



SHAKING UP AUDIT

IT LOOKS LIKE REFORM OF THE AUDITING PROFESSION IS A MATTER OF WHEN, NOT IF. **JEREMY WOOLFE** REPORTS FROM BRUSSELS

It was temptingly billed as the opportunity for a wide range of stakeholders to talk frankly about improving the European audit market. But the promotional material for the *Financial Reporting and Auditing: A Time for Change?* conference, hosted by the European Commission in Brussels last month, also hinted that delegates might be treated to precious insight into the thinking of internal market and services commissioner Michel Barnier following the publication of his radical green paper last autumn: *Audit Policy: Lessons from the Crisis*. Among the reforms proposed in the paper were mandatory audit rotation, a ban on selling non-audit services to audit clients and the appointment of auditors by a third party – proposals that have been widely debated both before and since.

The state of the European audit market took centre

stage during the second day of the conference, after a first day dedicated to the theme of international standard-setting and convergence. But it quickly became clear that, rather than breaking new ground, the conference was more of a consultation exercise in the wake of the green paper, with Barnier explaining in his keynote address that although the Commission was mostly open-minded when it came to audit reform, maintaining the status quo was not an option.

He did offer some hints as to his current position, however, warning that when it came to bonuses, 'things will not stay stagnant' and saying of the independence of auditors: 'Independence has to be solid, and visible.' On the subject of joint audits, which would effectively mean a Big Four firm working alongside a second-tier firm, he seemed ready to listen.

FINANCIAL LOBOTOMY

But, given the prevailing mood in the auditorium on the day, it was obvious that when it comes to auditing, Barnier believes that the status quo is doomed.

Jules Muis, former vice president and controller of the World Bank and also once the chief internal auditor of the European Commission, told an auditorium packed with 450 international delegates that 'auditing no longer speaks the language of finance'.

'If the history of the financial crisis is not going to repeat itself, we do have to make a major move,' he added, going so far as to suggest a financial 'lobotomy' was needed to strike out the need for company auditing altogether. Getting into his stride, he went on to suggest putting a 'bazooka' through the CFO function, saying CFOs shouldn't be allowed to judge their own work. He described the CFO function as 'bonus-driven' and an 'abomination'. He added that it was in taxpayers' interests to make sure that the audit market is fully functioning.

Meanwhile, Charles Cronin, head of standards for Europe, and Martin Sjöberg, director, European affairs, both at the CFA Institute, the global association of investment professionals, claimed that the interests of the 'systemically important financial institutions would be [best] served through a third party appointing and remunerating their external auditors'.

Auditors came in for more flak from Iain Richards, regional head of corporate governance at insurance giant Aviva. In January, Aviva was among three powerful investors that called for a radical overhaul of the audit market to reduce the dominance of the Big Four, saying the regulators should persuade the Big Four to give more work to mid-tier firms such as Grant Thornton and BDO. Picking up this theme, Richards said: 'It seems that we need intervention in the audit market, or we go another route altogether.' He was critical of what he described as 'widespread failure' by auditors and added that no change in the audit market was 'not an option for investors'.

Addressing an audience studded with auditors, Richards used an imaginary example to illustrate his point. He described how a financial director asks the auditor for an opinion on the high and low fair value of a particular asset. 'Possibly 70 low? And, perhaps, 140 high? So, we'll book it at, say, 95?' responds the auditor. 'Right,' orders the CFO, 'it's 140, and we expect you to sign it off as that.'

Richards' views were shared by Stephen Haddrill, chief executive of the Financial Reporting Council, who called for action on closing the expectation gap between what audit does and what users expect from financial statements. He said that investors should be given more information about the prospects of the company and a better picture of the future of the business and of the judgments made in the course of the preparation of the financial statements.

'We want investors to learn about the business and its future from the directors; we want the directors to say more about the things that really keep them awake at night and we want to empower auditors to challenge management by requiring them to say whether the board has really given a balanced and fair view on these matters as well as on the accounts,' he said.

But instead of introducing compulsory joint audits, Haddrill said that measures should be taken to encourage financial institutions to use non-Big Four firms as a source of advice to their risk committees and prohibit the use of Big Four-only clauses in banking and loan covenants.

MUTED RESPONSE

Somewhat surprisingly, references to a 'lobotomy' and other attacks failed to produce much reaction from the auditors present at the conference. The profession responded calmly to its critics and it appeared pensive when facing up to assaults on its competence. Admittedly, there were a few negative comments to suggestions raised in the green paper. But these mostly took on a technical slant.

Ernst & Young's global vice chair of assurance Christian Mouillon was not the only speaker to repeat that auditing was not to blame for the financial crisis, advocating a 'balance between governments, audit firms, and external stakeholders'.

Jens Røder, secretary general of the Nordic Federation of Public Accountants and a former PwC partner, criticised the suggestions in the green paper of joint audits and rotation 'which risks affecting audit quality'.

Referring to the concentration of the major audit firms, Patrick de Cambourg, CEO and chairman of Mazars, commented: 'Nobody is to be blamed for this, but the limited number of players has become of serious concern.'

He also listed a number of areas that need addressing, including encouragement of a single EU market for auditing, registration of auditors, harmonisation of standards, improved governance and education.

ENDLESS DEBATE

So where does that leave us now? On the whole, the conference added little more than detail to already known positions. The next major step is not due until the autumn, after the Commission has digested the 700 responses (10,000 pages) to its green paper. It is already threatened with delay, although Barnier says: 'We should make it by November.'

Then the bombshell that is the Commission's white paper should drop. This will set out definitive proposals for legislation and it will upgrade the Statutory Audit Directive, first published in 2006, although it is unlikely that any new legislation would come into force until 2015 at the earliest.

Meanwhile, in the near future, preparations are already underway for meetings in the European Parliament's Legal Affairs Committee (JURI) and its Economic and Monetary Control Committee (ECON). British MEP Dr Kay Swinburne will present a report on the green paper on 4 April, for a vote in ECON on 9 May.

'These will be constructively aimed to stimulate debate in the public interest,' one lobbyist told *Accountancy*. What they will mean for auditors in the long term, nobody knows yet. But it is hard to escape the conclusion that a shake-up to some degree is on the cards.

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