Committee on Economic and Monetary Affairs

2011/2037(INI)

11.5.2011

OPINION

of the Committee on Economic and Monetary Affairs

for the Committee on Legal Affairs

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

Rapporteur(*): Kay Swinburne

(*) Associated committee – Rule 50 of the Rules of Procedure

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SUGGESTIONS

The Committee on Economic and Monetary Affairs calls on the Committee on Legal Affairs, as the committee responsible, to incorporate the following suggestions in its motion for a resolution:

A. whereas the high market concentration of the 'big four' audit firms may cause an excessive build-up of risk, and whereas smaller firms are diverse and their growth and expertise should be encouraged through increased opportunities to compete,

B. whereas the collapse of a dominant audit firm would seriously undermine the credibility of the audit profession as a whole and could create major uncertainty about the quality of financial statements made for listed companies,

C. whereas, following the financial crisis, auditors have been identified as being able to play a key role in strengthening the risk management oversight of financial institutions, in particular,

D. whereas the role of the audit committees within financial institutions, in particular, has not been fully utilised,

E. whereas conflicts of interests are likely to exist when auditing firms offer different services to the same firm,

F. highlights the importance of the audit report for shareholders and the public; recognises the principle of 'an audit is an audit' and warns of the high risk of the application of different standards leading to legal uncertainty; therefore favours the extension of the scope to all financial institutions,

G. whereas, in the wake of the crisis, excessive risk-taking on the part of financial institutions has been significantly linked to flexible, scant and ineffective control and risk management mechanisms, particularly in systemically important financial institutions (SIFIs),

1. Calls for the provision of increased opportunities for smaller firms by preventing internal and external audit services being carried out by the same company as this could pose a risk to the auditor's independence; notes in particular that areas of audit services which are deemed to incur a conflict of interest shall not be carried out by the same company, including certain advisory services and evaluations of complex structured products; this should be monitored by the competent supervisory authorities;

2. Recommends that the audit committee as an entity of the supervisory board, not the executive board, should decide whether to permit the provision of non-audit services to the respective financial company and should negotiate the tender and details of the mandate; calls on the Commission to conduct an impact assessment of the viability and effects of a cap on non-audit services in relation to revenue;

3. Recognises that statutory auditing has a social function and is in the public interest and so welcomes the intention of the Green Paper to increase transparency and improve the quality of auditing reports in order to contribute to the stability of the financial market and improve access to financing; favours any measures based on the evidence that costs and burdens to financial institutions, in particular, are outweighed by improving their quality significantly, as well as by regular external evaluation and appropriate regulatory oversight; underlines the need for specific legislation;

4. Calls on the Commission to review audit committee practices with regard to tendering processes with a particular view to aspects of transparency and administrative burdens associated with a formal tendering process, whilst ensuring that the quality of auditing services is not affected; considers that, in order to guarantee the independence of audits, companies should consider an open tendering process for statutory appointments of external auditors every eight years, on a renewable basis; encourages the Commission to include the results of an annual discussion of the auditor selection in an audit committee report to the shareholder assembly;

5. Calls for audit committees to be required to publish in their report the occurrence of regular discussions with principal shareholders and any significant financial reporting issues raised during the course of the audit and to explain the basis of the decision on audit tendering and auditor appointment for all audit related work, but especially for the external audit contract;

6. Confirms that, with regard to maintaining a high standard of audit quality, the internal rotation of auditors, as confirmed in Directive 2006/43/EC, is to be preferred over external rotation;

7. Recognises that the implementation of joint audits could have positive effects on the diversification of the audit market; recalls the different market situation and different experiences of joint audit across Member States; calls on the Commission to assess the potential benefits and the costs of the mandatory introduction both for audit firms, in particular small audit firms, and for audited companies and financial institutions in particular, and how it might affect the concentration of the audit market and financial stability;

8. Calls on the Commission (DG Comp) to hold a detailed investigation into the audit market;

9. Calls for enhanced, two-way communication between auditors and financial supervisors of financial institutions, especially in relation to specific areas of concern, including the interaction between different financial products; calls for the same communication to be established for cross border entities by auditors and the European Supervisory Authorities;

10. Points out the need to harmonise the supervisory practices of audit and asks the Commission to consider integrating the European Group of Auditors' Oversight Bodies into the European System of Financial Supervision, possibly through ESMA;

11. Calls on the Commission to develop a pan-European liability regime for the auditing

profession;

12. Calls for the external auditors of financial institutions to report periodically, on a sectoral basis, to the ESRB in order to identify sectoral trends and potential sources of systemic risk and potential failures, observing that this should be done in a proportionate way;

13. Calls for the role of the audit committees of all financial institutions to be strengthened by requiring them to approve a risk model assessment which includes firm-specific comparisons to benchmarks including reporting potential future financing needs, bank covenants, future cash flows, risk management, management estimates and adherence to major accounting principles and any foreseeable risks with respect to the company's business model; demands that this assessment be presented to the executive and supervisory boards of financial institutions, along with the full audit report, annually for consideration and approval;

14. Points out that a high-quality audit system is an integral part of a sound corporate governance framework; asks the Commission to present their proposals on corporate governance and audit to the Parliament and Council in a consistent way;

15. Calls on the Commission to investigate the use of restrictive covenants by banks and other financial institutions on loans and other financial products to companies, which may be limiting auditor choice;

16. Calls on the Commission to look into the legal barriers existing both within the EU and between Member States and non-EU countries in connection with the forwarding of data during group audits;

17. Support the introduction of living wills for the 'big four' audit firms and those auditors providing significant audit services to the financial sector, including establishing cross-border contingency plans for the orderly transfer of client contracts should a significant player withdraw from the market;

18. Calls on the Commission and the Member States to ensure that audits of public bodies are exemplary and to prevent any conflicts of interest from arising as a result of links between the auditor and decision-makers within the public body being audited;

19. Calls for financial institutions' audit reports to include enhanced disclosure requirements for the valuation of less liquid assets to enable the comparison of financial instrument valuations between institutions;

20. Calls on the Commission and the Member States to ensure compliance with the findings published by national audit offices in pursuit of their audit remit;

21. Recommends that auditors be made aware of all instances where the risk committee has been overruled;

22. Group auditors should have a clear overview of the group and, in the case of financial institutions supervised on a group basis, should have dialogue with the group

supervisor;

23. Calls on the Commission to look at ways of making the operations of audit firms more transparent; notes that the introduction of an obligation to publish annual financial statements verified by the relevant public authorities would help to achieve this.

RESULT OF FINAL VOTE IN COMMITTEE

Date adopted	9.5.2011
Result of final vote	+: 39 –: 0 0: 1
Members present for the final vote	Burkhard Balz, Sharon Bowles, Udo Bullmann, Nikolaos Chountis, George Sabin Cutaş, Derk Jan Eppink, Diogo Feio, Markus Ferber, Elisa Ferreira, Vicky Ford, Ildikó Gáll-Pelcz, Jean-Paul Gauzès, Sven Giegold, Liem Hoang Ngoc, Gunnar Hökmark, Othmar Karas, Wolf Klinz, Rodi Kratsa-Tsagaropoulou, Philippe Lamberts, Werner Langen, Hans-Peter Martin, Íñigo Méndez de Vigo, Anni Podimata, Antolín Sánchez Presedo, Olle Schmidt, Edward Scicluna, Peter Simon, Peter Skinner, Theodor Dumitru Stolojan, Kay Swinburne, Marianne Thyssen, Ramon Tremosa i Balcells
Substitute(s) present for the final vote	Elena Băsescu, Pervenche Berès, Sari Essayah, Robert Goebbels, Syed Kamall, Krišjānis Kariņš, Olle Ludvigsson, Siiri Oviir