



VMW TAXAND

European Commission
Internal Market

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Our ref.:
Re: Green Paper
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Dear Sirs,

With regard to the Consultation on audit policy - Lessons from the Crisis, we hereby submit our comments to the Green Paper, COM(2010) 561 final, that the Commission published on 13 October 2010.

Background

Taxand is an global organisation of independent tax advisors. We are independent from auditors, but operate in the same market as audit firms providing non-audit services, such as tax advice. VMW Taxand is the Dutch Taxand firm. For more information see www.taxand.com and www.vmwtaxand.nl.

Comments

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

VMW Taxand (hereafter: Taxand) welcomes the Green Paper and the approach taken in it. Taxand believes that certain businesses in the audit market and their entering of associated service industries, such as tax advisory, financial advisory, management consultancy services, and, more recently, legal services, has the characteristics of an oligopoly that results in lowered professional standards for clients and unfair competition. The audit profession is highly regulated, giving the market for global audit and associated services a high entry barrier for newcomers. Taxand believes that the market for audit and associated services should be

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restructured, stimulating newcomers to achieve a more competitive market position. This will enhance the overall quality of global audit and associated services.

Taxand acknowledges that immediately after the Enron demise, audit firms tended to decline non-audit services to SEC-regulated audit clients, but Taxand has observed that more recently a number of audit firms have become less strict in following these guidelines. Taxand believes, in light of this relaxation in self-regulation, that there is a strong case to introduce a legal prohibition for the provision of non-audit services.

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

Taxand believes that the professional scepticism of auditors has been seriously compromised over the past two decades, as a result of the business models implemented by audit firms. The fees generated by providing audit services do not generate the income levels that auditors have been able to earn over past decades. The extra income has been brought in through fees from additional services provided by tax consultants, management consultants and IT consultants associated with the auditors. A number of audit firms employ pricing strategies for their audit services taking into account that non-audit service fees will compensate for the loss of fee potential on audit engagements. The audit engagement is considered the beginning of a sales process, rather than an independent source of income

Inside Big Four firms there is a constant discussion between auditors and non-auditors about the so-called "make and take", i.e. the income generating capacity of auditors and that of non-auditors, where the latter consider the auditor's "make" not in accordance with their "take" (i.e. their take is too high). Auditors, however, argue successfully that their engagement is the start of a pipeline of client engagements for other services. This is further advanced by a business culture in which there are bonuses and annual awards for auditors who are the most successful cross sellers for the firm.

This business culture has created and attracted professionals with a commercial rather than sceptical attitude, who are rewarded by the wrong incentives. The professional attitude of an auditor should be sceptical, not commercial. Taxand believes that professional scepticism will be re-inforced by prohibiting audit firms from providing non-audit services. This would require audit firms to change their business models to ensure that sales efforts, that flaw professional scepticism, are not leading the agenda, but instead the quality of their audit services.

(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?

For the reasons set out in the answer to Question (6), Taxand believes that the provision of non-audit services by audit firms should be prohibited.



We believe that such prohibition should not be limited to systemic financial institutions, as the business culture in audit firms fundamentally impairs the auditor's professional scepticism, not only in the case of systemic financial institutions.

(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?

Taxand believes there was a rationale for strengthening the expertise of audit firms over the last two decades. The complexities in the economy and its financial system require deep expertise and knowledge from auditors in a wide variety of areas. These complexities indeed require substantial investment in developing the necessary expertise and skills to audit complex organisations, such as banks, insurance companies, oil companies, etc. Investment is also required in the innovation of audit services. This, however, does not mean that the consolidation of large audit firms was the right answer.

First, Taxand notes that the last major step in the consolidation process resulted from the demise of Arthur Andersen in 2002, not from a purposeful decision to consolidate in order to strengthen the expertise and enhance innovation. Instead, this last step, according to VMW Taxand, has done more harm than good to the audit market, as it has created a landscape dominated by four providers that are 'too big to fail' and that has resulted in moral hazard.

Second, VMW Taxand is not convinced that the consolidation has resulted in any relevant innovation in audit services. Instead, the consolidation has resulted in an oligopoly for audit services, with high entry barriers and high interdependence. Like in any oligopoly, these two elements reduce the case for innovation, not enhance it. It is true that with the pressures to perform financially, auditors have sought to improve the efficiencies of their audits, but VMW Taxand questions whether this is the kind of innovation that improves the quality of audits and services to clients.

Third, consolidation has also affected the market for non-audit services, such as tax advisory, financial advisory and IT consultancy services. The market for these services also has the characteristics of an oligopoly.



The players can retain long run abnormal profits, with high barriers of entry preventing other firms from entering the market to capture profits. As these abnormal profits are shared with auditors, the latter have little or no incentive to innovate their own services or re-invent their business model. Instead, auditors have a great incentive to keep the market for associated services closed for newcomers. Taxand believes that the Big Four audit firms are of a size that allows each of them to split into two or more separate firms, resulting in a market of eight or more global firms, without there being a negative impact on the expertise or investment power of these newly created firms. Instead, Taxand believes that such firms - that would be prohibited from providing non-audit services - would become more innovative, and with that innovation would have a genuine opportunity to improve market share and profits.

We would welcome the opportunity to share more experiences and insights with the Commission.

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Best regards,

Roelof Vos

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