

STUDY

Requested by the ECON committee



What are the wider supervisory implications of the Wirecard case?

Public Oversight Systems for
Statutory Auditors in the EU



External authors:
Beatriz GARCÍA OSMA
Ana GISBERT
Begoña NAVALLAS



Economic Governance Support Unit (EGOV)
Directorate-General for Internal Policies
PE 651.383 - October 2020

EN

What are the wider supervisory implications of the Wirecard case?

Public Oversight Systems for Statutory Auditors in the EU

Abstract

While multiple causes underpin accounting scandals such as Wirecard, they often point at deficiencies in the audit profession and its oversight. Currently, the system of national public audit oversight boards (POBSAs) is fragmented and overly complex, characterized by limited responsiveness to red flags, and apparent lack of communication among the POBSAs, and with other supervisors. This suggests supervisory coordination and clear action triggers are imperative. Importantly, pervasively low transparency limits the usefulness of this briefing and hinders evidence-based policy making.

This document was provided by the Economic Governance Support Unit at the request of the ECON Committee.

This document was requested by the European Parliament's Committee on Economic and Monetary Affairs.

AUTHORS

Beatriz GARCÍA OSMA, Universidad Carlos III de Madrid, Spain.

Ana GISBERT, Universidad Autónoma de Madrid, Spain

Begoña NAVALLAS, Universidad Autónoma de Madrid, Spain

ADMINISTRATOR RESPONSIBLE

Cristina DIAS, Marcel MAGNUS

EDITORIAL ASSISTANT

Donella BOLDI

LINGUISTIC VERSIONS

Original: EN

ABOUT THE EDITOR

The Economic Governance Support Unit provides in-house and external expertise to support EP committees and other parliamentary bodies in shaping legislation and exercising democratic scrutiny over EU internal policies.

To contact Economic Governance Support Unit or to subscribe to its newsletter please write to:

Economic Governance Support Unit

European Parliament

B-1047 Brussels

E-mail: egov@ep.europa.eu

Manuscript completed in October 2020

© European Union, 2020

This document and other supporting analyses are available on the internet at:

<http://www.europarl.europa.eu/supporting-analyses>

DISCLAIMER AND COPYRIGHT

The opinions expressed in this document are the sole responsibility of the authors and do not necessarily represent the official position of the European Parliament.

Reproduction and translation for non-commercial purposes are authorised, provided the source is acknowledged and the European Parliament is given prior notice and sent a copy.

CONTENTS

LIST OF ABBREVIATIONS	7
LIST OF BOXES	9
LIST OF FIGURES	9
LIST OF TABLES	9
EXECUTIVE SUMMARY	10
1. INTRODUCTION AND BACKGROUND	12
1.1. Fraud, the role of the auditor, and public oversight	12
1.2. The developing case of Wirecard AG	13
1.2.1. Wirecard corporate governance	14
1.2.2. The role of the auditor	15
1.2.3. The role of the oversight system	16
2. CURRENT SUPERVISORY LANDSCAPE FOR THE PROVISIONING OF AUDIT SERVICES	17
2.1. Auditor oversight systems	18
2.2. Differences in oversight systems in Europe	19
2.2.1. Differences in the organization structure of the POBSAs	19
2.2.2. Differences in the regulatory role of the POBSAs	20
2.2.3. Differences in the supervisory role of the POBSAs	21
2.2.4. Differences in the disciplinary role of the POBSAs	21
2.2.5. Differences in transparency mechanisms	22
3. THE ROLE AND EFFECTIVENESS OF SELF-REGULATORY AUDIT BODIES	23
3.1. Audit quality and the expectation gap	23
3.2. The role and effectiveness of public audit oversight	24
3.2.1. Quality assurance reviews/inspections and investigations and audit quality	24
3.2.2. Effect of PCAOB inspection on foreign/EU auditors and companies	25
3.2.3. Effect of POBSAs on EU auditors and companies	26
3.3. The role and effectiveness of self-regulatory mechanisms	26
3.4. Enforcement styles and transparency.	28
4. REFLECTIONS ON SUPERVISORY IMPLICATIONS	29
4.1. Limitations of this briefing	29
4.2. Conclusions and supervisory implications	29
4.2.1. Macro-level: The role of the CEAOB and other international and EU bodies.	29
4.2.2. POBSA level: Prevention	30
4.2.3. POBSA level: Detection (Quality & Assurance (QA) and Inspections)	30

4.2.4. POBSA level: Remediation (Investigation and Discipline - ID)	31
4.2.5. Transparency	31
REFERENCES	32
ANNEX	38
Appendix A. Additional details on the case of Wirecard	38
Appendix B. Committee of European Auditing Oversight Bodies (CEAOB)	41
Appendix B.1. Conceptual framework,	43
Appendix C: Description of variables and dimensions studied for analysed POBSAs.	44
Appendix C.1. Austria, Belgium, France, Germany and Netherlands: Regulatory, Supervisory, Disciplining and Transparency	46
Appendix C.2. Denmark, Sweden, Finland, Ireland and Luxembourg: Regulatory, Supervisory, Disciplining and Transparency	49
Appendix C.3. Portugal, Spain, Greece and Italy: Regulatory, Supervisory, Disciplining and Transparency	51
Appendix D. Staff, PIEs and collaboration with professional corporations.	53
Appendix E. Evidence on effects of public oversight on EU audit firms and companies	54
Appendix F. Evidence on views of auditors on the public oversight system	56
Appendix G. Audit Market Concentration. Number of PIEs by auditor network in the EAA, Switzerland and the United Kingdom.	58

LIST OF ABBREVIATIONS

APAS	Abschlussprüferaufsichtsstelle (German POBSA)
CEAOB	Committee of European Auditing Oversight Bodies
EBA	European Banking Authority
EC	European Commission
EDGAR	Electronic Data Gathering, Analysis, and Retrieval system
EEA	European Economic Area
EGAOB	European Group of Auditor Oversight Bodies
EIOPA	European Insurance and Occupational Pensions Authority
ESMA	European Securities and Markets Authority
EU	European Union
FREP	Financial Reporting Enforcement Panel (Deutsche Prüfstelle für Rechnungslegung – DPR)
GAAP	Generally Accepted Accounting Principles
IAASB	International Auditing and Assurance Standards Board
IASB	International Accounting Standards Board
ID	Investigation and Disciplining
IESBA	International Ethics Standards Board for Accountants
IFAC	International Federation of Accountants
IFIAR	International Forum of Independent Audit Regulators
IFRS	International Financial Reporting Standards
INTOSAI	International Organization of Supreme Audit Institutions
IOSCO	International Organization of Securities Commissions
ISA	International Standards on Auditing

PC	Professional Corporations
PCAOB	Public Company Accounting Oversight Board
PIE	Public-Interest Entity
POBSA	Public Oversight Board for Statutory Auditors
QA	Quality Assurance
QAR	Quality Assurance Review
SEC	Securities and Exchange Commission
SMO	Standard of Membership Obligations (IFAC)
US	United States
XBRL	Extensible Business Reporting Language

LIST OF BOXES

Box 1: The role of the auditor	23
--------------------------------	----

LIST OF FIGURES

Figure 1: Timeline of significant events (Wirecard) [own elaboration]	14
Figure 2: Slippery slope of misreporting	28

LIST OF TABLES

Table 1: Summary of main organizational structure characteristics of POBSAs	20
Table 2: Summary of main regulatory competences of POBSAs	20
Table 3: Summary of main supervisory competences of POBSAs	21
Table 4: Summary of main disciplining competences of POBSAs	21
Table 5: Summary of main transparency policies of POBSAs	22

EXECUTIVE SUMMARY

Background

The recent Wirecard case raises questions about the reliability of statutory audited financial accounts, the scope of auditing, and the effectiveness of self-regulatory audit bodies in the European Union (EU).

Aim

Against that background, this briefing aims to:

- set out the current supervisory landscape for the provisioning of statutory audit services;
- set out the role and effectiveness of self-regulatory audit bodies; and
- reflect on the wider supervisory implications of cases such as Wirecard at the EU level, suggesting ways forward to prevent similar situations in the future, if possible.

Summary of Key Findings

The case of Wirecard is still developing, and we have only had access to secondary data. This is a significant caveat. The evidence reviewed, however, suggests a major accounting/audit failure. While multiple causes underpin scandals such as the case of Wirecard, they often do point at potential deficiencies in the audit profession and its oversight.

External audit quality control through supervisory mechanisms (articulated either via peer-review or public (governmental) oversight seeks to promote trust and confidence, by securing audit quality. This is achieved by incentivizing auditors to develop their competencies, and to comply with professional standards in collecting sufficient evidence to support audit opinions, and by imposing sanctions if they do not comply with the required standards.

Public oversight of auditors is however only one piece of the supervisory puzzle, where oversight over firm financial reporting is of particular importance, potentially requiring coordinated action. Great efforts and significant progress have been made over the last two decades to develop and harmonize the system of public audit oversight in the EU. This has no doubt improved the overall quality of audit oversight in the EU. However, the system remains fragmented and overly complex, characterized by:

- lack of supervisory authority for the Committee of European Audit Oversight Bodies (CEAOB), which is a weak “framework for co-ordination” of the 27 national public oversight bodies (POBSAs);
- appearance of lack of harmonization among national POBSAs, with heterogeneous a) quality assurance and inspection systems; and b) investigation and sanction systems;
- concerns over international and national coordination and cooperation among supervisors, leading both to instances when competences appear duplicated, and cases where there is lack of clear competence delimitation and leadership. This may create gaps where breaches of conduct or incipient fraud could go unnoticed. The case of Wirecard suggests complex firms may be particularly able to avoid supervision;
- slow action, and limited responsiveness to whistleblowing and red flags;
- limited stakeholder engagement and outreach from the CEOB and the POBSAs, and limited success in collaborating with the profession in promoting best audit practices;
- low transparency, which severely limits the usefulness of enquiries such as this briefing and hinders evidence-based policy making.

At the national POBSA level, and drawing both from observational and descriptive analyses of a sample of national POBSAs as well as from academic literature, the system is characterized by:

- heterogeneous reporting practices, lack of easily accessible repositories and no use of standardized formats (such as Extensible Business Reporting Language - XBRL).
- existence of trade-offs between independence, incentives, and expertise between peer review and public oversight, where peer-reviewers generally have more relevant knowledge, and inspectors are more independent and specialized in inspection;
- existence of threats of regulatory capture and political pressure linked to differing levels of independence and power;
- significant concerns over resource constraints particularly with respect to human resources. POBSAs appear to have insufficient staff and inspectors, given the high number of public-interest entities (PIEs).¹ This is further complicated by PIE definition appearing not to be homogenous across Member States.

The academic evidence reviewed, focusing on the case of United States (US), suggests that a system of public oversight may lead to greater audit quality than a system of peer review, but:

- public oversight is perceived as giving rise to greater box-checking mentality (rather than a focus on substance), where auditors embed check lists and other procedures in the audit process, to increase 'compliance visibility,' and promoting a standardized orientation that may increase the commoditization of the audit;
- quality assurance reviews/inspections and investigation impose disproportionately high costs on smaller auditors, at the risk of pushing them out of the market, leading to greater concentration and lower competence;
- collaborative (as opposed to coercive) supervisors with high power and that promote high trust may attain higher audit quality improvements.

This briefing provides reflections and recommendations to address these concerns. Overall, the harmonization of procedures (quality assurance, investigation, sanctions) and a significant improvement of the accountability and transparency mechanisms in place, are the cornerstones of the changes that should be addressed in the EU auditor oversight system, under the leadership and coordination of the CEAOB.

¹ Directive 2006/43/EC, amended by Directive 2014/56/EC, art. 2, defines a public-interest entity as (a) EU companies whose securities are admitted to trading on a regulated market of any Member State, (b) credit institutions, (c) insurance companies, or (d) an entity that is publicly relevant due to the nature of its business, its size or number of employees. The application of this fourth criterion varies across Member States. Wirecard is a PIE because it is publicly listed in the Frankfurt Stock Exchange.

1. INTRODUCTION AND BACKGROUND

High quality corporate financial reporting and disclosure is a cornerstone for the well-functioning of capital markets and the economic system. While the role of statutory auditors is not to detect fraud, high-profile audit and accounting scandals, such as the cases of Enron, WorldCom, Adelphia, Parmalat, and Tyco in the past, or the suspected current one of Wirecard, erode investor confidence in the statutory auditor profession and in reporting credibility, with severe consequences for capital markets, and often, needing regulatory responses to restore it.²

Multiple causes underpin accounting scandals and fraud, linked to (a) corporate governance; (b) managerial incentives and overconfidence; (c) financial and non-financial disclosure and tax regulations; (d) the role of market intermediaries (underwriters, analysts, etc.); (e) complex corporate structures; or (f) the transparency and regulation of securities markets.³ While, therefore, not the sole responsible party, accounting scandals also point at potential deficiencies in the statutory auditor profession, and its oversight.⁴

Aware of this crucial role, the European Union (EU) has issued several regulations in a continuous attempt to promote a system of public oversight. A system of public oversight promotes greater audit quality than a system of peer review. However, public oversight is not without limitations (Gipper et al. 2020). This is because auditing oversight is characterized by:

- The existence of trade-offs between expertise, incentives, and independence. That is, for example, inspectors appointed by public oversight bodies may be more independent than peer-reviewers who are active professionals, but they are likely to have lower up-to-date industry and technical knowledge and expertise.
- In addition, public sector supervisors may suffer from resource constraints, regulatory capture (for example, by national industry interests), political pressure (for example, to meet short-term oriented goals), or inefficient bureaucracies.

This means that scepticism remains as to whether public oversight systems have achieved their goals and are preferable to peer-review self-regulated ones (e.g., Coates and Srinivasan 2014, Glover et al. 2009). In this section, we briefly review the Wirecard case, as well as provide a general framework to understand the role of the statutory audit profession and its public oversight in ultimately preventing, detecting, and correcting fraudulent activity.

1.1. Fraud, the role of the auditor, and public oversight

Why do people commit fraud? This is not an easy question to answer, but the evidence suggests that three factors underpin fraud cases: there are (1) incentives and (2) opportunities to commit fraud, and those committing fraud have (3) the ability to rationalize it (Rajgopal and White 2020; Statement on Auditing Standards SAS No. 99).

Directive 2014/56/EU and Regulation No 537/2014 set the regulatory framework for statutory audits, aiming at the transposition and compliance with International Standards of Auditing (ISAs) issued by the International Federation of Accountants (IFAC) through the International Auditing and Assurance Standards Board (IAASB). Art 21.2 of Directive 2014/56/EU and ISA 240 deal with the auditor's responsibilities relating to fraud in an audit of financial statements. While the primary responsibility for the prevention and detection of fraud rests with those charged with governance and management of

² Financial crises often trigger similar responses. Michel Barnier, then Commissioner for Internal Markets and Services, noted after the financial crisis meltdown of 2007-2008 that auditors were “the dog that didn’t bark” (Hooke 2014).

³ See the IOSCO (2005) ‘fraud report’ for a detailed discussion of the different potential causes.

⁴ Public oversight is the rule in the EU, even if operations might be delegated to professional bodies. This report focuses on the public oversight of statutory auditors and audit firms. In some European countries several types of regulated auditors co-exist. Henceforth, we refer to statutory auditors simply as statutory auditors and auditors interchangeably.

the entity, the statutory auditor must “*obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error.*”

Reasonable assurance cannot be understood as complete certainty. An audit performed in full compliance with ISA does not guarantee fraud or errors will be detected. This risk is higher for fraud than for error, as fraud usually involves sophisticated, carefully organized schemes to conceal it, which may involve, for example, forgery or intentional misrepresentations to the auditor. Thus, auditors must maintain professional scepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist.

As a part of the audit planning, auditors must obtain an understanding of the entity’s control environment, and the oversight exercised by those charged with governance; also, on whether the risk of not detecting a fraud is high because management is in a position to directly or indirectly manipulate accounting records, present fraudulent financial information, or override control procedures. When the auditor suspects a fraud, it must communicate it to the appropriate level of management, to inform those with direct and primary responsibility for fraud matters. Depending on the circumstances, the auditor should change the nature, timing, and extent of audit procedures to obtain evidence and complete the audit engagement. The duty of the auditor to keep client information confidential may preclude reporting fraud to the regulatory or oversight authority (art 65, IAS 240), albeit auditor’s legal responsibilities vary, and in some Member States, auditors may have the statutory duty to report fraud or misstatement.

Directive 2014/56/EU also mandates Member States to organise an effective system of public oversight for statutory auditors and audit firms, designating a competent authority with ultimate responsibility for the oversight of: (a) the approval and registration of auditors; (b) the adoption of standards on professional ethics, internal quality control of audit firms and auditing; (c) continuing education; (d) quality assurance systems; and (e) investigative and administrative disciplinary systems. In section 2 we provide an overview of this system. However, public oversight of the auditor is only one piece of the supervisory puzzle, potentially requiring coordinated action between supervisors of financial information and of auditors.

In addition to national supervisors, whose nature and mandates differ at EU level, two pan-European coordination mechanisms oversee EU consistency for financial reporting and auditing supervision: the European Securities and Market Authority (ESMA), and the Committee of European Audit Oversight Bodies (CEAOB), which is, since 2016, a “framework for co-operation” of national audit oversight bodies.

1.2. The developing case of Wirecard AG

Wirecard AG (Wirecard, hereafter)⁵ was founded in 1999. A payment processor and financial services provider, Wirecard experienced significant growth since appointing CEO Markus Braun in 2002, expanding internationally. The first red flags on the quality of its reporting date back to 2007, when Wirecard was audited by RP Richter. Wirecard Supervisory Board commissioned Ernst & Young (EY) a special audit of the financial statements, of limited scope.⁶ Referring the conclusions of this special engagement, Wirecard notes in its Annual Report of 2008 that “on the whole, there were no indications of any misleading statements in the consolidated financial statements and consolidated management report for 2007” (p. 14). RP Richter signs the audit report of 2008, but Wirecard subsequently switches

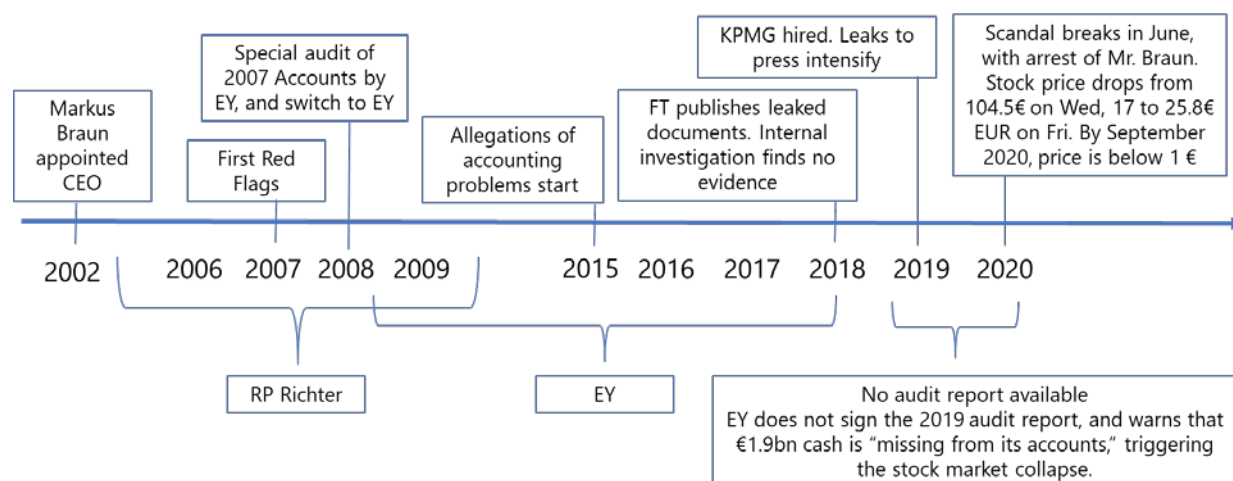
⁵ The information contained in this section is based *exclusively* on secondary sources, as identified. We have had no access to any forensic evidence, or primary data of the case, which is still developing. Starting from April 2015, The Financial Times published a series of articles, collectively dubbed “*The House of Wirecard*,” which by September 2020 comprises fifteen articles. Available online: <https://ftalphaville.ft.com/2015/04/27/2127427/the-house-of-wirecard/>, accessed September, 2020.

⁶ The scope was limited to “the presentation of capital flow account, the statement regarding the risks of business activities arising from the processing of internet based payments, compliance with the requirements relating to segment reporting and an appropriate evolution of such items as “goodwill” and other “intangible assets (customer portfolio, enterprise values) with special consideration being devoted to the acquisition of Trustpay International AG including its subsidiaries in 2007.”

to a joint audit with EY, which is one of the four large auditing firms worldwide (also known, collectively, as the “Big 4”).

From 2008 to 2018 there are allegations of money laundering, market manipulation, and accounting inconsistencies, which are picked up by several news outlets, particularly from 2015 onwards. Wirecard launches an internal investigation in 2018, due to information leaked by a whistle-blower of a “round tripping” fraud plan involving Singapore and India. A local legal firm and a forensic investigation finds no evidence.

Figure 1: Timeline of significant events (Wirecard) [own elaboration]



In October 2018, the whistle-blower contacts the Financial Times (FT), leaking documents, emails, and excel spreadsheets. It is unclear whether this whistle-blower first contacted the company or any local supervisory authority. In October 2019, the Supervisory Board of Wirecard appoints KPMG to conduct an independent special investigation on the “accusations against Wirecard AG published in the press and on the internet” (KPMG 2020). In June 2020, EY does not sign the 2019 audit report, warning that €1.9bn cash was “missing.”⁷ Since August 2020, Wirecard is managed by an Insolvency Administrator.⁸ Figure 1 summarizes this timeline.⁹

1.2.1. Wirecard corporate governance

Wirecard was ruled by a Management Board (MB), and oversighted by a Supervisory Board (SB), following the German two-tier-system in which management functions are separated from the supervising function. Following the German Code of Governance,¹⁰ the SB is tasked with advising and supervising the MB in the management of the company. The SB must approve transactions of fundamental importance (which may include those with related parties). Additionally, the SB monitors the effectiveness of the internal control system. Despite the increasing size and complexity of Wirecard, for the period 2016-2019, the size of the SB varied from three to five members, and no committees (audit committee, or nomination committee) were created for the period 2015-2019. These roles were assumed by the SB.

⁷ See, McCrum and Storbeck (2020), <https://www.ft.com/content/1e753e2b-f576-4f32-aa19-d240be26e773>.

⁸ The Local Court of Munich - Insolvency Court - opened insolvency proceedings over the assets of Wirecard AG in a ruling dated August 25, 2020 (Ref. 1542 IN 1308/20).

⁹ See also the timeline in McCrum (2020), <https://www.ft.com/content/284fb1ad-ddc0-45df-a075-0709b36868db>.

¹⁰ Available online: <https://www.dcgk.de/en/code.html>, accessed September, 2020.

According to the 2017 and 2018 Annual Reports, the SB met once a month to discuss questions related to basic strategy, M&A terms, and business performance among others, but no specific reference could be found about the whistle blowing case or the FT allegations.

1.2.2. The role of the auditor

The appointed auditor before EY was Control5H GmbH, a local firm based in Bavaria that merged in 2008 with another local audit firm, RP Richter, and continued to audit Wirecard financial statements until 2009. From 2009, and after the special engagement report, Wirecard is audited by EY and RP Richter, issuing a joint audit report also with an unqualified opinion.¹¹ Table A.1. in Appendix A details the auditors, audit fees, and conclusions of the audits from 2006 to 2018. All audit reports are unqualified. EY's tenure, by 2018, was coming to 10 years, which is the maximum engagement allowed under Regulation 537/2014. However, with due tendering, tenure can be extended, in Germany, to 20 years. The audit fee increased steadily over time, while the proportion of the fee that refers to the subsidiaries decreases over time, from representing around 50% of the total fee in 2006, to 14% in 2018.

According to the Annual Report of 2018, fifty-three subsidiaries were fully consolidated (fifty in 2017) and one Indian company was accounted using the equity method. EY audited the group financial statements and therefore was responsible to carry out all the needed audit procedures inside the consolidation perimeter. According to FT, some of the companies involved in the largest revenue generation were not audited.

It is unclear how EY reacted to rumours of malpractice during the period 2015-2018, given professional secrecy and client confidentiality. Wirecard delayed in three occasions the publication of the 2019 Annual Report, expecting an unqualified audit report for the group. But finally, BSP (Bangko Sentral ng Pilipinas) indicated that the money never entered the Philippines and BPI and BDO banks informed EY that documents accounting for €1.9bn cash deposits were "*spurious*." EY refused to sign the 2019 audit report, triggering in June of 2020, a stock market collapse.¹² EY declared that Wirecard engaged in "an elaborate and sophisticated fraud" and provided "false confirmations and statements with regard to escrow accounts." EY faces a class action lawsuit and criminal complaints from shareholders and bondholders.¹³

The case of Wirecard is still developing, and thus, at this stage, the role and in particular the performance of EY is not yet fully known. However, from secondary sources and the KPMG report,¹⁴ four issues stand out:

- *Core business in Europe had limited activity.* Wirecard international growth involved hundreds of partner companies, subsidiaries, associates, joint ventures, etc. Allegedly, group profits from partner companies in Philippines, Dubai and Singapore were inflated, and their financial statements were not audited by EY or its local network.
- *Inexistent companies, customers, employees, and partners.* Partners did not exist, third party acquirer employees denied the financial operations, or partner companies were liquidated. Customers listed in documents provided to EY did not exist.

¹¹ The auditor expresses an *unmodified or unqualified opinion* when it concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. A *modified or qualified opinion* means the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement, or that is unable to obtain sufficient appropriate audit evidence to conclude.

¹² See, Kelton (2020), <https://www.forbes.com/sites/erikakelton/2020/07/06/eys-shameful-year-nmc-health-luckin-wirecard-and-a-failed-attack-on-a-whistleblower/#fa4af8969e04>.

¹³ See, Kinder and Storbeck (2020), <https://www.ft.com/content/ae73160b-fd9a-4313-89f9-8fd70183158e>.

¹⁴ According to KPMG (2020) report, information requests were not always attended, there were delays in providing some documents, and most of them were electronic copies and not original documents. In addition, IT systems had access problems and interviews with key internal contacts were postponed. Contracts with third parties, acquirers' partners, account statements, and bank confirmations for trust accounts were not made available to KPMG.

- *Cash and cash equivalents.* The escrow accounts classified by Wirecard as cash or cash equivalent, according to KPMG, do not comply with IFRS requirements, and should have been classified as financial assets. Direct bank confirmation could not be found on the authenticity of the documents received to support the evidence of €1.9bn in cash.¹⁵
- *Internal control deficiencies.* Deficiencies existed particularly in the areas of receivables management and dunning, contract management and control, as well as reporting. Basic internal control elements like segregation of duties, written instructions, or documented four-eye check could not be found by KPMG.

In its audit report of 2018, EY indicates that it followed IAS 240 and carried out extended audit procedures. KPMG (2020) reports that EY performed an extra audit collaborating with its own forensic services, reviewing the allegations in the press. KPMG notes that EY should have extended its auditing activities to third parties outside the Wirecard group, but also, that the audit procedures performed by EY to examine the accusations were appropriate.

Given the nature of the alleged problems listed above, however, the fact that EY did not detect them would speak of potential deficiencies in conducting the audit. Allegations have been made that a whistle-blower warned EY as early as in 2016 of the fraud underway, and even, that senior managers at Wirecard may have “attempted to bribe an auditor.”¹⁶

1.2.3. The role of the oversight system

With respect to the German oversight system, several national authorities were at play, leading to a potential mutual delegation of responsibility and ultimate lack of effective supervision:

- *Federal Financial Supervisory Authority (BaFin).* Wirecard was classified as a technological company. BaFin investigated the accusations of money laundering, and opened an investigation in 2019 over market manipulation, and banned short selling for two months. It also imposed an administrative fine on Wirecard for not publishing its interim Annual Report of 2019. After the publication of the KPMG report, BaFin submitted a criminal complaint against the CEO, leading the Munich's Public Prosecutor's Office to access the headquarters of Wirecard. It has been alleged that staff of BaFin traded in Wirecard shares in 2019 and 2020, and BaFin has been sued by Wirecard investors for not taking action.¹⁷ Germany Finance Ministry announced a reform making BaFin a body with sovereign powers and able to intervene “directly and immediately.”¹⁸
- *Financial Reporting Enforcement Panel (FREP).*¹⁹ FREP is a private company that examines the accounts of public companies to ensure transparent and truthful reporting. The FREP started a probe in Wirecard, as required by BaFin, but the report was inconclusive. FREP has noted that fraud investigation is not part of their duties.²⁰ The German Government has cancelled the contract with FREP with effects from 2021.

¹⁵ See, Storbeck (2020a) <https://www.ft.com/content/6a660a5f-4e8c-41d5-b129-ad5bf9782256>.

¹⁶ See, Storbeck (2020b) <https://www.ft.com/content/3b9afceb-aeab-4dc6-8a5e-b9bc0b16959d>.

¹⁷ See, Matussek (2020), <https://www.bloomberg.com/news/articles/2020-07-24/germany-s-bafin-sued-over-alleged-failures-in-wirecard-scandal>.

¹⁸ See, Chazan and Storbeck (2020), <https://www.ft.com/content/77d6b91f-0cf9-48dd-a08d-2c46d4fe9791>.

¹⁹ The German FREP (Deutsche Prüfstelle für Rechnungslegung – DPR) is responsible for random quality controls of financial reporting quality of listed German companies in collaboration with BaFin. The enforcement procedure was established in 2004 in the German Financial Reporting Enforcement Act - Bilanzkontrollgesetz – BilKoG). The FREP has been active since 2005.

²⁰ See, O'Donnell (2020), <https://www.reuters.com/article/us-wirecard-accounts-responsibility-idUSKBN243200>.

- *Bundesbank*. Bundesbank and BaFin decided not to classify Wirecard as a financial company,²¹ and the role played by the Bundesbank was to support BaFin oversight.²² The Bundesbank responsibility was focused on the operational monitoring of credit institutions, reporting directly to BaFin.
- *Regional authorities*. Investigation of money laundering at financial companies is the responsibility of regional authorities, however, the Bavarian regional authority explained that Wirecard did not fit the definition of a financial company.
- *Public Oversight Body for Statutory Audit (POBSA)*. The German POBSA is the Abschlussprüferaufsichtsstelle (APAS) or Auditor Oversight Body (AOB). In October 2019, APAS started an investigation on EY. No final report has been made public. The reform announced by the German Finance Ministry also affects APAS sanctioning role. In September 2020 APAS produced a press release indicating that it had conducted a telephone conversation with EY in February of 2019. In this press release, APAS clarifies that the “legal mandate of APAS is not aimed at uncovering errors in accounting.”²³

ESMA announced a fast-track review of the German financial reporting system, mainly to assess whether BaFin and FREP applied the European guidelines on supervising and enforcing reporting of financial information.²⁴ This report is expected at the end of October 2020. Overall, and although we cannot assess what actions may already be under way, it would appear that the case of Wirecard “slipped through the cracks,” in that numerous supervisors may have seen the allegations against it and no clear actions were taken.

2. CURRENT SUPERVISORY LANDSCAPE FOR THE PROVISIONING OF AUDIT SERVICES

The amended Audit Directive (2014/56/EU) and the Audit Regulation (537/2014/EU), which apply since 17 June 2016, provide the backdrop for the supervision of audit services in the EU. These regulations introduced stringer requirements for the statutory audits of public-interest entities (PIEs), to reduce the risk of excessive familiarity between auditors and their clients, encourage professional scepticism, and limit conflicts of interest.

To that end, the Audit Regulation created the Committee of European Auditing Oversight Bodies (CEAOB) which is the “framework for co-operation” and coordination between the 27 different national audit oversight bodies (henceforth, Public Oversight Bodies for Statutory Auditors—POBSAs).²⁵ The CEAOB, inaugurated in July 2016,²⁶ aims to facilitate supervisory convergence, contributing to a more effective and consistent application of EU audit legislation. As part of its duties, and in collaboration with ESMA, the CEAOB invigilates the implementation and application of audit rules, technically examines International Standards on Auditing (ISAs), and monitors market quality and competition in the provision of audit services to PIEs.

²¹ See, Reuters (2020), <https://es.reuters.com/article/id UKKBN24264N..>

²² See, Bloomberg (2020), <https://www.businesstimes.com.sg/banking-finance/wirecard-probe-set-to-put-germany-finance-watchdog-s-under-the-spotlight>.

²³ See, APAS, September 18, 2020. *Statement on the reporting in the Wirecard Case*, available online at: https://www.apasbafa.bund.de/SharedDocs/Kurzmeldungen/APAS/DE/20200918_stellungnahme.html.

²⁴ See, Sweet (2020), <https://www.accountancydaily.co/esma-probe-german-regulators-over-wirecard>.

²⁵ The member POBSAs of the CEAOB are listed in Appendix B. These are the 27 POBSAs of EU Member States, plus ESMA, which is a member without voting rights. Representatives of the European Economic Area (EAA) also participate, while the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA) are observers.

²⁶ European Commission, daily news 13/07/2016. *New framework for cross-border cooperation on audit supervision*. Available online: https://ec.europa.eu/commission/presscorner/detail/en/MEX_16_2524#7, accessed September, 2020.

As we review next, the supervision of auditors in the EU is a complex and fragmented network of supervisory national bodies, where thus far, the CEAOB effort towards coordination and cooperation has achieved limited success (CEAOB, 2019).²⁷

2.1. Auditor oversight systems

How are auditors subject to oversight? Accounting scandals in recent years raised concerns about the efficiency of the professional self-regulated supervisory practices, giving way to an international transformation of audit profession oversight mechanisms.

In 2002, the United States issued the Sarbanes Oxley Act, creating the Public Company Audit Oversight Board (PCAOB), moving away from a self-regulated audit oversight system. The PCAOB issues (a) auditing standards; (b) and accounting quality assurance standards, (c) controls the registration process of audit firms and statutory auditors; and is responsible for the (d) execution of inspections²⁸ (assessment of the compliance with the quality controls) and the (e) enforcement procedures, that is, the investigative and sanctioning responsibility. Other countries in the world with pre-existing self-regulated oversight systems followed a similar path.

Directive 2006/43/EC required EU Member States to organize a public oversight institution to regulate, supervise and discipline statutory auditors and audit firms: the national POBSAs. The new Directive 2014/56/EU, amending Directive 2006/43/EC, and Regulation 537/2014 aim to strengthen inspection, investigation, and sanctioning responsibilities, to “detect, deter and prevent infringements of the auditing rules.” Different oversight systems had traditionally co-existed in Europe before the enactment of the 2006/43/EC Directive:

- Member States with a tradition of professionally self-regulated oversight system.
- Member States with a tradition in public oversight structures.
- Member States with a mixed model, where the auditing profession collaborates in the oversight process with the public supervisor.

EU Member States restructured their auditor oversight systems to comply with the content of the new Directive, trying to harmonize their structures. However, despite the efforts devoted, significant differences remain that undermine the harmonization of oversight procedures across the EU, and thus, even though all POBSAs are governed by a similar common objective of “guaranteeing the public oversight of auditors and auditing firms and the enforcement of audit regulation,” it could be expected that differences may exist in the quality of the implemented controls over the audit profession. Next, we review these differences.

²⁷ While we do not focus on their role, we emphasize that auditing is influenced by other supra-national organizations. Audits must be conducted in a thorough and ethical manner, consistent with the ISAs of IAASB, and with the Code of Ethics for Professional Accountants (of the International Ethics Standards Board for Accountants - IESBA). In turn, financial statements must be prepared following International Financial Reporting Standards (IFRS) as prepared by the International Accounting Standards Board (IASB). Other organizations that also influence the audit profession are the International Forum of Independent Audit Regulators (IFIAR), the International Organization of Supreme Audit Institutions (INTOSAI), and ESMA, which is a member of the International Organization of Securities Commissions (IOSCO). Finally, auditors are also subject to national Audit regulation, and may also need to audit financial statements that use national Generally Accepted Accounting Principles (GAAP).

²⁸ According to the PCAOB (2018), “the objective of an inspection is to assess the firm’s compliance with the standards and rules and other applicable regulatory and professional requirements in the firm’s system of quality control and in the portions of audits selected for inspection.”

2.2. Differences in oversight systems in Europe

To understand the differences among POBSAs, we provide a comparative analysis of key characteristics of oversight systems across a representative set of Member States.²⁹ The objective of this analysis is not to provide a complete picture of the current oversight system (as particular details rapidly), but rather, to illustrate the differences between the POBSAs.

Ultimately, POBSA oversight aims to **prevent, detect** and **remedy** instances of low audit quality, as illustrated in Appendix B.1. Linked to these conceptual elements, we focus on the three key POBSA roles identified in art. 32.4 of the Directive: (1) Regulatory, (2) Supervisory, and (3) Disciplining. Appendix C lists, for each category, the variables we study for 14 representative Member States. In addition, we look at the general organization and governance of the POBSAs and their transparency policies. POBSAs can delegate duties such as quality assurance for non-PIEs, auditor registration, or continuing education to other competent bodies (i.e., professional organizations). However, ultimate responsibility of the regulatory, supervisory, and disciplining mechanisms rests on the POBSA as one unique competent authority (Art. 30f of Directive).

A pervasive characteristic of the EU oversight system is low transparency. The heterogeneity in the content, structure, and information provided by POBSAs renders meaningful comparative analyses nearly unfeasible and does not permit drawing conclusions on whether specific systems work better than others. The CEAOB annual questionnaire of the supervisory activity is the only direct current mechanism to compare activities across oversight bodies. Thus, we acknowledge that information may be available and we were not able to find it.

2.2.1. Differences in the organization structure of the POBSAs

To understand the governance of POBSAs, we identify the Company's Act that established their responsibilities, the number of members of its Board, the presence of an advisory committee with an active participation of the audit profession, the financing sources, and the participation of the POBSA in the key international and EU organizations for auditor regulators. All POBSAs under study are members of the CEAOB and International Forum of Independent Audit Regulators (IFIAR). Appendix B and C details the information.

Directive 2006/43/EC mandated that POBSAs should be governed by non-practitioners knowledgeable in areas relevant to statutory audit, where Member States may "allow a minority of practitioners to be involved in the governance of the public oversight system" (Art. 32.4). The new Directive, however, removes this option, mandating that while POBSAs can engage practitioners to carry out specific tasks or experts to assist with tasks, neither the practitioners nor the experts can be involved in any decision-making of the POBSA. This relegates the profession, which steps back from being part of the decision-making, to a delegated role.

Governance and funding heterogeneity is obvious in Table 1, that summarizes our findings for the representative POBSAs under study. The main differences refer to the existence of Advisory Committees, and the participation of the profession. While a few POBSAs are integrated in the structure of the national securities market supervisors, most are separate bodies. Budgets are sometimes presented in an aggregated manner, which makes it difficult to evaluate if they are adequate (relative to their workload) and comparable.

²⁹ Since 2014, Accountancy Europe provides a descriptive analysis of all POBSAs in Europe. The last available analysis was updated in the Accountancy Europe website in July 2020. We limit our descriptive analysis to 14 Member States (Austria, Belgium, France, Germany, Luxemburg, The Netherlands, Ireland, Italy, Spain, Greece, Portugal, Denmark, Sweden, and Finland).

Table 1: Summary of main organizational structure characteristics of POBSAs

Organizational characteristics	Yes	No	n/a
Independent body	10	4	0
Advisory Committee	6	8	0
Board members knowledgeable in areas relevant to statutory audit*	12	0	2
Presence of members of the auditing profession in the Board or Advisory Committees	8	4	2

Funding	Self-financed	Mixed	Public
Funding source**	11	3	0

Source: Based on García Osma et al. (2017), Gisbert et al. (2020) and see Appendix C for details. See also Appendix D for summarized details on number of staff and PIEs *Board size varies between 2 (Austria) and 14 (France) **Financing sources must be adequate to fulfil supervisory and disciplinary roles and free of undue influence of auditors (art. 32.7 Directive 2006/43/EC as amended by Directive 2014/56/EC). ‘Public’: POBSA is fully financed by the state budget. ‘Mixed’: POBSA supplements the resources coming from fees or levies charged to auditors with governmental resources. ‘Self-financed’: POBSA funds originate entirely from fees or levies charged to auditors and professional corporations.

Independence of the supervisor is of particular importance, both from the industry and from local politicians. While there is no prior comparative research on the independence of POBSAs, studies analysing the EU financial sector suggests that threats of political interference exist (Giner and Mora 2020) and that EU supervisors that are more politically independent are associated with lower income smoothing in their supervised banks (e.g., García Osma et al. 2019).

2.2.2. Differences in the regulatory role of the POBSAs

The regulatory role is particularly relevant for prevention, as illustrated in Appendix B.1, and relates to the following duties: (a) controlling the access to the profession; (b) maintaining a public registry of auditors; (c) adoption of Standards of professional ethics and internal quality controls, and (d) establishment of continuing education mechanisms. Directive 2014/56/EC allows the delegation of some of these tasks to other bodies such as the professional corporations of auditors. As summarized in Table 2, delegation of duties across the oversight bodies under study is a widespread practice, but also, heterogeneous across POBSAs.

Table 2: Summary of main regulatory competences of POBSAs

Regulatory competences	Oversight Bodies (POBSA)	Professional Corporations (PC)	POBSA in collaboration with PCs
Access to the profession – examinations	6	8	-
Registration*	6	7	1
Permanent education	5	9	-
Ethics standard setting	6	8	-

Source: García Osma et al. (2017), Gisbert et al. (2020) and see Appendix C for details. *Regarding the public registry for auditors, 4 out of the 13 bodies with a public registry delegate the task to professional corporations. Just for one specific POBSA (Finland) we have not been able to identify the site for the public register.

2.2.3. Differences in the supervisory role of the POBSAs

The supervisory role is particularly relevant for detection, as illustrated in Appendix B.1, and encompasses the quality assurance reviews (QAR) and inspection procedures. Regulation 537/2014 mandates that QAR for PIEs – known as *inspections* - must be carried out by independent inspectors either employed or contracted by the POBSA (art. 26), while QAR for non-PIEs can be delegated to professional bodies under the oversight of the POBSA.

Inspectors must have experience in auditing, financial markets and financial reporting and training on quality assurance review. Practicing auditors cannot be elected as inspectors, until they have been out of the profession for at least three years, to avoid conflicts of interest with the inspected auditor. POBSAs are responsible for (art. 26.3 of Regulation 537/2014): (i) approving the inspection methodologies and periodic inspection programmes; (ii) approval and assignment of inspectors; and (iii) approval and amendment of inspection reports.

In addition, art. 30 of the Directive requires Member States to implement whistleblowing procedures that encourage reporting potential breaches of conduct. We identify whether the POBSA provides a clear easy, anonymous and direct access to a whistleblowing canal.

Table 3 illustrates the heterogeneous degree of collaboration with professional organizations. To identify potential deficiencies and differences, QAR procedures and oversight functions over the quality controls should be clearly described. Few Member States describe the objectives of the QAR so that all professional organizations that collaborate act under a common framework. Few POBSAs offer a detailed description of the QAR procedure: number of inspectors/reviewers, appointment, mechanisms of supervision, feedback, correction measures, appealing from the auditor, etc. This means users cannot easily compare the process across Member States.

Table 3: Summary of main supervisory competences of POBSAs

Supervisory mechanisms	POBSA	POBSA in collaboration with PC	Other*
Quality assurance reviews (Non-PIEs)	6	8	2
Inspections (PIEs)	14	0	-

Source: García Osma et al. (2017), Gisbert et al. (2020) and see Appendix C for details. *Other: QA reviews competences rely on other competent body different from the POBSA or PC.

In addition, definitions of PIEs vary across Member States. That may affect whether responsibilities can be complied with, as it influences the scope of action required.

2.2.4. Differences in the disciplinary role of the POBSAs

The disciplining role is particularly relevant for remediation, as illustrated in Appendix B.1, and encompasses the investigation and sanctioning mandates. Sanctioning powers can be exercised exclusively or in collaboration with other competent authorities (i.e. judicial system or professional bodies). Art. 30.4 of the Directive requires disclosure of sanctions to the public for a minimum of 5 years. Both pecuniary and non-pecuniary sanctions vary across jurisdictions.

Table 4: Summary of main disciplining competences of POBSAs

Disciplining mechanisms	POBSA	POBSA in collaboration with PC	Other**
Investigation procedures	7	5	2
Sanctioning procedures*	6	5	3

Source: García Osma et al. (2017), Gisbert et al. (2020) and see Appendix C for details. *Sanctions can be pecuniary and non-pecuniary. Non-pecuniary sanctions range from a notice requiring ceasing the breach of conduct to the temporary prohibition to sign audit reports. Both pecuniary and non-pecuniary sanctions vary across jurisdictions. **Other: Investigation and Disciplinary duties rely on other competent authorities different from the POBSA or PC.

Sanctions are not specified in the Directive, allowing Member States to establish their own regime, which must be “effective,” “dissuasive,” and “proportionate” as well as publicly available (Art. 30.4). However, there is a wide range of sanctions, potentially leading to differences in the incentives to avoid breaches of conduct. It is often difficult to identify the public repository of sanctions. Spain, Portugal, Sweden or Ireland are examples of greater transparency: sanctions are easily available, they offer detailed information of the auditor and client. In Ireland, the report includes a description of the investigation process, similar to the PCAOB system.

Investigation and disciplining (ID) procedures are not always adequately described in POBSAs websites and in some Member States, there appears to exist a parallel ID system in the profession, which may create duplicated and inefficient structures. Additionally, there is no information on whether clients of inspected auditors are informed about the results of any investigation and sanctioning procedure. The detailed information in the CEAOB annual questionnaire of POBSAs supervisory activity does not clarify, in the ID procedures, whether the sanction regime applies to audit firms, individual auditors, or both.

2.2.5. Differences in transparency mechanisms

Disclosure fulfils an important disciplining role, both *ex-ante*, in that auditors concerned about disclosure of deficiencies by the POBSA would likely improve their quality, and *ex-post*, in that interested parties can monitor auditors. Oversight bodies are required to publicly disclose an annual activity report with information about their oversight activities and an annual work programme (Art. 32.6 Directive 2014/56/EU).³⁰ In addition, Regulation 537/2014 requires the publication of the overall results of the quality assurance reviews (QAR) and inspections.³¹

All POBSAs publish these reports. However, the structure of the document, the measurement basis, and the presentation format differs significantly across Member States, hindering data collection and comparability. For example, it is not possible to calculate basic ratios, such as inspection coverage (number of inspections over the number of PIEs). These reports are usually only available in the national language, potentially limiting usefulness to international investors.

Table 5: Summary of main transparency policies of POBSAs

Transparency	Yes	No
Annual Report/Activity Report	14	-

³⁰ Art. 28 of the 537/2014, requires publication of: (a) annual activity reports, (b) annual work programmes; (c) a report on the overall results of the quality assurance reviews on an annual basis, (d) aggregated information of the findings and conclusions of inspections. Member States can publish the findings and conclusions from the individual inspections. However, Member States are reluctant to publicly disclose the individual results of inspections, investigations or disciplinary procedures.

³¹ Quality assurance reviews (QAR) conducted by the oversight body or delegated in a competent authority (i.e. professional corporations), are mechanisms in place that aim to assess the effectiveness of the statutory auditor system of internal quality control and the quality of specific audit engagements. Inspections are QAR of PIE statutory auditors and led by an inspector (art.26 Regulation 537/2014). Inspectors are independent and qualified experts designated by the oversight body.

Work Programmes	9	5
Detailed QAR/Inspection results	1	13
Sanctions publicly available	12	2
Statutory Auditor Register	13	1
Whistleblowing service	6	8

Source: García Osma et al. (2017), Gisbert et al. (2020) and see Appendix C for details.

Table 5 summarizes the differences in transparency. Quality Assurance reports are only publicly available in Ireland. Few POBSAs have a historical repository of sanctions available. Disciplinary sanctions are not easy to find and, when available, information is usually only available in the national language, or personal information is omitted as mandated by data protection rules. Only Ireland makes reports publicly available when the investigation process leads to a sanctioning procedure. Finally, whistleblowing services are not always available, and there are few cases where there is easy direct access through the POBSA website (i.e. Austria).

3. THE ROLE AND EFFECTIVENESS OF SELF-REGULATORY AUDIT BODIES

External audit quality control through supervisory mechanisms seeks to promote investors’ trust and confidence, by securing audit quality. This is achieved by incentivizing auditors to develop their competencies, and to comply with professional standards. Two modes of external audit quality control exist: peer review, and public (governmental) oversight, both of which involve the inspection of completed audit engagements and of auditor’s quality control systems, to ascertain whether audit firms have developed adequate quality control policies and procedures in compliance with professional accounting and auditing standards and applicable legislation.

The effectiveness of such external assessments cannot be discussed without reflecting on the challenges in defining audit quality, and the extent to which cases such as Wirecard can be considered audit failures. Thus, we first briefly reflect on these issues, and then move to discuss the role and effectiveness of supervisory mechanisms in securing audit quality.

3.1. Audit quality and the expectation gap

The current legal framework does not give auditors the task to detect fraud. This has proved difficult to communicate to the wider public, as an “*audit expectation gap*” exists, i.e., there is a distance between what users expect from the audit, and what the audit is (see Box 1).³²

Box 1: The role of the auditor

«The statutory audit results in the expression of an opinion that the financial statements give a true and fair view of the audited entities in accordance with the relevant financial reporting framework.»

³² It is unclear to users, preparers, and auditors what the auditor’s report intends to communicate, or what level of assurance it provides (Gray et al. 2011). Confusion with respect to the role, responsibilities and performance of auditors has been documented dating back over 100 years in the UK (Chandler et al. 1993). Further, a system of oversight focused on improved audit quality may not be equivalent to a system of oversight focused on improved fraud detection.

Source: Directive 2014/56/EU

Investors expect auditors to be ‘public watchdogs,’ holding higher expectations than auditors in internal control assurance, fraud, and illegal operations detection (McEnroe and Martins 2001, Asare and Wright 2012). This gap is driven by lack of knowledge on “the limitations of an audit (materiality, sampling techniques, role of the auditor in the detection of fraud, and the responsibility of management)” (EC 2010, 3–4), but also, by society’s high expectations (Porter 1993) and gaps between what auditors do and the requirements of standards. It is a question beyond the scope of this briefing to discuss whether the audit approach needs to be changed, to retain credibility and relevance, but certainly, cases such as Wirecard point at potential deficiencies in the audit and its oversight, suggesting auditors must also act to bridge this gap.

Indeed, significant efforts have been made to improve the audit report and audit communication. Standard setters and regulators have recently adopted an expanded audit report (EC 2014; IAASB 2015; PCAOB 2017), that goes beyond the traditional binary fail/pass model, and includes information on accounting and risk issues (key/critical audit matters) that enable users to better understand the reasons behind the audit opinion. Albeit this new report has not been in place for long, and the evidence is still tentative, these extended disclosures appear, thus far, to have had limited success in improving audit quality, or affecting audit fees (Bédard et al. 2019, Gutierrez et al. 2018), nor have they closed the expectation gap (Coram and Wang 2019). This may be expected, given evidence in Gray et al. (2011, p. 662) that “users do not read the auditor’s report.” Rather, they just look at it to check “if it has an unqualified opinion” and “the name of the accounting firm signing the report.” In addition, arguably, information contained in the auditor report about the client’s risk is likely available to investors elsewhere. However, these expanded audit reports are still in their infancy and the measurement of real benefits requires more years to be evaluated (Minutti-Meza 2020).

Therefore, it is not the role of the auditor to detect fraud and prevent accounting scandals, but clearly, audit oversight can *limit* the opportunities to commit it. As noted in Kedia and Philippon (2009), accounting manipulation plays a role in fraud. Misreporting supports the abnormal hiring and investment that characterize fraud cases such as Parmalat, or the current scandal of Wirecard, which grew through acquisitions of local businesses. High (fraudulent) profits sustain overvalued equity and allow managers to mimic successful companies.

3.2. The role and effectiveness of public audit oversight

Academic work usually analyses effectiveness along three main fronts: (i) the extent to which market participants (and particularly clients) react to oversight reports and the disclosure of deficiencies; (ii) the consequences of these reports, feedback and deficiencies on individual auditors (careers, salaries) and audit firm behaviour (audit procedures and quality control systems, often as measured by evidence of increased audit work, or greater audit fees); and (iii) the consequences on auditor outputs: the issuance of audit opinions and assessments of internal controls and the quality of client’s financial statements and reporting.

3.2.1. Quality assurance reviews/inspections and investigations and audit quality

Unfortunately, there is a dearth of research on the EU public oversight system, given its lack of transparency. Research requires access to data. Thus, most prior work is based on the case of US, where studies have analysed the consequences of implementing a system of public audit oversight, studying audit quality before and after the implementation of the PCAOB. Overall, the evidence suggests a superior effectiveness of public oversight bodies, relative to a regime of self-regulation peer review. In Appendixes E and F we summarize the key literature.

The PCAOB is a strong, transparent supervisor operating in a developed, highly litigious, capital market with high levels of investor protection. The PCAOB publishes in a repository that is easy to search *all* its inspection/review reports (which contain an auditor response), including reports of EU auditors that

audit companies cross-listed in the US.³³ Thus, it is not comparable to most national EU POBSAs, and we caution that inferences from this research may not hold in the EU.

There is evidence that PCAOB reviews/inspections have resulted in changes in audit firm behaviour, improving audit quality (e.g., Vanstraelen and Zou 2020). Audit firms are more likely to issue qualified opinions for their financially distressed clients subsequent to a PCAOB review/inspection that discloses auditor deficiencies, while no such benefits are found for audit firms where the report indicates no deficiencies (Gramling et al. 2011). Also, clients' financial statements are of higher quality (as measured by lower earnings management) after the first, and particularly, the second PCAOB review/inspection (Carcello et al. 2011). Audit quality also improves, because smaller, lower quality auditors exit the market (DeFond and Lennox 2011). This, however, comes at the potential cost of greater audit market concentration.³⁴ While there are no definitive conclusions on the impact of concentration on audit quality, the work of Francis et al. (2013), studying 43 markets, concludes that the overall Big 4 market share in a country is positively associated with client's earnings quality, while concentration *within* the Big 4 group is negatively associated with audit quality. This suggests that market domination by one or two firms rather than shared equally among the Big 4 negatively impacts audit quality. Similarly mixed findings on the consequences of auditor concentration can be found in other studies that focus on a single country (see, e.g., Boone et al. 2012; Huang et al. 2016).³⁵

Overall, there is agreement that public oversight improves audit quality across the board (Khurana et al. 2020). Given scarce resources, supervisory bodies select engagements on a risk-adjusted basis. This means that it is audits of the largest companies with more complex business models and operations that are more likely reviewed/inspected, while sufficient rotation avoids excessive oversight concentration in these firms. Given that companies such as Wirecard are usually audited by large audit firms, arguably, Big 4 firms are subject to greater scrutiny, improving audit quality for large public companies. Second, to the extent that inspection reports disclosing audit deficiencies are public, disciplinary actions damage auditor reputational capital, creating incentives to solve any deficiencies detected.

3.2.2. Effect of PCAOB inspection on foreign/EU auditors and companies

There is also some evidence on the effects of oversight by the PCAOB over EU auditors and EU companies. This research uses data made available by the PCAOB on international audit firms, and suggests greater audit quality in EU companies (considered as 'foreign companies' by the PCAOB) that are listed in the US *when* they are subject to PCAOB oversight.³⁶ This is of significance, given that companies cross-listed in the US are already subject to significant regulatory oversight by the Securities and Exchange Commission (SEC).

PCAOB inspections of foreign auditors detect audit deficiencies in over half of the reports, and quality control defects in two-third of the reports (Bishop et al. 2013). Where PCAOB reports induce improvements in audit quality for US auditors, this does not seem the case for foreign auditors, which may be linked to the PCAOB lack of sanctioning power over them.

³³ These reports include information on the presence, characteristics and number of audit deficiencies and quality control defects, year of inspection, number of clients, inspection length, time lag from inspection to issuance of report, audit firm characteristics (number of offices, partners, staff, issuer clients, other roles), and location of audit firm, among other details (Bishop et al. 2013).

³⁴ Growing audit market concentration and Big 4 dominance have been continued concerns for the EU (Lesage et al. 2017). According to Audit Analytics (2018), in 2017, of the more than 600 companies included in major large and mid-cap indices in UK, Germany, Italy, Spain and the Netherlands, over 98% are audited by the Big 4 (see, also, Appendix G). In 2010, the EC issued a 'green paper' proposing mechanisms to reduce concentration and increase competition (EC 2010). Despite indications that recommendations would be made to the European Parliament to reduce Big 4 dominance, as well as ban the provision of *all* non-audit services, and impose auditor rotation, and joint audits, ultimately, proposals have been more modest in scope.

³⁵ Boone et al. (2012) study US and report that greater concentration leads to greater tolerance for client' earnings management.

³⁶ All foreign auditors of US listed companies are required to register with the PCAOB no later than July 19, 2004.

Foreign/EU auditors subject to PCAOB inspection access (threat of inspection) are more likely to issue qualified audit opinions, and adverse opinions on internal controls, and their clients are likely to have lower earnings management (Lamoreaux 2016), particularly, after inspections (Krishnan et al. 2017). Research generally documents benefits for ‘foreign companies’ under the oversight of PCAOB. For example, companies are able to issue additional external capital when their auditors receive a ‘deficiency-free’ inspection report (Shroff 2020). Other studies looking at additional spillover effects of PCAOB inspections (on non-US companies that are *not* cross-listed in the US), find increases in auditor market share following inspection (Fung et al. 2017, Aobdia and Shroff 2017). PCAOB inspected auditors appear to increase their market share by 4 to 6% following the public disclosure of their inspection report.

These studies also help to understand cross-sectional variation in oversight systems across countries, as the differential benefits reaped by foreign companies, depending on their country of origin, speak of the quality of the local oversight systems. These studies suggest that countries that are members of IFIAR generally have better oversight (Lamoreaux 2016), and that the benefits of PCAOB oversight are greater for companies domiciled in countries where local audit regulators conduct no inspections, and have low quality country-level institutions such as high corruption, weak rule of law and low regulatory quality (Shroff 2020), that is, benefits for EU firms are relatively smaller.

While benefits may exist in sharing information among oversight bodies, there is no clear evidence on this. It is also not clear if joint inspections conducted with the foreign authority in the corresponding country (relative to PCAOB stand-alone inspections) are more beneficial, as Krishnan et al. (2017) documents positive effects, but Bishop et al. (2013), focusing on early inspections, find no evidence of differences between joint and stand-alone inspections.

3.2.3. Effect of POBSAs on EU auditors and companies

There are few studies analysing the EU. Sundgren and Svanström (2017) study Sweden, and find that disciplinary sanctions impact on individual auditors’ subsequent careers, insofar salaries of auditors at Big 4 firms are lower after the sanction. Sanctions have limited impact on the decision of clients to retain their auditors, or more generally, on the size of the auditor clientele. Finally, they find limited evidence of auditors’ remediation or changed behaviour, as they find no evidence of post-sanction changes in auditor’s propensity to issue qualified opinions. Carson et al. (2017) find greater financial statements quality in companies audited by firms in Member States where POBSAs conduct the inspections directly, and report on the deficiencies found at the aggregate level. Florou and Shuai (2020) find greater audit fees after POBSA inspection regimes are in place, which would be suggestive of greater work by auditors. These increases are greater where POBSAs have (i) more inspectors over total staff; (ii) do not allow direct revolving doors from inspection to the profession without a cooling period (see also Hendricks et al. 2019); (iii) have a mixed funding model (lower chance of regulatory capture), and (iv) where inspections are conducted both at the POBSA and at the auditors’ premises.

Overall, this limited evidence suggests that the PCAOB system may induce greater audit quality than the EU fragmented system. An example of fragmentation is that PCAOB oversight of EU cross-listed companies is negotiated individually by each POBSA, instead of by the CEAOB.³⁷

3.3. The role and effectiveness of self-regulatory mechanisms

The alternative approach is to delegate external reviews to peers. A self-regulation regime of peer reviews creates concerns that reviewers use inadequate tools and lack independence. Indeed, Turner

³⁷ This links to the limited mandate of the CEAOB. In 2005, the European Group of Auditor Oversight Bodies (EGAOB) was created to facilitate cooperation and coordination across EU public oversight systems (Commission Decision 2005/909/EC). The CEAOB is the new “framework for cooperation” and aims to enhance the consistent application of the new audit oversight regulation. Despite the experience of its predecessor, the CEAOB competences are still limited and its guidelines are non-binding. In Appendix B we detail the EU Member States that currently have a cooperation agreement with the PCAOB and the year when that agreement was signed. Many Member States have no agreement. A cursory look at these agreements reveals differences.

(2006, p. 397) former Chief Accountant of the SEC, noted that the period leading to the spate of accounting scandals in the early 2000s was characterized by a “weak self-regulatory system for auditors that resulted in one firm reviewing another, with an unspoken code of «Don’t tell on me, and I won’t tell on you».”³⁸

Thus, a system of public oversight is generally superior to a peer-review one. However, public oversight is not without limitations. It is possible to identify areas for improvement, by reflecting on differences between the two systems, and key notions linked to audit quality: (a) inspectors/reviewers should have both expertise and independence (DeAngelo 1981), that is, they should be *able to identify* deficiencies and be *willing to report* on them, and (b) inspections/reviews should be objective and based on reliable information, evaluation and justification. The first dimension is problematic, given trade-offs between both dimensions (DeFond 2010). Key differences (Carcello et al. 2011, Löhlein 2016) are:

- *independence*: inspectors, particularly POBSA full-time employees, are likely more independent and objective than peer reviewers, in addition, inspected firms have no voice in choosing inspectors. If firms can influence or choose the peer that performs the review, it compromises independence (Hilary and Lennox 2005, Lennox and Pittman 2009);
- *expertise*: inspectors are likely to have greater expertise in inspecting, as they specialize in this task; peer reviewers have as their primary activity audit-related responsibilities, and as active professionals, have greater industry and technical expertise (in accounting, auditing, internal controls, audit practices and methodologies, client industries, etc.). Inspectors’ knowledge, even if they come from practice would become dated relatively fast resulting in lower experience of inspectors, relative to peers (Glover et al. (2009);
- *inspection/review processes and coverage*: if implemented by POBSAs are likely more extensive and of greater scope under the public system (Goelzer (2006) (subject to budgetary constraints). Under peer-review it is common to negotiate a fee with the reviewer. Fee considerations may lead to selecting lower quality peer reviewers, or to performing less tests and checks.
- *ability to act*: unlike peer reviewers, inspectors are more likely to be able to take direct action and sanction firms, which can result in larger penalties.

The evidence suggests that audit clients found peer review reports to be *more* informative than PCAOB reports (Hilary and Lennox 2005). Unfavourable peer review reports are associated with actual audit quality as measured by the overworking of audit staff and acceptance of risky client (Casterella et al. 2009). These peer reviews also had more “information value.” PCAOB reports do not provide an overall opinion on the quality of the audit firm, and do not disclose information about its control systems.³⁹ This was available under the peer review system. Audit market participants, on average, switched away from audit firms that received unfavourable reports under the peer-review system, but not under the PCAOB system. As noted in Lennox and Pittman (2010), differences in “information value” depend on the information in the report.

Other concerns (DeFond 2010, DeFond and Lennox 2017) are that public oversight review may: (i) *not be representative*, if focused on the riskiest auditing issues among the riskiest clients (given budget constraints); (ii) *be trivial*, in that they may be too detail-oriented and identify inconsequential weaknesses. This may be likely if inspectors are under pressure to identify and report deficiencies, which is not a concern under peer-review; or (iii) *capture differences in professional judgment*, rather than

³⁸ Arthur Andersen received a ‘clean’ peer review report from Deloitte & Touche in December 2001, shortly before the Enron scandal that led to its collapse (Turner 2006; DeFond and Francis 2005).

³⁹ Inspections reports are available at <https://pcaobus.org/Inspections/Reports/Pages/default.aspx>, accessed September, 2020. These reports are easy to search, as they are categorized by country and year.

systematic audit failures. Auditors interact with audit committees and client personnel in an *ex-ante* setting, while inspections are *ex-post* with minimal or no client contact (Daugherty and Tervo, 2010).

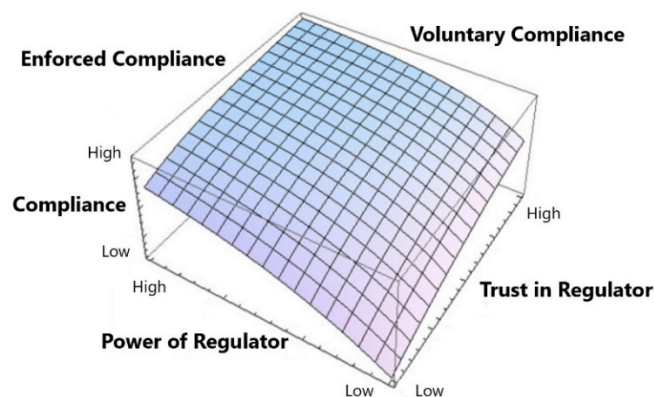
Several studies analyse the views of auditors and regulators on public oversight and peer-review systems. These studies suggest that public oversight inspections have a more disruptive impact on auditors' normal activities than peer-review, particularly over smaller auditors. In Appendix F we summarize this work. Overall, the public oversight inspections/reviews and auditor's desire for unqualified reports leads to auditors excessive documentation, and 'box ticking' approaches (rather than a focus on substance) embedding check lists and other procedures into their audit process, to increase 'compliance visibility,' that may promote a standardized orientation, increasing the commoditization of the audit.⁴⁰

3.4. Enforcement styles and transparency.

Two final key issues associated with public oversight are enforcement and transparency.

Different enforcement styles exist (Dowling et al. 2018), from *coercive* (rigid in interpreting rules and inquisitorial in evaluating behaviour) to *collaborative* (flexible and open to negotiation). Collaborative enforcement may foster cooperation (Hazgui and Malsch 2019), promoting compliance. Figure 2 illustrates the slippery-slope framework (Kitchler et al. 2008), whereby powerful and trusted regulators maximize compliance. Moving the dial on power or trust results in non-optimal outcomes. Enforcement should start with persuasive efforts, rather than punitive actions, and penalties should scale only if persuasion fails. This is the responsive regulation theory, tested in the US public audit oversight setting, where Ege et al. (2020) suggest that because the PCAOB was created as a reaction to public outcry (Malsch and Gendron 2011), it may have been more willing to start with a punitive approach, lowering its positive impact.

Figure 2: Slippery slope of misreporting



Source: Adapted from Kitchler et al. (2008) and Dowling et al. (2018).

Finally, with respect to transparency, transparent institutions promote accountability and good governance. However, transparency may constrain the capacity to negotiate and compromise, leading to inefficient and gridlock. Although these inefficiencies appear negligible when looking at the US Government (Harden and Kirkland 2020), we acknowledge their existence.

⁴⁰ Excessive bureaucracy is not unique to this process. Professionals recommend to "document, document, document," to protect against claims of failure to detect theft and fraud, as documentation is critical evidence in the defence of professional liability claims (including, "at a minimum, a well-crafted and detailed engagement letter, documentation regarding client inquiries made and responses received, and communication of internal control matters or suspicious activities noted" Ference (2014)).

4. REFLECTIONS ON SUPERVISORY IMPLICATIONS

4.1. Limitations of this briefing

The reflections and implications of this briefing are subject to three major caveats.

First, we have not had access to primary forensic data or original documents of Wirecard, nor access to supervisory staff in Germany. Our review of the case is based on secondary data. Principally, on the KPMG report (as translated to English by Wirecard), and allegations leaked to the press, which may be entirely false at worst, or even if true, biased, or filled with factual mistakes. The case is still developing, several lawsuits are pending, and the company is under the management of an Insolvency Administrator. Available financial information is incomplete.

Second, accounting scandals are extreme events. Each one is different, and thus, conclusions drawn from one case need to be considered with caution. Therefore, the implications and conclusions that follow build primarily on our analysis of the current landscape and the reviewed academic literature, and less on the Wirecard case, particularly given the first caveat.

Third, the severe lack of transparency that permeates auditor oversight system means that:

- the academic evidence discussed is based, almost exclusively, on the PCAOB and US. There is a dearth of research on EU public audit oversight and its efficiency because no data is available. This is a severe limitation to evidence-based policy recommendations.
- we cannot assess what actions, if any, supervisors have taken or may be underway in reviewing the case of Wirecard and its statutory auditor (EY).
- deficiencies in the oversight systems cannot be separated from deficiencies in the content, structure and information provided *about* the oversight systems. We acknowledge potential errors derived from our inability to find POBSA documentation.

4.2. Conclusions and supervisory implications

Our review documents a *fragmented, and complex supervisory system hindered by slow decision-making and resource constraints*. Competences appear duplicated, or unclearly delimited among the different bodies, creating gaps where breaches of conduct or incipient frauds could go unnoticed. The example of Wirecard suggests complex firms may be particularly able to avoid supervision, falling '*between the cracks*.' There is limited clarity on who should lead investigations and how to share information and coordinate the supervisory activities across competent bodies.

Wirecard, and firms like Wirecard, operate in a global economy; supervision that is only at the local level is likely to fall short of its objectives. Global companies in the global economy require global institutions. The harmonization of procedures (quality assurance, investigation, sanctions) and a significant improvement of the accountability and transparency mechanisms in place, are the cornerstones of the changes that should be addressed in the EU auditor oversight system, under the leadership and coordination of the CEAOB. Next, we list the major concerns [C] detected and reflect [R] on actions to improve the effectiveness of audit oversight.

4.2.1. Macro-level: The role of the CEAOB and other international and EU bodies.

[C1] CEAOB as a weak "framework for coordination." [R1]: CEAOB has made limited progress towards its mandate to coordinate and harmonize EU POBSAs. The role of the CEAOB should be reconsidered, and greater power assigned to it, perhaps including a clearer supervisory role. These changes may include giving the CEAOB greater resources (budget, staff) and clear competencies. Adequate oversight of auditors of PIEs (listed in Appendix G) likely requires that these audit firms have global structures that

guarantee similar audit quality across all Member States. The CEAOB could directly supervise these global structures.

[C2] *Limited coordination between supervisors.* [R2A]: The Wirecard case suggests supervisory bodies acted in an uncoordinated manner, without clear leadership. [R2B]: Coordination between the oversight of auditors and of financial reporting is fundamental.

[C3] *Multiple measurement bases for POBSA reporting.* [R3A]: Annual data on key results⁴¹ should be calculated under a single reporting system, to aid the CEAOB coordination activities. [R3B]: Consider XBRL tagging, and public, easy to search, repositories of audit oversight data.

[C4] *Lack of guidance on best practices on oversight procedures* [R4]: The oversight system ultimately aims to improve audit quality. The CEAOB should identify and promote best practices in audit oversight, through outreach, and increased transparency.

[C5]: *Multiple national agreements with international oversight bodies.* [R5]: The CEAOB should be responsible for agreements with other international oversight bodies (such as the PCAOB).

[C6]: *Multiple definitions of PIEs.* [R6]: PIE definition should be harmonized.

4.2.2. POBSA level: Prevention

[C7]: *Resource constraints.* [R7A]: POBSAs budgets are heterogonous and often insufficient. [R7B]: POBSAs should report comparable budgetary figures, given their respective workloads.

[C8]: *Slow decision-making and low reactiveness.* [R8A]: A channel for fast-track QA reviews, inspections or investigations should be articulated. [R8B]: POBSAs should be reactive to whistleblowing or allegation of misreporting.

[C9]: *Heterogeneous POBSA organization and governance* [R9A]: POBSA governance recommendations should be prepared. Report and discuss Advisors/Staff ratios. POBSAs have large boards, and insufficient staff. [R9B]: Codes of conduct should be created, to prevent conflicts of interest; attention should be paid to revolving doors (back to the profession).

[C10]: *Irregular presence of the profession.* [R10A]: POBSAs should have an Advisory body where the auditing profession is represented. [R10B]: QA review and inspection procedures should not foster a bureaucratic, box-ticking mentality and may consider more collaborative approaches.

[C11]: *Threats of regulatory capture and political pressures.* [R11]: These concerns are greater in public bodies. Supervisors should be powerful authorities and independent from politicians.

4.2.3. POBSA level: Detection (Quality & Assurance (QA) and Inspections)

[C12]: *Heterogeneous QA and inspection procedures.* [R12]: QA and inspections procedures must be disclosed on the POBSA website. When delegated, appointment criteria should be disclosed.

[C13]: *Insufficient number of inspectors.* [R13]: The number of hired or contracted inspectors should be proportional to the number of PIEs, so that the proportion of reviewed PIEs is similar across Member States. Ratio Staff/PIEs should be justified.

[C14]: *Low comparability of QA and inspection reports* [R14]: POBSAs must report on reviews and inspections. These reports should be comparable and publicly available. We recommend the Irish IAASA (2020) *Guide to reports on quality assurance*, that describes the quality assurance review process and explains the content of the reports on each quality assurance review.

[C15]: *Low information value of QA and inspection reports* [R15]: A standardized rating could be implemented, to grade auditor quality control systems and files reviewed/inspected. This rating should

⁴¹ Number and type of sanctions, number of QA reviews, number of inspections and coverage of PIEs, average time frame to accomplish a QA review, inspection/investigations, degree of accomplishment of recommendations from QA reviews, etc.

go beyond qualified/unqualified (e.g., A, B, C, D). We acknowledge the costs of preparing QA reports for non-PIE audit firms. QA review reports could be separately regulated.

[C16]: *Heterogeneous whistleblowing mechanisms* [R16A]: Whistleblowing mechanisms should be easily accessible. This imposes costs, in that whistle-blowers often act on suspicion (rather than searching for misconduct), and may be wrong, resulting in false accusations (Franke et al. 2020). [R16B]: A centralized whistle-blowing repository may be considered. [R16C]: Client companies should have clear procedures, and auditors should have access to this information.

4.2.4. POBSA level: Remediation (Investigation and Discipline - ID)

[C17]: *Heterogeneous ID procedures.* [R17]: ID procedures should be homogenous and have clear triggers to act. Clarify when the competent authority can proceed with an investigation (e.g., because of a QA review; *whistle-blower* allegations; at the securities supervisor request, etc.)

[C18]: *Heterogeneous sanctioning regimes.* [R18]: Sanctioning regimes should be harmonised.⁴² Otherwise, breaches of conduct are differently penalized across EU countries.

4.2.5. Transparency

[C19]: *Annual reports and Working programmes are non-comparable.* [R19]: Reports should have a comparable format, use the same measurement basis for QA and ID processes and consider English as additional reporting language. This makes the report globally accessible.

[C20]: *POBSAs websites are difficult to navigate and information is not homogenous.* [R20A]: POBSAs should have a well-structured website (in local and English language) with all relevant information. [R20B]: The register of auditors should be easily accessible through the website.

[C21]: *Heterogeneous information on delegated functions, QA reviews, inspections, ID and sanctions.* [R21]: Standardize reports and make them publicly available in repositories.⁴³

⁴² The CEAOB 2019 Report on the Enforcement Questionnaire shows that the sanctioning regime is imposed with different criteria across countries to the sanctioned auditor. Whether staff gets sanctioned also varies across Member States.

⁴³ QA reports should be accessible, with the responses of auditors to the recommendations of the oversight body. When the investigation process leads to a sanction, a report should be issued by the oversight body detailing the investigation process, identifying the auditor and the sanctions imposed.

REFERENCES

- Accountancy Europe. 2020. *Organisation of the Public Oversight of the Audit Profession in 30 European countries*. Available online: https://www.accountancyeurope.eu/wp-content/uploads/200609_Organisation-of-the-Public-Oversight-of-the-Audit-Profession-2020-survey-update.pdf, accessed September, 2020.
- Aobdia, D. and N. Shroff. 2017. Regulatory oversight and auditor market share. *Journal of Accounting and Economics* 63(2-3): 262-287.
- Asare, S.K., and A.M. Wright. 2012. Investors', auditors', and lenders' understanding of the message conveyed by the standard audit report on the financial statements. *Accounting Horizons* 26(2): 193-217.
- Audit Analytics. 2018. EU auditor market share: 2017 Audit Reports. Posted on May 21, by Steven Dixon. Available online at <https://blog.auditanalytics.com/eu-auditor-market-share-2017-audit-reports/>, accessed September, 2020
- Audit Analytics. 2020. Market concentration of PIEs – An analysis of transparency report data. Posted on August 26, by Krystle Beaubrun. Available online <https://blog.auditanalytics.com/market-concentration-of-pies-an-analysis-of-transparency-report-data-2/>, accessed September, 2020.
- Bédard, J., N. Gonthier-Besacier, and A. Schatt. 2019. Consequences of expanded audit reports: Evidence from the Justifications of Assessments in France. *Auditing: A Journal of Practice & Theory* 38(3): 23-45.
- Bishop, C. C., D. R. Hermanson, and R. W. Houston. 2013. PCAOB inspections of international audit firms: Initial evidence. *International Journal of Auditing* 17 (1): 1–18.
- Bloomberg (2020) *Wirecard probe set to put Germany finance watchdogs under the spotlight*. Bloomberg, September 1. Available online: <https://www.businesstimes.com.sg/banking-finance/wirecard-probe-set-to-put-germany-finance-watchdogs-under-the-spotlight> accessed September, 2020.
- Boone, J., I. Khurana, and K. Raman. 2012. Audit market concentration and auditor tolerance for earnings management. *Contemporary Accounting Research*, 29 (4): 1171-1203.
- Carson, E., R. Simnett, U. Thuerheimer, and A. Vaanstraelen. 2017. The effect of national inspection regimes on audit quality. Working paper. Available online: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3049828, accessed September, 2020.
- Carcello, J.V., C. Hollingsworth, and S.A. Mastrolia. 2011. The effect of PCAOB inspections on Big 4 audit quality. *Research in Accounting Regulation* 23: 85-96.
- Casterella, J. R., Jensen, K. L., and Knechel, W. R. 2009. Is self-regulated peer review effective at signaling audit quality?. *The Accounting Review*, 84(3), 713-735.
- Chandler, R., J.R. Edwards, and M. Anderson. 1993. Changing perceptions of the role of the company auditor, 1840–1940. *Accounting and Business Research* 23: 443–459.
- Chazan, G. and O. Storbeck, 2020. *Germany to beef up financial regulation after Wirecard scandal*. Financial Times, July 24. Available online: <https://www.ft.com/content/77d6b91f-0cf9-48dd-a08d-2c46d4fe9791>, accessed October 2020.
- Committee of European Auditing Oversight Bodies (CEAOB). 2019. *Annual report*. Available online: https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/ceaob-annual-report-2019_en.pdf, accessed September, 2020.

- Coates, J. C., and Srinivasan, S. 2014. SOX after ten years: A multidisciplinary review. *Accounting Horizons*, 28(3), 627-671.
- Coram, P.J., and L. Wang. 2019. The effect of disclosing key audit matters and accounting standard precision on the audit expectation gap. Working Paper. Available online: <https://dx.doi.org/10.2139/ssrn.3485879>, accessed September, 2020.
- Daugherty, B., and W. Tervo. 2010. PCAOB inspections of smaller CPA firms: The perspective of inspected firms. *Accounting Horizons* 24 (2): 189–219.
- DeAngelo, L. E. 1981. Auditor size and audit quality. *Journal of Accounting and Economics* 3(3): 183–199.
- DeFond, M.L., and J.R. Francis. 2005. Audit research after Sarbanes–Oxley? *Auditing: A Journal of Practice & Theory* 24: 5–30.
- DeFond, M. L. 2010. How should the auditors be audited? Comparing the PCAOB inspections with the AICPA peer reviews. *Journal of Accounting and Economics* 49(1-2): 104–108.
- DeFond, M., and C. Lennox. 2011. The effect of SOX on small auditor exists and audit quality. *Journal of Accounting and Economics* 52: 21-40.
- DeFond, M., and C. Lennox. 2017. Do PCAOB inspections improve the quality of internal control audits? *Journal of Accounting Research* 55 (June): 591-627.
- Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts Text with EEA relevance. <http://data.europa.eu/eli/dir/2014/56/oj>, accessed September, 2020.
- Dowling, C., Knechel, W. R., and Moroney, R. 2018. Public Oversight of Audit Firms: The Slippery Slope of Enforcing Regulation. *Abacus*, 54(3), 353-380.
- European Commission (EC). 2014. *Regulation 537/2014 on Specific Requirements Regarding Statutory Audit of Public-Interest Entities*. Brussels, Belgium: European Commission. Available online: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014R0537>, accessed September, 2020.
- EC. 2010. *Audit Policy: Lessons from the Crisis*. Green Paper. Available online: [https://www.europarl.europa.eu/meetdocs/2009_2014/documents/com/com_com\(2010\)0561/_com_com\(2010\)0561_en.pdf](https://www.europarl.europa.eu/meetdocs/2009_2014/documents/com/com_com(2010)0561/_com_com(2010)0561_en.pdf), accessed September, 2020.
- Ege, M., W.R., Knechel, P.T., Lamoreaux, and E. Maksymov. 2020. A multi-method analysis of the PCAOB's relationship with the audit industry. *Accounting, Organizations and Society*, forthcoming.
- Ference, S.B. 2014. *Failure to detect theft and fraud: It's not just an audit issue*. *Journal of Accountancy: Professional Liability Spotlight*. Available online: <https://www.journalofaccountancy.com/issues/2014/feb/20139031.html#:~:text=Commonly%20referred%20to%20as%20the,perception%20of%20a%20CPA's%20duties,> accessed September, 2020.
- Florou, A., and Y. Shuai. 2020. *The costs of Public Audit Oversight: Evidence from the EU*. Working paper. Available online: <https://ssrn.com/abstract=3595454>, accessed September, 2020.
- Francis, J.R., P.N. Michas, and S.E. Seavey. 2013. Does audit market concentration harm the quality of audited earnings? Evidence from audit markets in 42 countries. *Contemporary Accounting Research*, 30(1), 325-355.
- Franke, B., H. Moser, and D. Simons. 2020. *A carrot without a stick – The effect of monetary rewards on corporate whistleblowing*. Working paper. Available online: <https://dx.doi.org/10.2139/ssrn.2822313>, accessed October, 2020.

- Fung, S., K. Raman, and X. Zhu. 2017. Does the PCAOB international inspection program improve audit quality for non-US-listed foreign clients? *Journal of Accounting and Economics*, 64(1): 15-36.
- García Osma, B., A. Gisbert, and E. de las Heras Cristóbal. 2017. Public oversight systems for statutory auditors in the European Union. *European Journal of Law and Economics* 44(3): 517-552.
- García Osma, B., A. Mora, and L. Porcuna-Enguix. 2019. Prudential supervisors' independence and income smoothing in European banks. *Journal of Banking and Finance* 102: 156-176.
- Giner, B., and A. Mora. 2020. Political interference in private entities' financial reporting and the public interest: Evidence from the Spanish financial crisis. *Accounting, Auditing & Accountability Journal*, *forthcoming*.
- Gipper, B., C. Leuz, and M. Maffett. 2020. Public audit oversight and reporting credibility: evidence from the PCAOB inspection regime. *Review of Financial Studies* 33(10): 4532-4579.
- Gisbert, A., P. Gómez-Carrasco, E. de las Heras Cristóbal, and B. Navallas. 2020. Public oversight systems for statutory auditors within the European Union regulation. Working paper. Universidad Autónoma de Madrid.
- Glover, S. M., D. F. Prawitt, and M.H. Taylor. 2009. Audit standard setting and inspection of U.S. Public Companies: A critical assessment and recommendations for fundamental change. *Accounting Horizons* 23: 221-237
- Goelzer, D. L. 2006. *What corporate directors should know about the PCAOB*. Remarks delivered at the National Association of Corporate Directors, Minneapolis, April 27. Available at: https://pcaobus.org/News/Speech/Pages/04272006_GoelzerMinnesotaNACD.aspx, accessed September 2020.
- Gramling, A.A., J. Krishnan, and Y. Zhang. 2011. Are PCAOB-identified audit deficiencies associated with a change in reporting decisions of triennially inspected audit firms? *Auditing: A Journal of Practice & Theory* 30(3): 50-79.
- Gray, G.L., J.L. Turner, P.J. Coram, and T.J. Mock. 2011. Perceptions and misperceptions regarding the unqualified auditor's report by financial statement preparers, users, and auditors. *Accounting Horizons* 25(4): 659-684.
- Gutierrez, E. M. Minutti-Meza, K.W. Tatum, and M. Vulcheva. 2018. Consequences of adopting an expanded auditor's report in the United Kingdom. *Review of Accounting Studies* 23: 1543-1587.
- Hanlon, M., and N. Shroff. 2020. *Insights into auditor public oversight boards: whether, how, and why they 'Work'*. Working paper. Available online: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3527584, accessed September, 2020.
- Harden, J.J., and J.H. Kirkland. 2020. Does transparency inhibit political compromise? *American Journal of Political Science*, *forthcoming*. <https://doi.org/10.1111/ajps.12564>
- Hazgui, M., and B. Malsch. 2019. Navigation through the special and institutional contradictions of public audit oversight. *European Accounting Review*, 29, 4: 781-802.
- Hendricks, B.E., W.R. Landsman, and F.D. Peña-Romera. 2019. Can audit firms improve their PCAOB inspection reports by hiring PCAOB employees? Kenan Institute of Private Enterprise Research Paper No. 18-13. Available online at: <https://dx.doi.org/10.2139/ssrn.3205578>, accessed October, 2020.
- Hilary, G., and C. Lennox. 2005. The credibility of self-regulation: Evidence from the accounting profession's peer review program. *Journal of Accounting and Economics* 40 (1/3): 211-229.
- Hooke, J. 2014. "The dog that didn't bark": European Union institutes public accounting firm rotation. Committee for Economic Development Blog, published August 6. Available online:

<https://www.ced.org/blog/entry/the-dog-that-didnt-bark-european-union-institutes-public-accounting-firm-ro>, accessed September, 2020.

- Huang, T-C., H. Chang, and J-R. Chiou. 2016. Audit market concentration, audit fees, and audit quality: Evidence from China. *Auditing: A Journal of Practice & Theory* 35(2): 121-145.
- International Auditing and Assurance Standards Board (IAASB). 2015. *Communicating Key Audit Matters in the Independent Auditor's Report*. International Standard on Auditing (ISA) 701. New York, NY: International Federation of Accountants.
- International Auditing and Assurance Standards Board (IAASB). 2009. *The auditor's responsibilities relating to fraud in an audit of financial statements*. International Standard of Auditing (ISA) 240. New York, NY: International Federation of Accountants.
- Irish Auditing and Accounting Supervisory Authority (IAASA). 2020. "Guidelines to IAASA's reports on the quality assurance review of public-interest entity audit firms" Available at: <https://www.iaasa.ie/getmedia/d90e57ab-fffa-4451-9e76-c2467508e956/IAASA-s-guide-to-reports-on-the-quality-assurance-review-of-public-interest-entiy-audit-firms.pdf>, accessed the 1st October 2020.
- International Federation of Accountants (IFAC). 2012. *Statement of Membership Obligations*. Available at: <https://www.ifac.org/knowledge-gateway/developing-accountancy-profession/publications/statements-membership-obligations-smos-1-7-revised>, accessed on the 28th September 2020.
- International Organization of Securities Commissions (IOSCO). 2005. *Strengthening capital markets against financial fraud*. Technical Committee of the IOSCO Available online: <https://www.iasplus.com/en/binary/resource/0503iosco.pdf>, accessed September, 2020.
- Johnson, L.M., M.B. Keune, and J. Winchel. 2019. U.S. auditors' perceptions of the PCAOB process: a behavioral examination. *Contemporary Accounting Research* 36 (3): 1540-1574
- Kedia, S., and Philippon, T. 2009. The economics of fraudulent accounting. *The Review of Financial Studies*, 22(6), 2169-2199.
- Kelton, E. 2020. *EY's shameful year – NMC Health, Luckin, Wirecard and a failed attack on a whistleblower*, Forbes, July 6, available online: <https://www.forbes.com/sites/erikakelton/2020/07/06/ey-shameful-year--nmc-health-luckin-wirecard-and-a-failed-attack-on-a-whistleblower/#fa4af8969e04>, accessed September, 2020.
- Kinder, T. and O. Storbeck. 2020. *EY prepares for backlash over Wirecard scandal*. Financial Times, June 29, Available online: <https://www.ft.com/content/ae73160b-fd9a-4313-89f9-8fd70183158e>, accessed September, 2020.
- Kirchler, E., E. Hoelzl, and I. Whal. 2008. Enforced versus voluntary tax compliance: The "Slippery Slope" framework. *Journal of Economic Psychology* 29(2): 210–225.
- KPMG. 2020. *Report 'Concerning the independent special investigation'*. Wirecard AG, Munich, April 27, 2020. Convenience translation by Wirecard. https://www.wirecard.com/uploads/Bericht_Sonderpruefung_KPMG_EN_200501_Disclaimer.pdf, accessed September, 2020.
- Krishnan, J., Krishnan, J., and Song, H. 2017. PCAOB international inspections and audit quality. *The Accounting Review*, 92(5), 143-166.
- Lamoreaux, P.T. 2016. Does PCAOB inspection access improve audit quality? An examination of foreign firms listed in the United States. *Journal of Accounting and Economics* 61 (2-3): 313-337.
- Lennox, C., and J. Pittman. 2010. Auditing the auditors: Evidence on the recent reforms to the external monitoring of audit firms. *Journal of Accounting and Economics* 49: 84-103.

- Lesage, C., N.V. Ratzinger-Sakel, and J. Kettunen. 2017. Consequences of the abandonment of mandatory joint audit: An empirical study of audit costs and audit quality effects. *European Accounting Review* 26(2): 311-339.
- Löhlein, L. 2016. From peer review to PCAOB inspections: regulating for audit quality in the U.S. *Journal of Accounting Literature* 36: 28-47.
- Malsch, B., and Y. Gendron. 2011. Reining in auditors: On the dynamics of power surrounding an “innovation” in the regulatory space. *Accounting, Organizations and Society* 36(7): 456-476.
- Matussek, K. 2020. *Wirecard Investors Sue Bafin Over Failure to Spot Scandal*. Bloomberg, July 24. Available online: <https://www.bloomberg.com/news/articles/2020-07-24/germany-s-bafin-sued-over-alleged-failures-in-wirecard-scandal>, accessed September, 2020.
- McCrum, D., and O. Storbeck. 2020. *Wirecard says €1.9bn of cash is missing*. Financial Times, June 18, <https://www.ft.com/content/1e753e2b-f576-4f32-aa19-d240be26e773>, accessed October, 2020.
- McCrum, D. 2020. *Wirecard: the timeline*, Financial Times, June 25, available online: <https://www.ft.com/content/284fb1ad-ddc0-45df-a075-0709b36868db>, accessed September, 2020.
- McEnroe, J.E., and S.C. Martens. 2001. Auditors’ and investors’ perceptions of the “Expectation Gap”. *Accounting Horizons* 15(4): 345-358.
- Minutti-Meza, M. 2020. The art of conversation: The expanded audit report. *Accounting and Business Research*, forthcoming.
- Mock, T.J., J. Bédard, P.J. Coram, S.M. Davis, R. Espahbodi, and R.C. Warne. 2013. The audit reporting model: Current research synthesis and implications. *Auditing: A Journal of Practice & Theory* 32(1): 323-351.
- O’Donnell, J. 2020. *Who's to blame for Wirecard? Germany passes the buck*. Reuters, July 2. Available online: <https://www.reuters.com/article/us-wirecard-accounts-responsibility-idUSKBN243200>, accessed September, 2020.
- Porter, B. 1993. An empirical study of the audit expectation-performance gap. *Accounting and Business Research* 24: 49–68.
- Public Company Accounting Oversight Board (PCAOB). 2019. *Annual Report*. Available online: <https://pcaobus.org/About/Administration/Documents/Annual%20Reports/2019-PCAOB-Annual-Report.pdf>, accessed September, 2020.
- Public Company Accounting Oversight Board (PCAOB). 2018. *PCAOB 2018 Inspection Procedures: What does the PCAOB inspect and how are inspections conducted?* <https://pcaobus.org/Inspections/Documents/2018-Inspections-Procedures.pdf>, accessed September, 2020.
- Public Company Accounting Oversight Board (PCAOB). 2017. *The Auditor’s Report on an Audit of Financial Statements when the Auditor Expresses an Unqualified Opinion*. No. 2017-001, 236. Washington, DC: PCAOB.
- Reuters. 2020. *German watchdog defends Wirecard oversight before lawmakers*. Reuters, July 1. Available online: <https://es.reuters.com/article/idUKKBN24264N> accessed September, 2020.
- Rajgopal, S., and R. White. 2020. Cheating when in the hole: The case of New York city taxis. *Accounting, Organizations and Society*, forthcoming.
- Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing

Commission Decision 2005/909/EC (Text with EEA relevance). <http://data.europa.eu/eli/reg/2014/537/oj>, accessed September, 2020.

- Shroff, N. 2020. The real effects of PCAOB international inspections. *The Accounting Review*, forthcoming.
- Storbeck, O. 2020a. *Wirecard: the frantic final months of a fraudulent operation*. Financial Times, August 25. Available online: <https://www.ft.com/content/6a660a5f-4e8c-41d5-b129-ad5bf9782256>, accessed September, 2020.
- Storbeck, O. 2020b. *Whistleblower warned EY of Wirecard fraud four years before collapse*. Financial Times, September 30, Available online: <https://www.ft.com/content/3b9afceb-eaeb-4dc6-8a5e-b9bc0b16959d>, accessed October, 2020.
- Sundgren, S. and T. Svanström. 2017. Is the Public Oversight of Auditors effective? The impact of sanctions on loss of clients, salary and audit reporting, *European Accounting Review*, 26(4): 787-818.
- Sweet, P. 2020. *ESMA to probe German regulators over Wirecard*. Accountancy Daily, July 2020. Available online: <https://www.accountancydaily.co/esma-probe-german-regulators-over-wirecard>, accessed October, 2020.
- Turner, L. E. 2006. Learning from accounting history: Will we get it right this time? *Issues in Accounting Education* 21: 383–407.
- Vanstraelen, A., and L. Zou. 2020. PCAOB inspections and audit fees: An analysis of inspection rounds of small audit firms, *European Accounting Review*, forthcoming.
- Westermann, K. D., J. Cohen, and G. Trompeter. 2019. PCAOB Inspections: Public Accounting Firms on “Trial.” *Contemporary Accounting Research* 36(2): 694-731.

ANNEX

Appendix A. Additional details on the case of Wirecard⁴⁴

Wirecard was founded in 1999. At the time when the scandal hit news wires, Wirecard was “one of the world's fastest growing digital platforms in the area of financial commerce” according to the information still available at the Frankfurt Stock Exchange (FSE) website.⁴⁵ Wirecard appointed a new CEO (Markus Braun) in 2002, focusing on payment systems and digitalisation of payment processes. In 2005, Wirecard acquired InfoGenie, a listed company, and joins the FSE, avoiding the initial public offering process and rising subscribed capital from 10.5 mill € (in 2004) to 65.3 mill €. Given its fast growth, Wirecard joins TecDAX in 2006, and the DAX index in 2018.⁴⁶ Concurrent to the international expansion in Singapore and India, suspicions regarding the group financial statements arise. From 2008 to 2019 there are allegations of money laundering, market manipulation, and accounting inconsistencies, which accelerate after 2015, with news published by Financial Times (FT), but also, from a shareholders association and an anonymous short seller under pseudonymous.

Wirecard began an internal investigation in 2018, due to information leaked by a whistle-blower of a “round tripping” fraud plan involving Singapore and India. A local legal firm and a forensic investigation found no evidence on any round-tripping without economic substance, or of corruption, and non-material adjustments were made. In October 2018, the whistle-blower contacted FT journalists and leaked documents, emails, and excel spreadsheets, some of them still available on the FT website. It is unclear whether the whistle-blower contacted the company first, although allegations exist that it may have contacted EY in 2016. When KPMG asked for all existing information submitted to the internal whistle-blower system regarding the objects of investigation, no confirmation was made by Wirecard and no representation letter was given. At the end of KPMG investigation, Wirecard confirmed no information had been received through the whistle-blower system.

In Table A.1, we summarize key audit data of Wirecard.

⁴⁴ The information contained in this summary of the Wirecard case is based on secondary sources. We have had no access to any forensic evidence, or primary data of the case, which is still developing. Starting from April 2015, The Financial Times published a series of articles, collectively dubbed “*The House of Wirecard*,” which by September 2020 comprises fifteen articles. Available online: <https://ftalphaville.ft.com/2015/04/27/2127427/the-house-of-wirecard/>, accessed September, 2020.

⁴⁵ <https://www.boerse-frankfurt.de/equity/wirecard-ag/company-details>, accessed September, 2020.

⁴⁶ See, Dan McCrum, June 25, 2020, FT article, *Wirecard: the timeline*, available online: <https://www.ft.com/content/284fb1ad-ddc0-45df-a075-0709b36868db>, accessed September, 2020.

Table A.1. Key audit data of Wirecard 2006-2018, including Audit and Non-Audit Fees (Total and Subsidiaries) in thousand €.

Year	Auditor	Opinion	Report	Level	Audit Fee (AF)	Subs/ Total	Non-Audit Services Fee (NAF)			Total	NAF/ AF
							Tax advisory services	Other assurance services	Other services		
2018	EY	Unqualified	Key Audit Matters (KAM): <ul style="list-style-type: none"> • Citigroup’s customer portfolios in Asia • Valuation of goodwill • Valuation of acquired customer relationship • Measurement of receivables and recognition and presentation of revenues from acquiring partners • Accounting treatment of matters on the basis of the findings from investigations, which were performed due to the allegations of a whistleblower in Singapore Emphasis of matter paragraph: <ul style="list-style-type: none"> • Accounting treatment of allegations of a whistleblower in Singapore 	Total	2,100		--	--	300	2,400	13%
				Subs.	300	14%	--	--	200	500	
2017	EY	Unqualified	Key Audit Matters (KAM): <ul style="list-style-type: none"> • Citigroup’s customer portfolios in Asia, • Valuation of goodwill, • Valuation of customer relationships, Recoverability of receivables Recognition and presentation of revenues from acquiring partners	Total	1700		--	--	500	2,200	23%
				Subs.	400	24%	--	--	--	400	
2016	EY	Unqualified	--	Total	1055		--	--	284	1,339	21%
				Subs.	268	25%	--	--	1	269	
2015	EY	Unqualified	--	Total	710		--	74	258	1,042	32%
				Subs.	196	28%	--	74	--	270	
2014	EY	Unqualified*	--	Total	513		--	--	36	549	7%
				Subs.	197	38%	--	--	18	215	
2013	EY	N/A**	N/A	Total	408		--	--	85	493	17%
				Subs.	173	42%	--	--	29	202	

2012	EY	N/A**	N/A	Total	400		--	--	180	580	31%
				Subs.	172	43%	--	--	26	198	
2011	EY	Unqualified***	N/A	Total	--		--	--	--	--	
				Subs.	--		--	--	--	--	
2010	RP Richter & EY	Unqualified	<ul style="list-style-type: none"> • Emphasis of matter paragraph • Action raised by an investor association, claiming the 2007 financial statements to be declare null 	Total	536		--	192	208	936	43%
				Subs.	226	42%	--	92	8	326	
2009	RP Richter & EY	Unqualified	<ul style="list-style-type: none"> • Emphasis of matter paragraph • Action raised by an investor association, claiming the 2007 financial statements to be declare null and actions for two shareholders meeting resolutions 	Total	527		--	165	100	792	33%
				Subs.	217	41%	--	105	12	334	
2008	RP Richter	Unqualified	--	Total	351		30	60	550	991	65%
				Subs.	175	50%	--	--	--	175	
2007	RP Richter	Unqualified	--	Total	380		30	--	5	415	8%
				Subs.	170	45%	--	--	--	170	
2006	Control5 H Gmbh	Unqualified	-	Total	291		270	--	6	567	49%
				Subs.	146	50%	270	--	6	422	

Notes:

Annual reports are downloaded online: <https://www.wirecard.com/mandatory-capital-market-information>, accessed September, 2020. Subs. stands for subsidiaries,

* The audit report, translated to English, is presented -but not signed- in the Annual Report of 2014 (page 237-238).

** Annual report is not available on the website of Wirecard.

*** As noted in the Annual Report of 2011 (page 2).

**** The audit report, translated to English, is presented in the Annual Report of 2008 (page 187)

Appendix B. Committee of European Auditing Oversight Bodies (CEAOB)

Country	POBSA	Cooperation Agreement PCAOB	Membership IFIAR
Austria	Austrian Auditing Oversight Authority - AAOA/Abschlussprüferaufsichtsbehörde – APAB	2018	2006
Belgium	Belgian Audit Oversight College (CTR/CSR)	.	2012
Bulgaria	Commission for public oversight of statutory auditors	.	2009
Croatia	Ministry of Finance of the Republic of Croatia	.	2011
Cyprus	Cyprus Audit Oversight Board	.	2016
Czech Republic	Public Audit Oversight Board	.	2014
Denmark	Danish Business Authority	2014	2006
Estonia	Estonian Auditing Activities Oversight Board	.	.
Finland	Finnish Patent and Registration Office - Auditor Oversight Unit	2013	2007
France	Haut Conseil du Commissariat aux Comptes – H3C	2013	2006
Germany	Abschlussprüferaufsichtsstelle - APAS / Audit Oversight Body - AOB	2012	2006
Greece	Hellenic Accounting and Auditing Standards Oversight Board - AOOB	2015	2010
Hungary	Auditors' Public Oversight Authority - Ministry for National Economy of Hungary	2015	2009
Ireland	Irish Auditing and Accounting Supervisory Authority (IAASA)	2017	2006
Italy	Commissione Nazionale per le società e la borsa- CONSOB Ministry of Economy and Finance	2016	2006
Latvia	Ministry of Finance of Latvia – Commercial Companies Audit Policy and Oversight Unit	.	.
Lithuania	Authority of Audit, Accounting, Property Valuation and Insolvency	.	2009
Luxembourg	Commission de Surveillance du Secteur Financier - CSSF	2015	2010
Malta	Accountancy Board	.	2009-2013
Netherlands	The Netherlands Authority for the Financial Markets - AFM	2011	2006
Poland	Polish Agency for Audit Oversight- PANA	.	2011

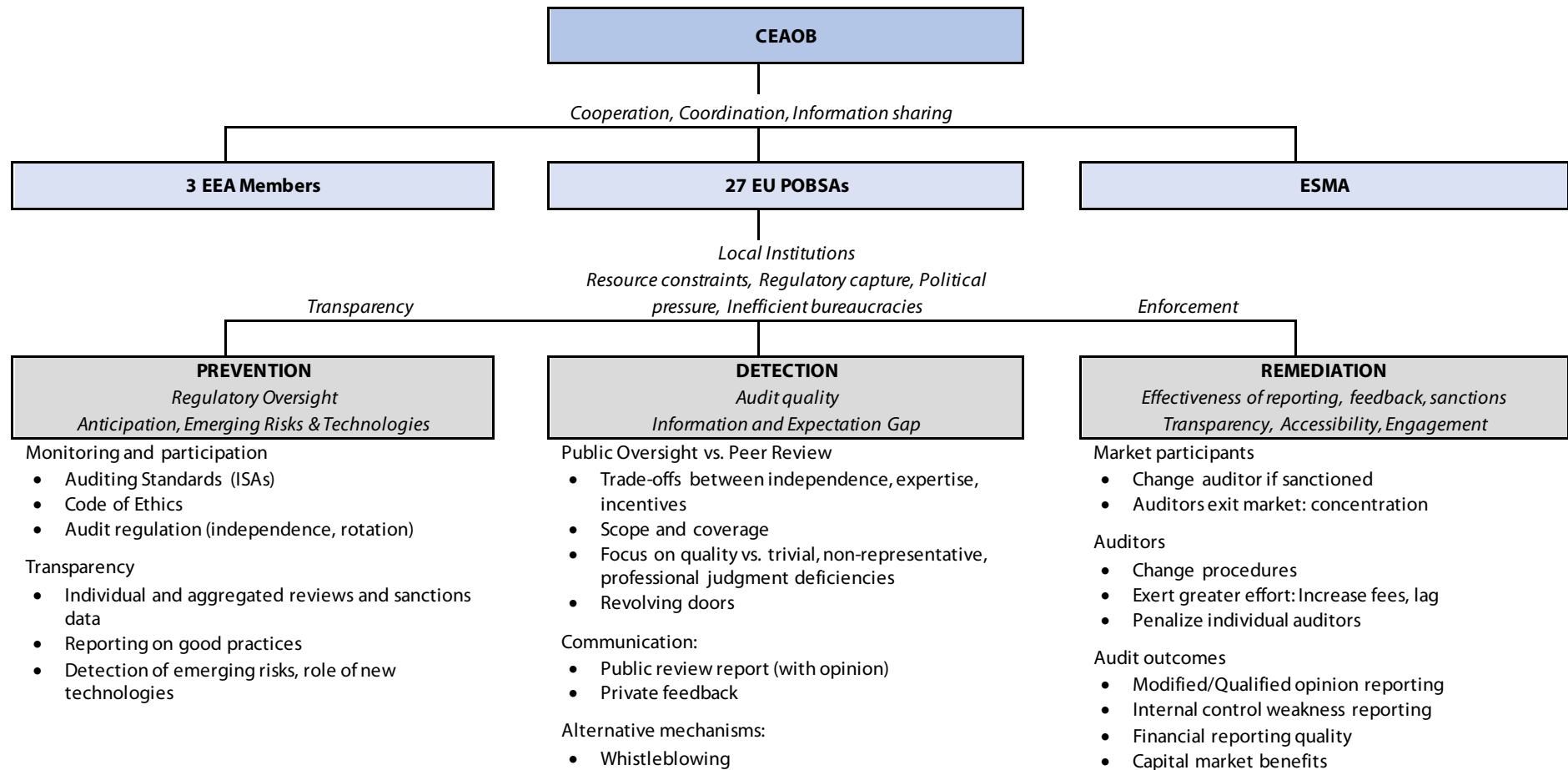
Portugal	Comissão do Mercado de Valores Mobiliários - CMVM	.	2011
Romania	Authority for Public Oversight of the Statutory Audit Activity (ASPAAS)	.	2018
Slovakia	Auditing Oversight Authority - UDVA	.	2009
Slovenia	Agency for Public Oversight of Auditing - APOA	.	2013
Spain	Instituto de Contabilidad y Auditoría de Cuentas - ICAC	2012	2006
Sweden	Swedish Inspectorate of Auditors - Revisorsinspektionen	2014	2006
ESMA	European Securities and Markets Authority - ESMA	-	-

EEA Representatives			
Iceland	Coming soon	.	.
Liechtenstein	Financial market authority (FMA)	.	2012
Norway	Finanstilsynet	2011	2006

Notes:

- Information as reported by the European Commission (links to the relevant agencies have been updated, when original ones did not work). Available online: https://ec.europa.eu/info/files/ceaob-composition_en, accessed September, 2020.
- Website of the CEAOB: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/regulatory-process-financial-services/expert-groups-comitology-and-other-committees/committee-european-auditing-oversight-bodies_en, accessed September, 2020.
- Data on PCAOB international cooperation agreements available at: <https://pcaobus.org/International/Pages/RegulatoryCooperation.aspx>, accessed September 2020
- Data on the International Forum of Independent Audit Regulators (IFIAR) membership at 2020 is available at: <https://www.ifiar.org/members/member-directory/>, accessed September, 2020. Data on when countries become members of IFIAR is obtained manually from IFIAR annual reports 2012-2018 and IFIAR activity reports 2009-2011 available at: <https://www.ifiar.org/about/publications/>, accessed September, 2020.

Appendix B.1. Conceptual framework,



Notes:

We provide a visual conceptual framework for the current EU public oversight system, with the CEAOB coordinating and promoting information sharing among the POBSAs, which ultimately have the roles of Prevention, Detection and Remediation of low-quality audit. These 27 POBSAs, as local institutions, must face resource constraints, risk of regulatory capture and political pressure and inefficient bureaucracies. Transparency and enforcement are important for prevention and remediation.

Appendix C: Description of variables and dimensions studied for analysed POBSAs.

Dimension 1 - GENERAL CHARACTERISTICS	Variable description
Name	Identification of the POBSA and the Ministry or Governmental Body, if applicable, that the POBSA is associated with. All POBSAs are independent bodies.
Legislation	Legislation that establishes the main competences of the oversight body
Board members	Number of Board Members
Advisory committee	Presence of an advisory committee in the organizational chart
Accounting knowledge across Board members	Identifies whether the members of the Board are linked to the auditing or accounting profession
Participation of the profession	Identifies the presence of members from the audit profession in the Advisory Committee.
Funding source	Self-financed with fees or levies charged to auditors, audit firms and professional corporations, mixed model with governmental funding or public funding.
Professional Corporations in the Member State	Identification of the Professional Corporation of auditors and accountants
Membership	Membership of the POBSA in international Organizations

Dimension 2 - REGULATORY – PREVENTION	Variable description
Quality assurance regulatory body	Identification of the competent body
Access to the profession – examinations	Identification of the competent body
Registration	Identification of the competent body
Permanent education	Identification of the competent body
Ethics standard setting	Identification of the competent body

Dimension 3 - SUPERVISORY – DETECTION	Variable description
Quality assurance reviews – QAR - (Non-PIE's)	Identification of the competent body
Inspections (PIEs)	Identification of the competent body
Frequency	Frequency of QAR and Inspections
Whistleblowing service	Presence of public easy access to the whistleblowing system

Dimension 4 - DISCIPLINING - REMEDIATION	Variable description
Investigation procedures	Identification of the competent body
Sanctioning procedures	Identification of the competent body
Range of sanctions	Range of pecuniary sanctions when available

Dimension 5 – TRANSPARENCY	Variable description
Annual Report / Activity Report	Presence of a publicly available Annual or Activity Report
Work Programmes	Presence of a publicly available Work Programme
Inspection results	Presence of a publicly available inspections results
Sanctions	Presence of public easy access to the sanctions
Register	Presence of public easy access to the auditors' register

Notes:

- The data collected for all the analysed POBSAs has been mainly retrieved from two key sources: (a) Each of the POBSAs individual websites (listed in Appendix B); and (b) the IFAC description of the auditor legal regulatory environment and adoption of international standards across each of the IFAC members; Retrieved information tabulated in Appendix C1-C3 and summarized in section 2 of this paper. The lack of harmonised and detailed information in the accessed POBSAs websites and the use of secondary information sources presents a significant constraint in the data collection procedure that may lead to unintended inaccuracies, errors or omissions.

Appendix C.1. Austria, Belgium, France, Germany and Netherlands: Regulatory, Supervisory, Disciplining and Transparency

	Austria	Belgium	France	Germany	The Netherlands
	APAB	CTR/CSR	H3C	APAS/AOB	AFM
POBSA	Ministry of Finance	Ministry of Economy	Ministry of Justice	Ministry of Economics Federal Office of Economics Affairs and Export Control	Ministry of Finance
Legislation	Austrian Auditor Oversight Act of 2016 (Abschlussprüfer-Aufsichtsgesetz – APAG)	Audit Act of December 2016	Ordinance n° 2016-315 of 17 March 2016 re. statutory audits Decree n° 2016-1026 of 26 July 2016. Financial Securities Act 2003-706	Abschlussprüferaufsichtsreformgesetz (APAReG) German Companies Act – HGB	Audit Firms Supervision Act of 2006
Board members	2	6	14	10 (2 executive Boards)	3-5
Advisory committee	Yes – Quality Assessment Commission	Yes	No	Yes	No
Accounting knowledge across Board members	Yes	Yes	Yes, two former auditors in the Board	n/a	Yes
Participation of the profession	Yes, in the Quality Control Commission – 7 members, 4 of them nominated by the KSW for a period of 4 years	Yes, an advisory committee that includes representatives of professional bodies	No, although there are two former auditors in the Board	n/a	n/a
Funding source	Self-financed	Self-financed, budget controlled by the FSMA	Self-financed	Mixed	Self-financed
Auditors Professional Corporation	Kammer der Wirtschaftstreuhänder (KSW) - statutory auditors	IRE - Institut des Réviseurs d'Entreprises	CNCC CRCC CESOEC	Wirtschaftsprüferkammer WPK	Koninklijke Nederlandse Beroepsorganisatie van Accountants (NBA Netherlands)
Membership	IFIAR/CEAOB	IFIAR/CEAOB	IFIAR/CEAOB	IFIAR/CEAOB	IFIAR/CEAOB
REGULATORY					
Quality assurance regulatory body	WTBG allows KSW to issue the Directive of the Practices of the Public Accounting Profession (WTARL, always under APAK oversight)	The Audit Act of 2016 stipulates that a quality assurance (QA) review system for all audits be established and operated by the CSR. The IRE prepares the Handbook of International Quality Control applicable in Belgium. The CSPE (Conseil	H3C with the opinion of the CNCC	IDW (Institut der Wirtschaftsprüfer) issues the quality control standards. The Institute has adopted ISQ1 for application	NBA with the approval of the Ministry of Finance.

		Supérieur des Professions Économiques) approves and endorses the auditing regulation			
Access to the profession – examinations	KSW (oversighted by APAB)	IRE (oversighted)	H3C	WPK (oversighted)	NBA Netherlands
Registration	APAB	IRE (oversighted)	CNCC (oversighted)	WPK (oversighted)	AFM
Permanent education	KSW (oversighted y APAB)	IRE (oversighted)	CNCC (oversighted)	WPK (oversighted)	NBA Netherlands
Ethics standard setting	KSW (oversighted by APAB)	IRE (oversighted)	H3C	WPK (oversighted)	NBA Netherlands
SUPERVISORY					
Quality assurance reviews	APAB - Committee for External Quality Inspections (AeQ) KSW/IWP for other auditors	CSR, can delegate in the IRE	CNCC (oversighted)	WPK (Quality Commission) – (oversighted)	NBA Netherlands (oversighted)
Inspections	APAB - Committee for External Quality Inspections (AeQ) KSW/IWP for other auditors	CSR/FSMA	H3C With the support of AMF (Autorité des Marchés Financiers)	APAS/AOB	AFM
QA/Inspection Report Available	No	No	No	No. However, the transparency reports of auditing firms are available through the WPK website	No
Procedure explained in the website	Yes			Yes	No
Frequency	1-3 years – PIE's 6 years – Non-PIE's	1-3 years – PIE's 6 years – Non-PIE's	Five largest – every year 1-3 years – PIE's 6 yers – Non-PIE's	1-3 years – PIE's 6 yers – Non-PIE's Annually: firms with more than 25 PIE's	1-3 years – PIE's 6 yers – Non-PIE's
DISCIPLINING					
Investigation procedures	APAB KSW/IWP for other auditors	CSR	H3C – PIE's Regional Chamber of Discipline for Non-PIE's	AOB – PIE's WPK – Non-PIE's	Ministry of Justice's Disciplinary Court – individual auditors AFM – audit firms
Sanctioning procedures	APAB KSW/IWP for other auditors	Disciplinary duties rely on the Commission of Sanctions FSMA	H3C – PIE's Regional Chamber of Discipline for Non-PIE's	AOB – PIE's WPK – Non-PIE's	Ministry of Justice's Disciplinary Court – individual auditors

					AFM – audit firms
Procedure explained in the website	Yes	No	Yes	Yes, both in the AOB and WPK website	No
Range of sanctions	400-350.000 € (those publicly available)	2.500.000€ or up to three times the loss avoided or the profit gained through the breach	Up to 1M€. Detailed available at the H3C website	Up to 500.000 €. Detailed in art. 68 of the Public Accountant Act (WPO)	Up to 4.000.000€
TRANSPARENCY					
Annual Report	Yes, in German	Yes	Yes, in French	Yes, in German	Yes, in Dutch
Activity Report	Yes, in German	Yes, in the Annual Report	Yes, in the Annual Report.	In the Annual Report	In the Annual Report
Work Programmes	Yes, in German	Yes, in French/Dutch	Yes, in French (in the Actualité section of the website)	Yes, in German	Yes (agenda)
Inspection results	Overall results	Overall results	Overall results	Overall results in the WPK Annual Report and AOB Annual Report	Overall results
Sanctions	Yes, without personal data	Yes, available at the FSMA website	Yes, with no personal data. Difficult to find in website. They can be fully consulted at the Regional disciplinary chamber	Yes, in collaboration with the WPK. Detailed list available at the AOB website.	Yes, Max. 4.000.000 €
Register	Yes – Direct link in the website	Yes, in the IRE	Yes – Updated list in the website	Yes, in the WPK	Through the NBA
Whistleblowing service	Yes – Direct link in the website	n/a	n/a	n/a	Not easily available

Appendix C.2. Denmark, Sweden, Finland, Ireland and Luxembourg: Regulatory, Supervisory, Disciplining and Transparency

	Denmark	Sweden	Finland	Ireland	Luxembourg
POBSA	Danish Business Authority DBA; Erhvervsstyrelsen	Supervisory Board of Public Accountants; Revisorsinspektionen (RI)	Auditor Oversight Unit	IAASA Audit Inspection Unit	CSSF
	Ministry of Business	Ministry of Justice	Finish Patent and Registration Office	Independent State Body	Ministry of Finance
Legislation	Audit Act 468/2008 Audit Act 632/2016	Auditors Act 2018	Auditing Act (1141/2015)	Company's Act 2014	Law of July 23, 2016
Board members	13	9	9	9	7
Advisory committee	No	No	Yes	No	Yes, three advisory committees
Accounting knowledge across Board members	Yes	Yes, at the disciplinary board	Yes	Yes	No, civil servants
Participation of the profession	Yes	Yes	Yes, 2 practicing auditors must be nominated as experts and advise the Board	Yes, the professional bodies are represented in the Board with a max of 3 members	n/a
Funding source	Self-financed	Self-financed	Self-financed	Mixed model	Self-financed
Auditors Professional Corporation	FSR – Danske Revisorer	FAR-SRS	Suomen Tilintarkastajat ry	11 prescribed accountancy organizations. Only 6 are recognized accountancy bodies (Recog. Acc. Bodies) RAB's: ACCA; ICAEW; Chartered Accountants Ireland; ICAS; CPA Ireland	IRE (Institut des Réviseurs d'Enterprises)
Membership	IFIAR/CEAOB	IFIAR/CEAOB	IFIAR/CEAOB	IFIAR/CEAOB	IFIAR/CEAOB
REGULATORY					
Quality assurance regulatory body	DBA	RI	AOU	IAASA	CSSF
Access to the profession – examinations	FSR (oversighted)	RI	AOU	Recog. Acc. Bodies	CSSF
Registration	DBA	RI	AOU	Recog. Acc. Bodies	CSSF
Permanent education	DBA	RI	AOU	Recog. Acc. Bodies	CSSF
Ethics standard setting	FSR (oversighted by DBA)	RI	AOU	Recog. Acc. Bodies	CSSF

SUPERVISORY					
Quality assurance reviews (Non-PIE's)	DBA	FAR-SRS based on an agreement with the RI	AOU	Recog. Acc. Bodies	CSSF
Inspections	DBA	RI	AOU	IAASA	CSSF
QA/Inspection Report Available	Some Reports are available on the DBA website	Yes, they are available. They also publish the methodology	No	Yes, they have the 9 quality assurance reports available of the website	No
Frequency	1-3 years – PIE's 6 years – Non-PIE's Every year for audit firms auditing Large Cap and Mid Cap listed companies	1-3 years – PIE's 6 years – Non-PIE's	1-3 years – PIE's 6 years – Non-PIE's	1-3 years – PIE's 6 years – Non-PIE's	1-3 years – PIE's 6 years – Non-PIE's Annually Big 4
DISCIPLINING					
Investigation procedures	Disciplinary Board of Auditors (Revisornaevnet)	RI	AOU	IAASA together with the accountancy bodies fo non-PIE's statutory auditors	CSSF The IRE is also allowed to carry out its own ID system
Sanctioning procedures	Disciplinary Board of Auditors (Revisornaevnet)	RI (Board of Disciplinary Procedure)	AOU – Audit Board Suomen Tilintarkastajat ry also has their own system of I&D for their member	IAASA together with the accountancy bodies for non-PIE's statutory auditors	CSSF The IRE is also allowed to carry out its own ID system
Procedure explained in the website	Yes (QA controls)	Very briefly	Very briefly	Yes (QA Controls)	CSSF
Range of sanctions	Up to 200.000 €	500 € - 2% of annual revenue	n/a	100.000 multiplied by the number of statutory auditors in the firm at the time of contravention	500 – 1.000.000 €
TRANSPARENCY					
Annual Report	Yes,	Yes, in Swedish	Yes,	Yes, in English	Yes, in English
Activity Report	In the Annual Report	In the Annual Report	No	Yes	Yes
Work Programmes	Yes	n/a	n/a	Yes	Yes
Inspection results	Overall Results	Overall Results	Overall Results	Overall Results	Overall Results
Sanctions	Yes, on the website. Not easy to find. No sanction repository.	Yes, in the website	No	Yes, a Public Note of the case is available at the IAASA website	Yes, available at the CSSF website
Register	Yes	Yes, on the website	No	Recog. Acc. Org	Yes, repository is available at the CSSF website
Whistleblowing service	Yes, direct access through the website	n/a	n/a	n/a	Yes, procedure explained at the CSSF ; Email available

Appendix C.3. Portugal, Spain, Greece and Italy: Regulatory, Supervisory, Disciplining and Transparency

	Portugal	Spain	Greece	Italy
POBSA	CMVM	ICAC	ELTE/HAASOB	CONSOB
	Ministry of Finance	Ministry of Economics	Ministry of Economics and Finance	Ministry of Economics and Finance
Latest Legislation	Law 148/2015	Law 22/2015	Law 4305/2014	Law 135/2016
Board members	5	13	7	5
Advisory committee	Yes	Yes	No	No
Accounting knowledge across Board members	Yes	Yes	Yes, the Deputy Chairmen must be persons with broad training in accounting and auditing	n/a
Participation of the profession in the governance	Yes, in the supervisory and Advisory Committee	Yes, in the Audit Committee	No	No
Funding source	Self-financed	Self-financed	Self-financed	Mixed model
Auditors Professional Corporation	OROC (Ordem dos revisores oficiais de contas)	ICJCE (Instituto de Censores Jurados de Cuentas); CGEE	SOEL (Institute of Certified Accountants of Greece)	CNDCEC - Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili
Membership	IFIAR/CEAOB	IFIAR/CEAOB	IFIAR/CEAOB	IFIAR/CEAOB
REGULATORY				
Quality assurance regulatory body	CMVM	ICAC	ELTE	CONSOB and Ministry of Economy and Finance MEF
Access to the profession – examinations	OROC	ICAC	SOEL (oversighted)	MEF
Registration	CMVM	ICAC	SOEL (oversighted)	CONSOB/ CNDCEC
Permanent education	OROC	ICJCE (oversighted)	SOEL (oversighted)	CNDCEC
Ethics standard setting	OROC/CMVM	Independence is established by law.	ELTE (following the SOEL proposal)	CNDCEC
SUPERVISORY				
Quality assurance reviews – Non-PIE's	OROC (Quality Control Commission) (oversighted by CMVM)	ICAC –delegates on the professional corporations (ICJCE) due to the lack of resources	SOEL- Quality Control Committee	MEF - (RGS – Ragioneria Generale dello Stato)
Inspections (QA for PIE's)	CMVM	ICAC	Quality control board (SPE) – ELTE	CONSOB
Frequency	1-3 years – PIE's 6 years – Non-PIE's	1-3 years – PIE's 6 years – Non-PIE's	1-3 years – PIE's 6 years – Non-PIE's	1-3 years – PIE's 6 years – Non-PIE's

DISCIPLINING				
Investigation procedures	CMVM and OROC for non-PIE's	ICAC	ELTE - Quality Control Board	CONSOB and MEF Overlapped with the CNDCEC
Sanctioning procedures	CMVM and OROC for non-PIE's	ICAC	ELTE - Disciplinary Board	CONSOB and MEF Overlapped with the CNDCEC
Range of sanctions	From 2.500 € Up to 5.000.000 €	6% of annual fees in the last financial year Sanctions for PIE's engagements can be increased 20%	Up to 100.000 €	1.000/10.000 – 150.000€/500.000€ Depending on Non-PIE/PIE
TRANSPARENCY				
Annual Report	Yes, in Portuguese	Yes, in Spanish	Yes, in Greek	Yes, in Greek
Activity Report	Yes, in Portuguese	Yes, included in the Annual Report	Yes, included in the Annual Report	Yes, included in the Annual Report
Work Programmes	n/a	Yes	n/a	n/a
QA and ID results	Overall Results	Overall Results	Overall results	Overall Results
Sanctions	At CMVM website	Yes, direct access to the repository with personal data	Yes, but not easily available	Yes, Bolletino
Register	Yes, at the OROC and CMVM website	Yes	Yes, available at the website	Yes
Whistleblowing service	Yes, directly at the CMVM website	Yes, through email or at any public official registry	n/a	n/a

Appendix D. Staff, PIEs and collaboration with professional corporations.

Region	Country	N° Staff members dedicated to auditors oversight	N° PIE's	PIE's/Staff	Additional information
EU - CE	Austria	10	203	20.3	3 out of the 10 members of the staff are inspectors.
EU - CE	Belgium	12	309	25.8	The POBSA collaborates with the professional corporations in the oversight procedures for non-PIE's.
EU- Sca	Denmark	11	337	30.6	There are 5 Inspectors for PIE's and 3 reviewers for non-PIE's; Sanctioning is delegated to an independent body (Revisornævnet)
EU- Sca	Finland	18	420	23.3	11 out of the total 18 members of the staff are devoted to the auditor oversight role. The sanctioning decisions are made by the Audit Board, which consist of outside/non-staff experts (chair, vice-chair and 7 members).
EU-CE	France	47	1,720	36.6	7 members are devoted to investigations and sanctions.
EU-CE	Germany	25	1,070	42.8	46 staff in total in 2018. 35 staff members of the WPK are working in the enforcement and quality assurance unit
EU-SE	Greece	7	254	36.3	
EU-AS	Ireland	41	751	18.3	
EU-SE	Italy	19	900	47.4	The POBSA does not collaborate with the professional corporations.
EU-CE	Luxembourg	10	400	40.0	9 inspectors. The POBSA does not collaborate with the professional corporations.
EU-CE	Netherlands	45	723	16.1	
EU-SE	Portugal	14	1,095	78.2	
EU-SE	Spain	30	1,452	48.4	20 members of the staff are devoted to the oversight activities. The other 10 staff members are in the sanctioning division. Staff is 74 persons in total.
EU-Sca	Sweden	24	696	29.0	

Source: CEAOB enforcement questionnaire (2019)

Appendix E. Evidence on effects of public oversight on EU audit firms and companies

Authors	Sample	Main proxies studied Descriptive evidence	Relevant EU/International Evidence
Bishop, Hermanson, and Houston (2013)	171 first-time and 56 second-time PCAOB inspection reports of international companies (2005-2012; 35 countries, 1 EU, 1 EEA country)	Over half of the inspection reports identify audit deficiencies, and two-thirds cite quality control defects; related to substantive testing and failure to perform sufficient audit procedures	<ol style="list-style-type: none"> 1) No effects, PCAOB acts alone or in cooperation; or legal tradition; 2) No clear improvement from first- to second-time inspections.
Lamoreaux (2016)	<u>Foreign US cross-listed companies</u> 9,137 firm-year observations. All foreign US client companies listed (1999-2012; 47 countries, 15 EU, 2 EEA countries)	Audit quality as measured by (i) propensity to report a qualified opinion; (ii) adverse opinions on internal control quality; (iii) earnings management	<ol style="list-style-type: none"> 1) Auditors subject to PCAOB inspection access are more likely to issue qualified opinions and adverse opinions on internal controls; and earnings management is lower in their clients. 2) Effects are weaker, but present, in jurisdictions with local auditor oversight.
Krishnan, Krishnan, and Song (2017)	<u>Foreign US cross-listed companies</u> 3,957 firm-year observations cross-listed clients of inspected foreign auditors from 178 inspection reports (2000-2011; 22 countries, 2 EU, 1 EEA countries)	Audit quality as measured by (i) earnings management around the inspection year, and (ii) value relevance of accounting numbers around the inspection report date.	<ol style="list-style-type: none"> 1) Lower abnormal accruals post-inspection. 2) Greater effect joint inspections with local POBSA (compared to stand-alone). 3) No effect with vs. without deficiencies. 4) Mixed findings for value relevance.
Aobdia and Shroff (2017)	<u>International companies</u> 3,829 auditor-year (203,566 company-year) observations, out of which, 1,685 auditor-year (114,248 company-year) observations inspected (2003-2013; 36 countries, 5 EU, 1 EEA countries)	Change in audit market share after inspection and report. Average inspection lasts one-two weeks. Inspection report available 571 days after. Unresolved quality control criticism can be made public one year after report (resolved not public).	<ol style="list-style-type: none"> 1) 16 inspections (7 reports) of EU/EAA auditors; no quality control defects; audit engagement deficiencies in EAA country. 2) PCAOB inspected auditors observe on average a 4% increase in their market share following the public release of their PCAOB inspection report. 3) No effect of local public oversight.
Fung, Raman, and Zhu (2017)	<u>International companies</u> All foreign inspection reports. Non-US-listed foreign public client companies audited by PCAOB-registered foreign auditors (2006-2011; 55 countries, 19 EU, 2 EEA)	Audit quality as measured by (i) financial reporting quality (discretionary accruals, propensity to just meet or beat earnings expectations, and accruals quality), and (ii) likelihood issuing a qualified opinion.	<ol style="list-style-type: none"> 1) Initial inspection improves audit quality over effect of threat of inspections. 2) Greater effects where there are no improvements in enforcement, have lower liability standards for accountants.
Shroff (2020)	<u>International companies not cross-listed in US</u> 52,329 firm-year observations from countries that allow PCAOB to inspect domestic auditors (2002-2014; 35 countries, 5 EU countries)	Change in external financing frictions for non-US clients (excluding cross-listed companies) of PCAOB inspected auditors, compared with companies in the same country-industry-year. Clients of “unqualified” inspection auditors raise 11% more capital and invest 8.8% more, also have	<ol style="list-style-type: none"> 1) Lower effects where local POBSA is similar to PCAOB. 2) Effects concentrated in countries with low corruption, strong rule of law, high regulatory quality. No effect of strong institutional environment.

		more accounting-based covenants and longer loan maturities in debt contracting.	
Sundgren and Svanström (2017)	<u>EU companies</u> 158 sanctions from Swedish Public Oversight Body (2006-2009)	Audit clientele impact; Sanctioned auditors' salaries; Audit firm changes in reporting behaviour (change in qualified audit opinions)	<ol style="list-style-type: none"> 1) Lower salaries sanctioned auditors, particularly in B4 firms; 2) No effect clientele (n. clients); 3) No effect audit report
Carson, Simmet, Thürheimer and Vanstraelen (2017 WP)	<u>International companies</u> 24,740 listed companies, 159,150 observations (2003-2012, 51 countries, 14 EU, 1 EEA countries)	Audit quality as measured by earnings management, small profit reporting, and timely loss recognition. POBSAs differ in (i) inspections conducted by POBSA or by professional bodies under POBSA supervision; (ii) frequency of inspections; (iii) disclosure of inspection results (if reported, vary on whether reports provide aggregated overview or identify findings at individual audit firm level); (iv) ability to enforce sanctions, and have oversight over enforcement process.	<ol style="list-style-type: none"> 1) Earnings management decreases and timely loss reporting increases for companies audited by auditors that become subject to inspection. 2) Effects greater for B4 clients. 3) Effects greater when POBSA: <ol style="list-style-type: none"> a) Discloses inspection results on an aggregated manner. b) Direct inspection system instead of delegated to profession. c) No clear evidence enforcement or frequency matter.
Florou and Shuai (2020 WP)	<u>EU vs. IFRS companies not cross-listed in US</u> 11,144 firm-years, 1,191 unique companies from the EU (includes UK), and 9,503 firm-year from control countries (2000-2016; 13 EU countries, 7 IFRS countries without public audit oversight)	Effects of POBSA inspection on auditors' compliance costs as measured by audit fees. Look at POBSAs: effects of human resources, cooling-off periods (to avoid revolving doors) back to practice, multiple sources of financing (to avoid regulatory capture), inspections at both POBSA and auditor offices.	<ol style="list-style-type: none"> 1) Audit fees go up by 4.1% in the post-inspection period. 2) Effects only for POBSAs with <ol style="list-style-type: none"> a) high number of inspectors over staff. b) cooling-off periods c) adopt mixed-funding model d) inspections both at POBSA and auditors' premises

Notes:

- See references for full details on the papers cited.

Appendix F. Evidence on views of auditors on the public oversight system

Authors	Sample	Main proxies studies Descriptive evidence	Main results
Daugherty and Tervo (2010)	146 questionnaires to US audit firms on first PCAOB inspection through December 2007.	<u>Perceptions of auditors</u> on consequences and process of first PCAOB inspections in smaller firms (subject to inspection every 3 years)	<ol style="list-style-type: none"> 1) Doubts inspection process improves audit quality, particularly in small audit firms. 2) Inspection process influences small auditors' consideration to cease public audits 3) Inspections by PCAOB are not seen as an improvement over peer-review inspections. 4) Anticipation of inspection has increased hours incurred in engagement. 5) Inspector's findings related to quality control systems should remain confidential.
Dowling, Knechel, and Moroney (2018)	4 interviews with regulators and 11 interviews with audit partners in Australia (Nov 2012-Mar 2013).	<u>Perceptions of regulators and auditors</u> on audit response to oversight and enforcement. Studied dimensions: power, trust, and compliance environment.	<ol style="list-style-type: none"> 1) Auditor partners perceive regulators exercise their power in an increasingly coercive manner rather than collaborative-. <ol style="list-style-type: none"> a) In response, firms embed checklists and other procedures into their audit process, to increase compliance visibility. b) Box-checking is attractive "because it offers a 'regulated transparency' that gives comfort to both audit firm and regulator," but also may lead to over-reliance on check-list and failure to consider other factors. Use of checklists also lead to standardized orientation, which increases commoditization of the audit. 2) Scepticism over future greater improvements in audit quality due to the inspection. 3) Concern regulators interpret auditing standards different than intended by standard setters
Westermann, Cohen, and Trompeter (2019)	55 questionnaires and 20 interviews with US auditors of varying rank (2012-2017).	<u>Perceptions of auditors</u> on inspections of the PCAOB inspection process	<ol style="list-style-type: none"> 1) Perception that the process has improved audit quality overall. 2) Pressures to pass the inspection lead to undesirable work practices (e.g., excessive documentation, "box ticking" approach to auditing rather than focus on substance.) 3) Costs of process is a de-emphasis on technical accounting knowledge. 4) Regulatory risk matters to inspectors (focus on areas of low audit risk) rather than client risk.
Johnson, Keune, and Winchel (2019)	20 interviews with experienced US auditors	<u>Perceptions of auditors</u> on power and trust effects on compliance	<ol style="list-style-type: none"> 1) Desire for "unqualified" report impacts audit procedures and quality control. 2) Antagonistic perception of inspectors, in a setting with powerful regulator (PCAOB): compliance driven more by 'fear' of enforcement than agreement with feedback.
Ege, Knechel, Lamoreaux, and Maksymov (2020)	8 interviews with PCAOB inspectors and 6 interviews with US audit partners.	<u>Perceptions of auditors and inspectors</u> on the consequences of regulatory response	<ol style="list-style-type: none"> 1) Negative language from auditors in their response to inspections led to greater likelihood of future inspections and restatements. 2) Inspectors view public disagreement as indicator of noncompliance, and included disagreement into subsequent inspections, escalating penalties. 3) Perceptions that PCAOB did not use persuasion as a first reaction to noncompliance, potentially leading to lower interaction, and a certain culture of resentment towards PCAOB.
Hanlon and Shroff (2020 WP)	170 questionnaires to inspectors, representing 27% of inspection staff from POBSAs in 20 countries (4 EU, 1 EEA)	<u>Perceptions of inspectors</u> on how and why auditors changes audit procedures and quality control systems	<ol style="list-style-type: none"> 1) Auditors frequently or very frequently respond to feedback increasing documentation (86%), conducting firm-wide training (83%), increasing audit/testing effort (64%) and scrutiny of management estimates (64%) and changing audit-quality review process (62%). 2) Fewer auditors change compensation policies for engagement managers (12%) or partners (30%), controls over auditor independence (38%), or remove lower quality partners (39%).

		in response to POBSA inspections.	<ol style="list-style-type: none"> 3) Desire for “unqualified” reports impact on decision to make changes. 4) The disclosure of inspection reports is perceived as one of the most important tools to induce changes in auditor behaviour, but also, incentivizes gaming the inspection process. 5) 80% (76%) of the inspectors agree that POBSA inspectors have greater authority (enforcement options) than peer-reviewers. 6) Inspectors do not perceive that they are rewarded for identifying a larger number of deficiencies during inspections
Vanstraelen, Schelleman, Meuwissen, and Hofmann (2012)	10 interviews with audit report users, 10 with audit report preparers in EU.	<u>Perceptions of users and auditors</u> on changes needed to audit reporting	<ol style="list-style-type: none"> 1) Users want to be able to rely on reports of the public oversight bodies to facilitate forming an opinion on the quality of the auditor.

Notes:

- See references for full details on the papers cited.
- As noted in Dowling et al. (2018, p. 355), in the US, standard setting and inspection are the responsibility of one body (the PCAOB), while elsewhere, standard setting and inspection are performed by two independent bodies. In Australia it is the Auditing and Assurance Standards Board and the ASIC, respectively. This means examination of the actions of the regulator is not confounded by a standard-setting role.

Appendix G. Audit Market Concentration. Number of PIEs by auditor network in the EEA, Switzerland and the United Kingdom.

	2015	2016	2017	2018
PwC	4,809	3,674	3,554	3,471
KPMG	4,624	4,226	3,877	3,567
Deloitte	5,054	3,414	3,198	2,584
EY	3,857	3,540	2,700	2,479
Total Big 4	18,344 (87%)	14,854 (84%)	13,329 (84%)	12,101 (81%)
BDO	949	975	773	922
Mazars	832	746	668	846
Grant Thornton	502	509	431	435
Crowe	205	213	242	201
Nexia	147	180	176	140
Baker Tilly	141	152	215	214
Total Non-Big 4	2,776 (13%)	2,775 (16%)	2,505 (16%)	2,758 (19%)
Total PIEs	21,120	17,629	15,834	14,859

Notes:

- This table reports the number of PIEs disclosed by auditor network throughout the EEA, Switzerland and the United Kingdom for years 2015 to 2018. Data comes from Audit Analytics (2020), accessed online: <https://blog.auditanalytics.com/market-concentration-of-pies-an-analysis-of-transparency-report-data-2/>, accessed September, 2020.
- The large decrease in the number of PIEs from 2015 to 2016 is mostly driven by Spain, due to a change that narrowed the definition of PIE.
- Data for 2019 is not tabulated, as this year is described by Audit Analytics as incomplete. The data reported for 2019 suggest a similar distribution: 81% for Big 4, and 19% for Non-Big 4.

While multiple causes underpin accounting scandals such as Wirecard, they often point at deficiencies in the audit profession and its oversight. Currently, the system of national public audit oversight boards (POBSAs) is fragmented and overly complex, characterized by limited responsiveness to red flags, and apparent lack of communication among the POBSAs, and with other supervisors. This suggests supervisory coordination and clear action triggers are imperative. Importantly, pervasively low transparency limits the usefulness of this briefing and hinders evidence-based policy making.

This document was provided by the Economic Governance Support Unit at the request of the ECON Committee).

PE 651.383

IP/A/ECON-BU/IC/2020-115

Print ISBN 978-92-846-7343-8 | doi: 10.2861/699753 | QA-02-20-907-EN-C

PDF ISBN 978-92-846-7342-1 | 10.2861/020445 | QA-02-20-907-EN-N