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Mr. McCreevy presents statutory audit package

Check Against Delivery
Seul le texte prononcé fait foi
Es gilt das gesprochene Wort

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Chairman, Honourable Members,

It is my pleasure to be at the Legal Affairs Committee today to announce a series of measures in the area of statutory audit.

As you will recall, the Statutory Audit Directive, also known as the 8th Company Law Directive, was adopted in May of 2006 under the co-decision procedure and comes into effect on 29th of June of next year. The Directive sets out a framework of robust principles which Member States are to implement into their national legislation. It also envisages that the European Union will continue to focus on some specific policy areas, such as auditor liability, International Standards for Auditing, inspections of audit firms, and relations with third countries. We have been working on these issues for the last year and a half, listening to stakeholders, commissioning studies, talking to Member States and sounding out Honourable Members of this House. Today I am here to tell you how I intend to bring these issues forward.

How can we ensure that the audit profession meets all our expectations? The three key words here are: competition, quality and international co-operation.

We need to introduce more competition in the audit profession – we have known that for a while. All of us dread to think what would happen if one of the Big Four were to run into trouble and disappear from the audit market. Let me be clear here: I am not thinking of imposing a solution on markets. I am thinking of generating an environment where market forces work better and competition thrives.

But at the same time we need to ensure that more competition does not mean poor standards. Quite the opposite – We need to continue to improve the quality of audits.

So let me now turn to the Audit Package I am proposing today. It deals with the following six elements:

- Auditor Liability
- Ownership Restrictions
- Audit Quality and Inspections
- The Implementation of the Statutory Audit Directive by Member States
- International Standards on Auditing and
- Co-operation with Third Countries

Auditor Liability

Let me start with auditor liability. You will remember that we have already had a lively debate on auditor liability in this Committee when we discussed the Directive itself. As a direct outcome of these discussions, we commissioned a study and carried out a wide public consultation. A major concern expressed by stakeholders during this consultation was the lack of choice when selecting an audit firm. This is particularly acute in the market for audit engagements of listed companies. According to the study the "Big Four" account for 85% of audits of listed companies in the EU.

So why is this market so concentrated? Well mainly because of the principle of unlimited, joint and several liability which is characteristic for the auditing profession. This is exacerbated by the fact that auditors are unable to obtain sufficient insurance cover. This acts as a disincentive for potential new entrants to the auditing market for large listed companies.

But not only do we not have any new players coming into the market, we also run the risk of losing some of the existing players. As I mentioned earlier, there is a serious risk that catastrophic claims might cause the collapse of one of the major audit networks. As we have only a very limited number of networks, such a collapse would pose a significant threat for the ongoing supply of high quality audits

I believe that we should make every endeavour to encourage new entrants into the market for large audits and to create the conditions for them to invest in building stronger international networks.

But how can we convince them to make the significant financial commitments needed to expand into the market for larger audits, if liability risks are high and insurance cover is not available? We cannot reasonably promote the objective of greater choice without first addressing the liability risks facing the audit profession.

That is why in the first quarter of 2008 I intend to put forward a Recommendation to Member States asking them to limit auditor liability. I do not intend to impose the means by which liability is limited. This will be for each Member State to decide. Existing solutions such as a liability cap, proportionate liability or indeed a contractual arrangement between the auditor and the audited firm would all seem adequate means to deal with this issue. Obviously, liability would not be limited in cases involving wilful misconduct by auditors.

Some have expressed concerns that limiting liability could undermine the quality of the audits. I take this seriously. However, there is no evidence for this in Member States, which already limit liability. Germany, for example has had limited liability since the 1930s. Not only has this not been to the detriment of audit quality in this country – Germany has also one of the most competitive environments in Europe for the audit of smaller listed companies.

Ownership restrictions

There is increasing attention being paid to the ownership structure of audit firms. International bodies such as IOSCO, the International Organisation of Securities Commissions, and at national level in the UK or the US have all been discussing the future of the audit profession. I welcome such reflections. We all need to think of how to bring new capital into the audit profession. Some have suggested that we should do away with ownership restrictions in audit firms and allow other players – not only audit partners - to invest in an audit firm. An external study carried out for the Commission suggests that a relaxation of ownership restrictions in the audit profession could help reduce market concentration. Audit firms fear that such relaxation could reduce the quality of audits and pose a risk to auditor independence. I want to hear more about both sides of the argument before deciding on the way forward. I have therefore decided to launch a public consultation on this issue in the first quarter of 2008. I encourage all those who have a view or experience in this field to share it with us.

Audit Quality and Inspections

I mentioned this earlier. The audit market needs more competition but this should not be to the detriment of audit quality. With the 8th Directive we have put an end to the long self-regulation of the audit profession. Clearly it is not appropriate in the 21st century. A cornerstone of the Directive is the establishment of an external quality assurance carried out by an independent public oversight body. According to the Directive the external quality assurance system should be objective and independent from the auditing profession.

Within this framework the Directive allows for a wide array of possibilities as to how Member States should organise independent inspections of audit firms as long as the requirements of the Directive are met. However, Member States have indicated that they would welcome some guidance on this issue. It is important also that quality standards are high in the Union.

I therefore intend to bring forward in the first quarter of next year a Recommendation on the independence of inspections of audit firms who are engaged in the auditing of listed companies. In substance, this Recommendation will give more responsibilities to the public oversight bodies, strengthen the independence of inspectors and provide more transparency on the outcome of inspections. At this stage full independent oversight carried out only by inspectors would not be feasible in some Member States. There would not be enough independent inspectors with sufficient expertise. Therefore, for a transitional period, professional bodies and practitioners will be allowed take part in the inspection process. But their role will be limited. They will not, for example, be able to take charge of an inspection and at all times they will be required to work under the supervision of independent inspectors.

The Implementation of the Statutory Audit Directive by Member States

As I said before by the 29th of June of next year Member States will have to implement the Statutory Audit Directive. Ensuring a timely and correct implementation of this rule is a key priority for me. You know my mantras by now. And one of them is that it is not enough to adopt rules. It is at least as important to implement them. And to do so on time and accurately. My services have worked closely with Member States to assist them during the implementation phase and they will of course continue to do so. I am a great believer of "naming and shaming" when it comes to implementation of rules. It has worked very well in other areas of the Internal Market. I want to monitor the implementation progress very closely. Therefore I intend to present a first "Scoreboard" of the implementation of the 8th Directive in Spring 2008 describing where Member States stand, particularly as regards the establishment of an independent public auditor oversight.

Another of my pet concerns it to avoid "gold plating" of the rules – that is requirements imposed in national implementation rules which go beyond those of the Directive. Too often I have seen national regulators impose extra provisions when transposing EU legislation. These extra provisions are often far more than trivial adjustments. I shall therefore be particularly vigilant to any "gold plating" which add unnecessarily to costs, or forecloses markets, or creates other barriers to cross-border competition. If we want to increase choice and competition in the audit market, the single market dimension needs to be taken into account when transposing and applying the Directive.

International Standards on Auditing (ISAs)

Let me now turn to international issues. As I said earlier it is important to find global solutions to a global profession.

This brings me to the issue of ISAs or International Standards for Auditing. These are standards developed at international level by IAASB the International Auditing and Assurance Standards Board.

The Statutory Audit Directive and in particular its Article 26, allows the Commission to make ISAs mandatory for the European Union. I certainly support the notion of having international standards. But it is too early to decide if these standards should be applied in the EU.

Why? First, because the standard setter – the IAASB – has embarked on a so-called "Clarity Project" which the Commission is involved in. This project aims at defining more clearly which parts of the ISAs should be mandatory standards and which parts are guidance for the auditing profession. By the end of 2008, this project should produce its results. I want to see how this work proceeds.

My second reason for waiting is that the Commission has launched two studies which will be carried out by external consultants in the course of next year: One will look at the costs and benefits of introducing ISAs in Europe and the other will identify potential differences between ISAs and US auditing standards.

And finally, I want to wait to have a close look at the governance of the standard setter. I am all for independent standard setters, but they should respect due process and be adequately governed. They should also be accountable to their stakeholders. So I need to be convinced that appropriate safeguards exist when it comes to the IAASB.

The Directive does not set a target date for introducing ISAs in Europe and this has been a wise decision. So my intention is not to make a decision on ISAs at this stage but to look at this issue again towards the end of 2008. By then the Clarity Project will hopefully have done justice to its name and we shall also have more information based on our own studies.

Co-operation with Third Countries

The Statutory Audit Directive requires Member States to look into the quality of the audits of the myriad of third country companies listed on European markets and audited by their auditors in their home jurisdictions. The principle is that Member States should register such third country auditors and subject them to their systems of oversight. However, for third country jurisdictions which have an oversight system in place which is considered to be equivalent to the EU system, the Directive allows Member States to rely on the findings of third country auditors without obliging them to register in their jurisdictions.

We need to decide what is going to happen with the audits of third country companies listed on our markets when the Directive starts applying next June. We do not have sufficient time before that date to carry out in depth equivalence assessments of third country jurisdictions.

I want to avoid disruptions in capital markets. I want to give all players sufficient certainty about what is going to happen when the Directive starts applying. Therefore, in full conformity with Article 46 of the Directive I intend to propose transitional measures. These measures which will be brought forward in January will allow audit firms from certain third countries to continue their activities for the duration of the transition period. Third countries concerned will be those which currently have or are likely to have an independent oversight system in the short or medium term. The transitional period should apply to financial years starting between the date of application of the Directive and 1st of January 2011. In order to protect investors transitional periods will only be granted if audit firms concerned provide information about themselves, the auditing standards and independence requirements applied when carrying out audits as well as about any inspection reports. During this transitional period, the Commission will assess the equivalence of third countries which already have public oversight systems in place and will discuss progress with other third countries which show a potential to move towards such a system.

Conclusion

Chairman, Honourable Members, let me now summarise what I am proposing in this Audit package:

- A Recommendation limiting Auditor Liability to be brought forward in 2008.
- A consultation on Ownership Restrictions in Audit Firms to be launched in the first quarter of 2008.
- A recommendation setting high standards on Audit Quality and Inspections also in the first quarter of 2008.
- A Scoreboard to monitor the Implementation of the Statutory Audit Directive by Member States
- Further work on International Standards on Auditing which will enable us to decide whether or not to adopt them by the end of next year.
- And in January 2008 transitional measures to allow us to rely on certain third country audits until 2011 so that in the meantime we can then definitively decide on the equivalence of third country oversight systems.

I trust that I can count on your support in achieving the important objectives which I have outlined today.

Thank you.