'lowballing', the practice of offering cut-price auditing with a view to obtaining compensation by charging for additional services; therefore takes the view that the ban must apply to all firms and their clients, particularly where major audit firms are concerned;

15. Takes the view that the fees an audit firm can charge a single client should not exceed a certain percentage of its total income so as to prevent a situation in which the audit firm loses its economic independence;
16. Believes that firms that audit public interest entities ought to publish their accounts and that these accounts, as well as the methods used, should be checked to ensure they are in order;

Concentration and market structure

17. In view of the current configuration of the audit market, believes that the collapse of one of the Big Four firms would undermine the credibility of the auditing profession as a whole;
18. 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; believes, furthermore, that these plans should be designed to minimise the risk of an audit firm leaving the market without good reason and reduce the uncertainty and disruption that would cause, whilst ensuring that the market does not end up being dominated by an even tighter oligopoly;
19. Takes the view that the contingency plans ought to include a mechanism via which the regulator is informed of any problems threatening an audit firm nationally or internationally, these plans being designed to stabilise audit firms and prevent a sudden collapse resulting from an exodus of clients and staff whilst an investigation is ongoing; takes the view that there should be an objective study of the causes of the problem, irrespective of the penalties imposed, establishing whether the problems are intrinsic to the audit firm concerned or whether the firm can be rescued either in part or entirely; takes the view that there should also be a response plan in which the regulator establishes whether, and under which conditions, the audit firm should continue to receive aid; takes the view that, where necessary, the plan should provide for the orderly transfer of clients and staff to other audit firms;
20. Considers that there is a need to create, or encourage the creation of, a voluntary code of ethics for the Big Four firms, encouraging them to restrict their own growth, thereby protecting the development of medium-sized audit firms, which would ultimately also be beneficial for the survival of the major firms themselves;
21. States that it is vital to introduce a ban on restrictive clauses in contracts that favour the Big Four firms; calls for mergers between small and medium-sized audit firms to be encouraged; urges 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;
22. Calls on the Commission to bring in a system of compulsory tendering on a periodic basis for public interest entities, under which at least one non-Big Four company would have to be included; takes the view that the audit committee must be given a key role in this process, in which shareholders must also take part;

Creation of a European market

23. Urges the Commission to come forward with proposals aiming to enhance harmonisation as a way of creating a European passport for auditors;

International cooperation

24. Calls on the Commission to step up its efforts to increase convergence;

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25. Instructs its President to forward this resolution to the Council and the Commission.