

## AUDIT ROUND TABLE Prague, Czech Republic

### PROGRAMME

#### Introduction

The purpose of the round table is to invite discussion on a number of issues raised by the EU's draft regulation and directive on audit, which have aroused considerable controversy inside and outside the profession, and which are currently being considered by the European Parliament.

ACCA has reviewed the EU's proposals and has been engaging in discussions about them with officials and MEPs in Brussels.

ACCA is now very interested to hear from auditors and audit stakeholders in the Czech Republic about what they feel the implications of the draft legislation are for them.

Participants at the meeting will be invited to consider the following questions.

#### Topics for discussion

- **Should there be a time limit on audit engagements at the PIE level and if so what should this be?**

In many cases, auditors are re-appointed to the same company client for many years in succession. For some observers, this gives rise to concern that the auditor becomes too familiar with the client, and possibly too keen to secure re-appointment by the client, that the professional and legal onus to be 'independent' of the client, and to adopt a healthily 'sceptical' attitude with respect to the client's affairs, can become, or appear to become, compromised. Arguments in favour of making no change to the current rules include that regular changes would increase costs and risk reducing the quality of audits by obliging new auditors to spend significant amounts of time getting to understand the business of a new client, during which time errors can occur. With a view to ensuring that auditors remain sufficiently independent of their clients to be able to carry out a suitably objective audit, it is being proposed that there be a legal cap on the amount of time that one auditor or audit firm can continue to audit the same PIE client. This cap would supersede the ethical rules to which auditors are subject, which call for regular rotation of the engagement partners, and not the audit firm itself. The draft regulation proposes that the new cap be set at six years, apart from in the case of joint audits where each of the joint auditors may serve for a maximum of 9

years. Is this a reasonable limit for the permitted duration of an audit engagement?

- **Does the provision of additional non-audit services compromise the auditor' s independence and if so how should this problem be addressed?**

Very often, auditors provide additional consultancy services to their audit clients. These services may include advice on matters such as tax and the design of IT services. As with the issue of long engagements with the same client, companies often like to buy in other services from the auditor because of the existence of a high degree of trust between the two parties and because the auditor will already have valuable knowledge of the client' s business. Some, however, suspect that if the fees received from the additional services are of such a level of materiality that an auditor becomes dependent on that additional income, the auditor will be less likely to be prepared to dispute matters in the client' s accounts which he would otherwise be prepared to do. The draft regulation proposes to impose significant restrictions on the additional consultancy services that auditors are able to provide to audit clients, with some being banned altogether and some being made subject to approval by the company' s audit committee or national competent authorities. Even where additional services are expressly allowed, they are to be subject to a financial limit. Are such restrictions necessary to ensure audit quality or are they an unjustifiable intrusion into the freedom of companies and shareholders to buy in services on the open market?

- **Is it feasible to expect the audit committee to play a more prominent role in assessing the independence of the auditor?**

Under the draft regulation, every PIE will be expected to establish an audit committee, of which at least two members should be competent in accounting or audit matters. The committee will have responsibility for a number of specified matters, including monitoring the effectiveness of the company' s internal control system, supervising the audit process and making a recommendation for the appointment of the company' s auditor. Is it reasonable to expect audit committees to perform these functions, and could they be expected to go further and provide shareholders with a specific assessment of the independence of the auditor?

- **How should the structure of the audit report be developed so as to make it more informative to users?**

The standard audit report currently provides very limited information to users about the challenges that the auditor faced and decisions he had to make before coming to his opinion. Some observers have argued for some time that it would be helpful for the audit report to be more forthcoming about these

matters. The draft regulation proposes a new long form structure for the audit report which requires the auditor to set out 19 separate items of information, including key areas of risk of mis-statement, going concern and an assessment of the client's internal control system. Even if expansion of the form of the audit report is considered to be a good idea, should this matter be regulated by EU law or should the form of the audit report be set by standards issued by IAASB?

- **Should auditors be obliged by law to report concerns about their PIE clients to regulators?**

One of the most significant failings that was suggested by investigations into the financial crisis of 2007/8 was that auditors and market regulators failed to communicate with each other, and neither side passed on information which was potentially useful to the other side. The EU is keen to ensure more effective communication, at least from the auditor to the regulator, and with this in mind is proposing that there be a legal obligation for auditors to report to the market regulator and also to the audit regulator where issues arise which are of interest to either or both. A legal duty to do this is clearly intended to ensure that regulators are able to intervene more quickly in the affairs of companies which are in trouble. Do participants accept that it is reasonable for auditors to be expected to perform this function, and should auditors expect regulators to share relevant information with them in return?

- **Will the proposed changes help to address the issue of domination of the PIE audit market by the Big 4 firms?**

In most countries in the EU and elsewhere in the world, almost all listed companies are audited by one of the Big 4 firms. The EU sees this situation as representing not only a threat to fair competition but also a threat to the financial stability of the capital markets. This lies behind much of what the EU is proposing in the regulation, including the proposal to compel the largest firms to concentrate solely on audit work. Do participants think that the new changes will enhance competition and lead to more firms conducting listed company audits, or is there a danger that they will only reinforce the dominance of the big firms?

- **Do we need a new European quality certificate for auditors of PIEs?**

The new legislation envisages that a new quality certificate be developed for auditors and audit firms that carry out audits of PIEs. The intention is that this will provide an additional mark of quality over and above the conditions that would have been fulfilled to achieve authorisation in the first place. Given all the other conditions that auditors and audit firms will have to fulfil, is it necessary to introduce another test of this kind? How will this impact on concentration in the PIE audit market?

- **What is the future for the SME audit in Romania/Czech Republic [delete as appropriate]?**

The draft directive on accounting proposes the increase of the turnover threshold for the definition of the ‘small company’ to 10 million euros – this will be applied on a maximum harmonisation basis so that no member state is entitled to set a lower threshold than this. Further, the same directive provides that no small company – as defined by reference to the revised size criteria – is to be subject to audit under EU law (though individual member states shall still be entitled to impose an audit requirement if they wish to do so). Additionally, the draft directive on audit says that member states should be required to ensure that, if and when SMEs are audited, the audit standards used should be applied in a way which is ‘proportionate to the scale and complexity of the business of those undertakings’. What will this mean for the amount of audit work that is carried out at the SME level? Should we try to make audit more attractive to SMEs and SMPs and if so how?

- **Who should regulate auditors outside the PIE sector?**

Currently, the work of auditors who do not audit the accounts of PIEs may be monitored and supervised, by way of delegated authority, by professional bodies or other agencies that are approved by government. The draft directive on audit proposes that, in future, this should not be allowed to happen – the involvement of professional bodies should be restricted to the approval and registration of auditors and audit firms. Is this a sensible way forward for the regulation of SMPs and will governments be able to cope?

- **Will the various changes proposed for PIE audits help to improve the quality of audit work at this level?**

The EU proposals amount to a regulatory solution to issues relating to the role of audit in corporate failures. As well as introducing many new legal requirements the draft legislation proposes to convert much of what is currently set out in professional and ethical guidance into law. Do participants believe that the highly regulatory approach to audit issues favoured by the EU will result in improvements in the quality of audit work?