



CCBE COMMENTS ON THE PROPOSED REGULATION AND DIRECTIVE RELATING TO THE SPECIFIC REQUIREMENTS REGARDING STATUTORY AUDIT OF PUBLIC-INTEREST ENTITIES

CCBE comments on the proposed Regulation and Directive relating to the specific requirements regarding statutory audit of public-interest entities

The Council of Bars and Law Societies of Europe (CCBE) is the representative organisation of around 1 million European lawyers through its member bars and law societies from 31 full member countries, and 11 further associate and observer countries.

The CCBE has the following comments on the proposed [Regulation](#) and [Directive](#) relating to the specific requirements regarding statutory audit of public-interest entities.

1. Scope of the audit

The scope of intervention of auditors should not be extended. Indeed, such a step could affect the quality of auditing. In particular, members are against the possibility for auditors to comment on the company's strategy and its development prospects - any assessment on the future of the audited entity would be too intrusive. Moreover, if audit firms were to develop such skills, smaller firms would not have the same resources to conduct such assessment: the *Big Four* would therefore be favoured.

One member was nevertheless in favour of such a measure provided auditors shall not be liable when assessing the future of the company.

Regarding the limitation of financial services other than audit, the CCBE notes that such restriction would prejudice medium-size audit firms. These companies tend to develop multiple services to maintain their activity. The CCBE also emphasise the risk that the *Big Four* may spread their services through branches to bypass the limitations from the Regulation. Despite these risks, it is still important to limit the provision by audit firms of other financial services to controlled companies.

Regarding the legal advice tasks performed by audit firms, the CCBE also supports limiting the supply of such services.

Spain has established restrictions with regard to this aspect, in the form of 'incompatibilities', if offering audit activities and legal services to the same client. But these restrictions are being avoided as the company creates different legal entities with different management boards.

In practice, the Big Four and other audit firms have specialized divisions acting under the same commercial name but configured as independent legal entities. In fact, they are a "formally independent" body that carry out different activities, but behind them underlies a common interest, which infringes the principles of free competition.

This could be corrected with the establishment of an absolute prohibition between legal practice and audit, in stricter terms than the ones provided by Spanish legislation.

The issue of the incompatibility regulation becomes more evident when analysing the situation of the audit firms' clients.

When these firms advise clients on audit items and, through internal tools described before (independent divisions under the same commercial name), on legal advice, the free competition principle can be broken: if the client is not satisfied with the legal advice, but at the same time it receives satisfactory auditing by the same company, it becomes very difficult to cancel the legal service. It would be a kind of "hostage-client" and would not be in line with the principles of fair competition.

2. Designation of several audit firms

The CCBE welcomed the opportunity to involve several audit firms in the audit of a same public-interest entity (PIE).

This has already been a requirement in France for fifteen years for companies which prepare consolidated accounts. The appointment of two auditors was successful and enabled the development of mid-sized firms, which now work with the *Big Four* in auditing accounts. The solution was also adopted in Denmark before being left out due to costs and the organisation which co-auditing required. For the European Commission this measure should not generate significant management costs too as it would be limited to PIEs.

The designation of several firms to audit the accounts of a PIE has three main advantages.

First, it can improve the quality of the audit. Indeed, if different audit firms work in the same audit for the same entity, they may have to exchange their views and discuss the audited data. In case of a discrepancy when analysing data, each auditor could expose their position in the report.

Moreover, such co-auditing would promote and increase visibility for medium-sized audit firms. In France, where companies which prepare consolidated accounts are required to appoint two auditors, medium-sized audit firms work together with the *Big Four* to audit groups of companies.

Finally, this proposal has a systemic advantage. In an audit market now dominated by the *Big Four*, the failure of one of the four major audit firms would create a systemic risk. The proposed Regulation addresses this issue by requiring larger audit firms to set up contingency plans to deal with situations which threaten the continuation of their activities. But, were the *Big Four* reduced to three, how would audits be ensured? Medium-sized firms should be further exposed and the *Big Four* should be encouraged to collaborate with such firms.

The CCBE agreed on the need to make it compulsory to appoint several audit firms to audit PIEs. One member expressed scepticism about the mandatory nature of such co-auditing with joint committees as it felt it was not necessary to impose these for the following reasons:

- Risk of additional costs incurred by companies
- Risk that some matters may not be dealt by any auditor - leading to a decrease in audit quality
- Risk that the second auditor might conduct a superficial audit and just check the work done by the first auditor
- Risk of adding complexity and work for the audited entity, which must communicate with two auditors who may have different opinions.

The CCBE nevertheless believes that, despite such potential risks, nominating several auditors should be imposed on PIEs for true efficiency.

3. Networking

Networking is beneficial for the development of small and medium-size firms. However, further rules should help define such network.

The proposed Regulation which aims for every audit firm to declare in its annual report to which network it belongs is welcomed.

4. Rotation of audit firms

Commercial and accountancy legislation is so demanding concerning accounting issues and financial states that needs of advice in purely accounting will be larger from now on. It is expected that the new requirements in this area will oblige companies to assume new duties, for instance, a permanent revision state of the accountancy.

In this situation, not really far from now, the long-term relations of an audit company are dangerous, concerning the implication of captivity. This pleads for the convenience of a regulation about the

intervention of various audit firms into the accounts control of the same entity. Rotation is more needed than ever.

The rotation of audit firms is also an incentive to exhibit and promote small and medium-size audit firms.

The six-year period seems reasonable - auditors' mandates also last 6 years in France without it being an issue.

5. Internal Audit Committee

Paragraph 3 of Article 23(1), of the proposed Regulation reads as follows:

*'The audit committee or body performing equivalent functions **is allowed** to disclose the supplementary report to the governing, administrative or supervising body of the audited entity.'*

Such wording gives the feeling that internal audit committees are independent bodies. However, this is not the case - these committees report to the administrative or supervisory body from which they originate.

It is therefore proposed to amend the wording of Article 23 (1), paragraph 3, as follows:

*'The audit committee or body performing equivalent functions **must provide** the supplementary report to the governing, administrative or supervising body of the audited entity.'*

6. Strengthening of public control mechanisms of financial information

Transparency of information and better operation of markets are essential.

Considering the question of "relevant information", false statements have to be strongly pursued. In this sense, the creation of European authorities of supervision also seems an idea of relevant interest.

Finally, the CCBE also raised the point whether, for issues such as quality of audit certificates which are important for cross-border activities of companies, and for the various proposals to facilitate the cross-border activities of audit companies in the pursuit of their freedom of service, the sole appropriate instrument would be a directive instead of a regulation.