



EACB Comments on European Commission Green Paper on Audit Policy: Lessons from the Crisis

8 December 2010

The European Association of Co-operative Banks (EACB) is the voice of Co-operative Banks in Europe. It represents, promotes and defends the common interests of its 28 members and co-operative banks in general. Co-operative banks form decentralised networks which are governed by banking as well as co-operative legislation. The co-operative banks business model is based on three pillars: democracy, transparency and proximity. Through those pillars co-operative banks act as the driving force of sustainable and responsible development by placing the individual at the heart of their activities and organization. In this respect they widely contribute to the national and European economic and social objectives laid down in the Lisbon Agenda. With 63.000 outlets and 4.200 banks, co-operative banks are widely represented throughout the enlarged European Union playing a major role in the financial and economic system. In other words, in Europe one out of two banks is a co-operative. Co-operative banks have a long tradition in serving 160 million customers, mainly consumers, retailers and SMEs. They have also developed a strong foothold in the corporate market providing services to large international groups. Quantitatively co-operative banks in Europe represent about 50 millions members, 750,000 employees with a total average market share of about 20%.

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General Remarks

The members of the European Association of Cooperative Banks (EACB) are pleased to provide their views on the Green Paper on Audit Policy: *lessons from crisis*, issued beginning of November 2010.

Generally, we see and understand the political will and intention to improve the information provided by the financial statements of companies within the EU. We are convinced that the work of an auditor is relevant for the reliability of the information in financial statements. Therefore, we support the Commission's intention to request auditors to go back to the "basics" of auditing.

However, above all, we are concerned that the impact of the implementation of the Directive 2006/43/EC on *statutory audits of annual accounts and consolidated accounts on the quality of audit within Europe* have not been assessed yet. Therefore, before setting any additional measures on audit policy in the EU, we would recommend an impact assessment of the implication of the Directive in the near future. The Green Paper provides ideas on how the work of an external auditor can be improved. However, we generally consider that some of the ideas presented in the Green Paper are much too far reaching by putting inappropriate emphasis on state regulation and control. Typically, we think that good auditing principles should not be threatened by measures of state inspection such as statutory appointment, external rotation or joint audit. We are skeptical that those measures would really have a positive impact on the markets, however, we are convinced that they might increase the cost of audits.

Although we support that a better co-operation between auditors and a supervising authority for regulated industries may have positive impacts on the quality of supervision and audits, we find however that when supervisors can enact directives referring to bank audits, there might be a risk that both auditor's and supervisor's responsibilities to be blurred. From our perspective, this practice, could affect the independence of the auditor and is already binding the auditor's resources for supervision responsibilities.

Moreover, in practice, a bank's decision to issue a loan is based on the financial information (e.g. financial statements) about the debtor. Therefore, we think that it is important that information in financial statements are reliable and thus that financial statements are audited. Nevertheless, in order to avoid an increase of burdens for SMEs, we would highly recommend that regarding the implementation of new rules for the audit industry, it should be considered if those rules have really to be applicable to all types of companies or only for listed companies.

Furthermore, considering the general quality of audit reports, we believe that their complexity directly comes from the complexity of audited IFRS accounts. In this respect, we would induce that when assessing the quality of audits, a discussion on the general over complexity of IFRS should take place.

Regarding auditing practices in some Co-operatives, we would like to recall that in some Member States, (e.g. Austria, Germany, and Italy) for cooperative banks, which are members of a national/regional cooperative association, the auditor may be appointed by this association and not by the audited cooperative. According to our members, this appointment model guarantees the independence of the auditor. Moreover, in those typical cases, the national/regional cooperative association does not only have to appoint the auditor, but also to install an early-warning system and to coach the cooperative in business administration, legal and accounting matters. This is notably a key element of the resilience of cooperative banks during the financial market crisis. Yet, this model is designed and suitable for co-operative banks of limited size.

Our views are more detailed in our responses to the ED questionnaire below:



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EACB comments on the Green Paper

INTRODUCTION

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

As we have previously stated, the EACB members understand the Commission's effort for holding a comprehensive debate on audits of financial statements and auditor reports. However, we also consider that there is a need to assess the results of the initiatives already implemented or started such as the recent Directive on Statutory audit. Moreover, we think that other international initiatives (i.e. IFAC/IAASB) should be taken on board in the Commission's assessment in addition of the results of the consultation.

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

The role of auditors is to check whether the financial statements are reliable.

The limits of audits (e.g. materiality, sampling techniques, role of the auditor in the detection of fraud and the responsibility of management) may cause an expectation gap with the stakeholders. An improved communication with the stakeholders may narrow this gap (see our answer to question 4).

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

EACB members are aware that some reports performed in some Member States pointed out important concerns regarding audit services. In particular, the quality of the audits is severely addressed.

Therefore, we support the Commission's intention to improve the quality of audits and we especially think that the application of the ISAs for the listed company fits the purpose.

THE ROLE OF THE AUDITOR

Communication by auditors to stakeholders

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

EACB members think that audits provide comfort on the true and fair view given by the annual accounts, only. In this respect, we strongly support the Commission's intention to request auditors to go "back to the basics" of auditing.

Therefore, we do not think that the role of audits is to provide comfort on the financial health of the company. Instead, statements concerning the financial health of a company should primarily remain to be the responsibility of rating agencies or supervisors of financial institutions (i.e. solvency or liquidity standards).

(5) To bridge the expectation gap and in order to clarify the role of audits, should the audit methodology employed be better explained to users?

We doubt that explaining the audit methodology of audit reports to users would provide any benefit. Moreover, due to the highest complexity of audit processes applied in major



firms (especially banks), we think that it may be extremely difficult to make them understandable by the majority of users.

(6) Should "professional scepticism" be reinforced? How could this be achieved?

Professional scepticism is currently encouraged in the International Standards on Auditing (ISAs), as well as in audit methodologies applied by the majority of firms. Therefore, it seems difficult to assess why it should be even more reinforced.

(7) Should the negative perception attached to qualifications in audit reports be reconsidered? If so, how?

Nowadays the "mental barrier" to give a qualified opinion is too high, which in turn, leads to even fewer qualified opinions, which raises the barrier to give qualified opinion and so on. This means on the other hand, that market reacts very strongly on the possible qualification. The qualification is on the other hand, very powerful and useful way of communication from auditors to users. Having said that, all the major risks, accounting estimates and principles etc. should be revealed in the annual accounts or in the notes. The auditor is only allowed to give a qualified opinion if he disagrees on some parts (or relevant information is not given in notes/accounts although the auditor has required to do so) or wants to point out some facts already mentioned in the notes or annual accounts.

(8) What additional information should be provided to external stakeholders and how?

n/a.

(9) Is there adequate and regular dialogue between the external auditors, internal auditors and the Audit Committee? If not, how can this communication be improved?

Although, in some member states external auditors are required by law to present a report in the meeting of the supervisory board and in the audit committee of the audited entity, we generally think that it is one of the cornerstones in a modern audit to ensure adequate communication to the client. In fact, that is already required for instance by the audit methodologies. Therefore, we generally do not see any special need to be more fostered by law or by any standards.

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

As stated before, we strongly think that audits should go "back to the basics" of auditing (i.e. focus on auditing accounts only).

Moreover, we believe that as long as the CSR is a part of the voluntary reporting, the audit of that report should not be made a part of the statutory audit. Auditors could be requested to give their opinion of the CSR report in a different report on a contractual/voluntary basis. However, we think that any future expectations of the company should stay in the responsibility of the company. Thus, auditors would hardly dispose of the necessary expertise to be able to verify the substance and the expectations regarding the reporting in the field of CSR.



(11) Should there be more regular communication by the auditor to stakeholders? Also, should the time gap between the year end and the date of the audit opinion be reduced?

From our perspective, the primary goal of an auditor should be to give an audit opinion of the annual accounts (cf. “back to the basics”), and additional public reporting would blur that basic task. As preparer of financial reports, the time gap between the year-end and the date of the audit opinion should not be reduced. In fact, we fear that such reduction would cause the decrease of the quality of financial reports. Moreover, we consider the requirement set out by Article 4 of the Transparency Directive (2004/109/EC) to publish audited annual financial reports within four months after the end of the reporting year for companies whose own securities are traded on a regulated market as strict enough.

(12) What other measures could be envisaged to enhance the value of audits?

n/a.

International Standards on Auditing (ISAs)

(13) What are your views on the introduction of ISAs in the EU?

We would support the introduction of the ISAs in the EU for listed companies (see our answer below).

(14) Should ISAs be made legally binding throughout the EU? If so, should a similar endorsement approach be chosen to the one existing for the endorsement of International Financial reporting Standards (IFRS)? Alternatively, and given the current widespread use of ISAs in the EU, should the use of ISAs be further encouraged through non-binding legal instruments (Recommendation, Code of Conduct)?

The “big four” have already adapted the ISAs in their audit methodologies, therefore we do not think that it would add any value to make them legally binding. Moreover, it would make a risk to make the ISAs more inflexible to react on the rapid changes in environment.

However, on the other hand, implementing the ISAs remains a challenge to SMPs, especially in the audits of the SME's (see below).

(15) Should ISAs be further adapted to meet the needs of SMEs and SMPs?

We think that the rigorous implementation of ISAs to the smallest audits make the audits very costly and heavily bureaucratic without adding any value to the result.

Therefore, we think that ISAs should be further developed to better suit also for the audits of entrepreneurs and other micro-companies. (see also the answer to question number 37, which could be an alternative).



GOVERNANCE AND INDEPENDENCE OF AUDIT FIRMS

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

In some Member States (e.g. Austria, Germany and Italy), the regional/national cooperative association appoints the auditor of a cooperative. Moreover, the auditor of a limited company is elected by the general assembly and appointed by the supervisory board, which represents the shareholders). In those cases, the supervisory board also conducts the negotiations about the remuneration.

However, from a most general perspective, we believe that such interest conflicts are already taken care of by existing rules and regulations designed to insure the independence of the auditor from the audited company. We consider those rules to play an effective role and therefore, we do not see a need for change.

(17) Would the appointment by a third party be justified in certain cases?

Generally, our members think that appointment by a third party should be limited to very rare cases (e.g. co-operatives' practice in some member states). Therefore, the designation of the auditors should remain the task of the General Assembly.

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

We strongly believe that the continuous engagement of audit firms should NOT be limited in time. Therefore, we do not support the introduction of a mandatory rotation of audit firms.

We consider mandatory rotation of audit firms would be inefficient, increase the costs, lower the quality of the audit for a couple of years, and thus, endanger the quality of the annual accounts over those years. From the experience of our members as preparers of financial reports, we have learned that when changing the audit firm it takes quite some time for the new auditor to become familiar with their business model, internal structure and business processes.

Moreover, in smaller territories the number of auditors who really understand for instance banking and insurance business, is limited and concentrated only in some audit-companies. The statutory change of the audit company would in that situation be impossible in practise, or would mean that the resources would change from one audit company to another (which in turn, would not increase the independency).

Furthermore, we think that changing the responsible partner within the audit firm as currently required is sufficient to insure both, the independence of the auditor and a high quality of the audit at the same time.

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

We generally share the view that it would not be justified to prohibit audit firms completely from consulting for clients who they audit. In fact, one of the major tasks of the audit committees is to evaluate the independency of the audit firm, taking into



account also all the additional work done by the auditors. The public oversight is obtained by disclosing the total fees in the notes.

We agree however, that there are some situations (e.g. when the audit firm would have to audit its own work) where a strict separation between auditing and consulting would make sense. Nevertheless we are of the opinion that generally the prohibition of non-audit services by audit firms would only create inefficiencies and additional costs. In fact, we believe that in uncritical situations an auditor gets to know his client quite well if he also consults for him. Moreover, in some cases, prohibiting the non-audit services would lead to a situation, where the most competent auditor would prefer not to perform the audit, in order to perform more profitable non-audit services. This might affect the quality of the audit.

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

We are aware that in some Member States limits have already been fixed by law. However, we are not convinced that introducing such limits at EU level would have positive consequences on the market concentration (i.e. the smaller audit firms would not be able to take bigger clients, if the proportion of all the fees, the fee received from that potential big client would be quite high).

(21) Should new rules be introduced regarding the transparency of the financial statements of audit firms?

We see no need for rules that go beyond the scope Article 40 of the EU Directive on Statutory Audits (Transparency Report).

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

We do not see any further measure to enhance the independence of auditors.

(23) Should alternative structures be explored to allow audit firms to raise capital from external sources?

n/a.

(24) Do you support the suggestions regarding Group Auditors? Do you have any further ideas on the matter?

The EU Directive on Statutory Audits regulates the group auditor's responsibilities and obligations. Therefore, we do not see a special need for any further regulation.

SUPERVISION

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

When developing the supervision at the EU level, one should not ignore the supervision the biggest audit companies already do by themselves and the supervision, which is done at the national level.



The EU level supervision should be done merely by creating convergent methodologies and policies, not by "direct supervision" or inspections itself. As a result, we think that no specific "eu-level audit supervisors" should be established.

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

The auditor is an insider and as such, he should not be able or forced to provide confidential information to any third party. If this is not the case, the prerequisites of the efficient audit would be endangered. The specific case regarding the financial institutions should be a rare exception of that general rule. The auditor could however, in rare special cases, verify the information given by a company to regulators or supervisors.

CONCENTRATION AND MARKET STRUCTURE

(27) Could the current configuration of the audit market present a systemic risk?

We are not convinced that the audit market could present a systemic risk. We recognise that due to the current concentration of the market (i.e. Big Four), there might be a vertical concentration of especially advisory services provided to listed companies. Moreover, we doubt that audit fees are facing to an important competition. Therefore, we do not consider that the failure of one "big" (as happened in the past) would represent a systemic risk: the audit market would respond quickly (i.e. the remaining three would most likely increase their market share, but the "remains" of the fallen audit firm would definitely continue in a different form).

From our views, should we consider a potential risk in a failure of one of the "big", it would be more a "reputation risk" than a proper systemic risk.

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

While some of our members see some advantages in having more than one statutory auditor, the added value of joint audits is not obvious for the vast majority of our members.

Some entities currently use joint audits. They see merits in having additional competences at hand and they argue that it would support the independence of auditors (i.e. collusion with the management would be more difficult). However, others have abandoned this approach since they considered it to be an administrative and financial burden without providing any result in benefits for the business regarding audit quality.

As for compulsory joint audit in the EU, some EACB members have strong reservations. Joint audits would require additional coordination efforts and cause duplications (i.e. costs incurred for joint audits would be 15%-20% higher than for conventional audits), which would not be compensated by any improvement of audit quality.

First, an obligation of audits performed by an audit firm consortium with the inclusion of at least one smaller firm raises additional concerns. The benefits of this extra regulation of the market, that would increase the costs for the audited entities, would have to be carefully demonstrated. Moreover, some of our members are convinced that generally, international listed companies would prefer to have a free choice to mandate international big audit firms (i.e. for their international reputation). In addition, even



thought joint audits would have been performed by a big firm and a smaller one, our members think that the bigger firm would finally run the audit anyway.

Moreover, we think that the impact of mandatory joint audits performed by at least one smaller is as such, currently, difficult to assess. Actually, in France, there are no requirements regarding the size of the audit firms carrying out the joint audit. Consequently, the two audit firms involved are often large global networks. While it appears that joint audits have had the benefit of enabling certain firms to grow, its real impact on the higher segment of the audit market has been limited with only one additional audit firm being involved on a regular basis.

Therefore, we think that the use of joint audits should be left to the entity's choice and depends on the market circumstances and local cultures.

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

We do not agree. We even see a danger that mandatory rotation could make life even more difficult for smaller audit firms for they might lose more audit engagements than they acquire via forced rotation.

(30) How should the "Big Four bias" be addressed?

The "big four bias" might be a concentrated market and a potential focus on advisory services instead of audit activities. However, in our views, for international listed companies, the Big four provide very high level audits to their clients (e.g. audit methodologies based on ISAs, expertise of complex IFRS, consistent processes). Therefore, there are inherent dynamics that render the concentration of the audit market very strong. Moreover, international clients look for known names (i.e. reputation issue) to validate the financial accounts.

(31) Do you agree that contingency plans, including living wills, could be key in addressing systemic risks and the risks of firm failure?

n/a.

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

In our view, there is not any more broader rationale to consolidate large audit firms. Moreover, we think that for the audits of large listed companies, the implementation of the ISAs, the complexity of IFRS and development of complex business environment and technology contribute enough to consolidate the large audit firms.

However, we think that it is important to keep the specificities of the audit market for some cooperative banks in Europe.

CREATION OF A EUROPEAN MARKET

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

n/a.



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

We think that it might be a good idea in principle. However, the auditor has to understand the national corporate law, taxation, national accounting principles, local language etc. in order to perform an audit properly. The biggest audit firms can do that using their existing network. Nevertheless, we think that an European passport might be a helpful tool for small and medium audit firms.

SIMPLIFICATION: SMALL AND MEDIUM SIZED ENTERPRISES AND PRACTITIONERS

(35) Would you favor a lower level of service than an audit, a so called "limited audit" or "statutory review" for the financial statements of SMEs instead of a statutory audit?

We could not find a jointly agreed answer to this question.

Should such a service be conditional depending on whether a suitably qualified (internal or external) accountant prepared the accounts?

NO. We think that there should be some requirements also to the "statutory review", and they should be fulfilled regardless of who has prepared the accounts. One would imagine, that gaining the comfort to give the "statutory review" opinion, would require less work if the accountant is suitably qualified / chartered, than if not.

(36) Should there be a "safe harbor" regarding any potential future prohibition of non-audit services when servicing SME clients?

n/a.

(37) Should a "limited audit" or "statutory review" be accompanied by less burdensome internal quality control rules and oversight by supervisors? Could you suggest examples of how this could be done in practice?

n/a.

INTERNATIONAL CO-OPERATION

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

n/a.