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8th December 2010

Green Paper: Audit Policy: Lessons from the Crisis

Dear Sirs

On behalf of BDO, we appreciate the opportunity to comment on the Commission's recently issued Green Paper entitled *Audit Policy: Lessons from the Crisis*.

BDO is the largest global audit and accounting network aside the four dominant networks and currently has member firms in 119 countries, including all Member States of the European Union. The origins of BDO are predominantly in Europe and over 40% of its member firms' aggregate turnover is generated in EU member states.

We commend the Commission for taking the initiative to produce this Green Paper and welcome its publication. We recognise our self-interest in this matter and have sought to approach the issues raised in the Green Paper in an open and positive manner, recognising the public interest responsibilities of the audit profession. We have consulted widely within the BDO network and with external stakeholders and we make our submission with a commitment to participate fully in the debate and embrace the changes that will inevitably ensue.

We note the number and size of other entities that will engage in this consultative process and highlight the comparatively limited capacity of BDO and smaller market participants to make representations to policy makers.

Question 1: Do you have general remarks on the approach and purposes of this Green Paper?

1.1 BDO welcomes the European Commission's Green Paper and is committed to making a positive and constructive contribution to the debate which this Paper initiates. We fully support public policies and other measures that will enhance the quality and relevance of audits, that reflect the needs of the end-user and that build market trust and confidence.

1.2 The launch of this debate is also evidence of the critical importance of auditing in a world where shareholders, regulators and other stakeholders are looking to have more confidence in markets with better transparency and greater integrity. This is what the audit profession provides and wishes to continue to provide in the modern business world.

1.3 We believe that it is necessary, desirable and inevitable that all aspects of audit policy be considered in the aftermath of the economic crisis and that the audit profession should play a constructive part in the ensuing debate. However, as the 8th Statutory Audit Directive has only recently been transposed by the last of the 27 Member States, we would like to see a further period during which the Directive is fully operational across the EU, followed by an assessment of how it has operated, before policy proposals are brought forward in areas covered by that Directive.

1.4 We support the Commission's view that any policy proposals made should be differentiated, calibrated and proportionate to the size and characteristics of the audited entity and, in some instances (e.g. regulatory oversight), to the size of the audit firm.

In this regard, we have assumed that the EU Directives' definition of companies' sizes are applicable and intended to delineate large, medium and small companies and thereby define what is meant by the SME sector.

1.5 We strongly urge that unnecessarily burdensome regulation is not introduced for SMEs. In particular we counsel against regulation being applied to all sizes of entities when it is intended to be directly responsive to the business and corporate governance failures of large financial institutions which contributed to the recent global financial crisis.

1.6 We particularly welcome the stated desire of the Commission to assume leadership of this debate at the international level. The audit profession, and its clients, is increasingly global and any proposed changes need to be considered on a global basis. Furthermore, the Commission needs to consider the effect on the audit profession within the EU of events that occur outside the EU. We particularly encourage the Commission to engage fully at an early stage with policy makers and relevant stakeholders in all G20 countries, particularly those in the United States, China and Japan, which are the largest G20 economies outside the European Union.

1.7 We believe that there needs to be a fundamental review of the nature of the audit model and note that this has not been addressed by the Green Paper. We comment further on this in our response below.

1.8 Europe is emerging from one of the worst economic and financial crises in modern history and it is clear that there are lessons to be learned by many, including auditors, from the many causes of the crisis. Whilst it is widely accepted that this was not a crisis caused by audit failure, the discussion and debate triggered by the Green Paper is a necessary part of ensuring the sustainability of the audit profession and assessing whether auditors could do more in the future and what that 'more' should be.

1.9 We also welcome the indication that the Commission is prepared to intervene in the market in which BDO and its competitors operate, particularly to address the issue of concentration. We have previously supported a market-based response but it is clear that this has not been effective and that some regulatory and/or Governmental action is now required.

Question 2: Do you believe that there is a need to better set out the societal role of the audit with regard to the veracity of financial statements?

2.1 The fundamental role of audit was established in a different era and was related to the introduction of limited liability companies etc. That role has evolved in many ways but we agree that there is a need to consider further the expectations of stakeholders in relation to any societal role that audit has and, to the extent practicable, address any expectation gap arising.

2.2 If audit is to have a societal role in relation to 'the veracity of financial statements', this needs to be carefully defined. It is arguable that this role should extend only to 'public interest entities' - whether listed or otherwise - in order not to increase the burden on other audited entities by imposing standards in excess of those necessary to meet the needs of the users of those particular financial statements.

2.3 We support the view that the audit model must evolve to better respond to the needs and expectations of the modern investor and a range of other stakeholders, including a societal role not previously articulated or defined. We agree that by becoming more responsive, the audit can continue to enhance trust and confidence in financial reporting across the European Union and globally. We believe that it would be desirable to see the development of a range of assurance models that respond to the needs of the full spectrum of users, rather than relying solely on the statutory audit for such assurance.

2.4 Any considerations around the role of audit and/or possible extension of that role must also consider the role of financial reporting. We believe that financial reporting has become overly complex and needs to be reviewed to be better based on the needs of users and other stakeholders. The role of audit must evolve in line with that debate.

2.5 In addition, we believe that there are substantial issues relating to the audit market structure, in particular the domination found at the very top-end of that market.

2.6 The debates on sustainability and corporate and social responsibility reporting are areas where we believe the profession can make a contribution. The provision of assurance by auditors on the management's assessment of the risk profile of a company, and on future-looking information provided by management, is also worthy of consideration as part of an extended mandate for the audit profession. Any such change needs to be part of an overall review of the role and responsibilities of the auditor.

2.7 This Green Paper is a unique opportunity for the profession, the Commission and others to work together to shape the future role of audit and the contribution it makes, as well as the regulatory framework that surrounds it. In this regard, we reiterate the importance of engaging with policy makers outside the European Union, including significant emerging economic powers such as China where the audit profession is relatively immature and where the policy makers are taking a different approach to the development of the audit profession, particularly with regard to the structure of the market.

Role of the Auditor

Question 3: Do you believe that the general level of "audit quality" could be further enhanced?

3.1 Efforts to enhance audit quality must be tireless, enduring and focused on continuous improvement. We believe that there has been significant improvement in audit quality in recent years. We also believe that the current level of audit quality is high and that audit continues to be valued by stakeholders.

3.2 It is not clear what is meant by 'the general level of audit quality' in the Green Paper. Recent reports from oversight bodies in various jurisdictions highlight the need for continuous efforts to raise audit quality, but until agreed metrics for defining and measuring 'audit quality' are developed and established, it will be difficult to assess progress in this area.

3.3 The evolution of robust independent oversight of audit firms in many jurisdictions, allied to continuous investment in quality monitoring systems by larger audit networks, has undoubtedly raised audit quality standards and will continue to do so.

3.4 We believe, however, that one cannot consider the issue of 'audit quality' without considering the nature of the financial reporting model. Business is now more complex and more global, and more information is available on a 'real time' basis than has previously been the case. Whilst the audit model has evolved, it is essentially still based on reporting on historical information which may no longer be relevant by the time it is published. We believe that there continues to be a role for historical information, but the pace of change in certain sectors often means that such information is not sufficient. The recent global financial crisis was triggered by the failure of a number of financial services companies in which significant change had taken place subsequent to the most recent audited financial information. We believe that there needs to be a radical review of the financial reporting model and the consequent nature and purpose of audit to ensure it remains relevant, and that any review of 'audit quality' needs to take this into account.

3.5 We also believe that there is a risk that 'audit quality' may be adversely affected by the pressure, in many countries, to reduce audit fees. We note that a number of regulators share this concern.

Question 4: Do you believe that audits should provide comfort on the financial health of companies? Are audits fit for such a purpose?

4.1 The role of auditors is, in the main, determined by statute and has remained largely unchanged in substance for a very long time. The existing audit model is not designed to provide comfort on the financial health of a company, aside from the requirement to evaluate the ability of the audited entity at a given point in time to continue as a going concern for the foreseeable future.

4.2 In this regard, the auditor's primary function is to report on the company's annual accounts and to express an opinion thereon. Additional requirements, such as reporting on the consistency of the directors' report or corporate governance statements accompanying those accounts, have become commonplace in many jurisdictions.

4.3 It should also be recognised that the complexity of financial reporting has made the financial statements of large companies very difficult to understand and interpret. In many cases, this complexity, when combined with information overload, has made financial statements a barrier to communication and to the provision of information on the underlying financial health of the company.

4.4 Accordingly, there needs to be a review of the nature and purpose of financial reporting and the additional assurance that can be provided by the auditor. Examples of information developed by the reporting entity on which auditors might be able to offer additional assurance include prospective information and greater commentary on the going concern aspects of the company's situation (the French Procedure d'Alerte could offer some possibilities in this regard).

Question 5: To bridge the expectation gap and in order to clarify the role of audits, should the audit methodology employed be better explained to users?

5.1 We support discussion about the role of the auditor and initiatives to enhance user understanding of the auditor's work. Given that previous attempts to bridge the expectation gap do not appear to have been successful, we encourage any initiatives, including giving financial statement users a better explanation of audit methodology, to address this issue.

5.2 We also believe that users of financial statements would benefit from enhanced understanding of the factors that promote audit quality. Furthermore, we believe that confidence in the role, scope and understanding of the limitations of audit could be enhanced by public reporting of the review of individual audit firms by regulators and oversight bodies. This reporting would need to be in a balanced and constructive format and comment on the positive aspects of audit rather than focus solely on matters requiring improvement.

5.3 Given the nature and complexity of business, we do not believe that it is appropriate to 'go back to basics', for example focusing strongly on substantive verification of the balance sheet. This issue is mentioned in the second paragraph of Section 2.1 of the Green Paper, although it is not the subject of a specific question in the Paper. As noted above, however, we do think there is merit in a fundamental review of the financial reporting model and, as a consequence, of the related audit model.

Question 6: Should "professional scepticism" be reinforced? How could this be achieved?

6.1 Professional scepticism is one of the key requirements of an audit. ISA 200 defines professional scepticism as "an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence". The auditor is required to consider the reliability of information and, in case of doubt or indications of possible fraud, to investigate further and to determine what additional audit procedures may be needed. BDO supports this risk-based approach.

6.2 Professional scepticism and what it constitutes suffers from its inherent subjectivity, but it is at the core of the training and professional approach of an auditor. In this regard, BDO has invested and will continue to invest considerable resources in personnel training and in its audit methodology. We welcome input from oversight authorities, based on their inspection experiences, on how to further reinforce such scepticism and best practices around its application.

Question 7: Should the negative perception attached to qualifications in audit reports be reconsidered? If so, how?

7.1 Because qualified audit reports deliver a strong message on the truth and fairness of a set of financial statements, they send an important message to the marketplace in relation to any particular set of audited financial statements. Inevitably this will create a negative perception, but this is the reality.

7.2 It may be possible to address the 'all or nothing' paradigm by requiring, for example, greater disclosure of key risks and uncertainties and key issues affecting the financial statements, e.g. disclosure of critical accounting policies. We believe that such disclosure should be made by the management of the audited entity or its audit committee and reported on by the auditor.

7.3 We would welcome discussion by all stakeholders on the usefulness and format of the auditor's report, including the desirability of moving away from prescribed 'boilerplate' language towards more comprehensive reports. The format of such reports in Germany may provide a useful starting point for such a discussion.

Question 8: What additional information should be provided to external stakeholders and how?

8.1 We would welcome discussions with external shareholders about what additional information they wish to see provided, including the examples suggested on page 8 of the Green Paper. Other possible additional information could include the provision of information on the key risks and uncertainties faced by the entity, including a comprehensive description of the company's risk management system indicating how such risks have been mitigated.

8.2 As a result of such discussions it would be possible to comment further on how such information should be provided and what the auditor's role might be in relation to providing assurance on it.

8.3 In general, the responsibility for additional information provided to external stakeholders should rest with company management/directors. Auditors should be required to provide assurance on these disclosures based on the needs of stakeholders.

Question 9: Is there adequate and regular dialogue between the external auditors, internal auditors and the Audit Committee? If not, how can this communication be improved?

9.1 The practices in this regard vary between countries and between companies. In general, we welcome enhanced and more regular dialogue between external auditors, internal auditors and audit committees.

9.2 In our experience, audit committees would benefit from having greater guidance on their roles and responsibilities. We believe that the Commission and national regulators should issue guidance to audit committees with the intention of raising the level of their contribution and indicating a common approach and purpose to such committees or their equivalent across the European Union.

9.3 In particular, we would like to see guidance issued to audit committees highlighting the importance of supporting and raising audit quality, rather than focusing on reducing audit fees. Recent comment from regulators in Canada, Australia and the UK, amongst others, has drawn attention to this concern.

Question 10: Do you think auditors should play a role in ensuring the reliability of the information companies are reporting in the field of CSR?

10.1 Yes. Where information categorised as falling under *Corporate Social Responsibility* is included in the financial statements, it should fall within the scope of the audit of those financial statements. Where such information is provided by management separate from the financial statements, then some form of assurance from auditors may be appropriate if the investor community would find this of value. The scope of that assurance and the nature of the report will need to be carefully considered.

10.2 The recently formed *International Integrated Reporting Committee* (IIRC) is currently seeking to create a globally accepted framework for accounting for sustainability. This framework should bring together financial, environmental, social and governance information in a clear, concise, consistent and comparable format. Any role for auditors in relation to this framework should be considered by reference to the needs and wishes of users.

Question 11: Should there be more regular communication by the auditor to stakeholders? Also, should the time gap between the year end and the date of the audit opinion be reduced?

11.1 We would support a comprehensive assessment of the nature of auditor communication with all stakeholders. This debate should take place in the wider context of the future role of audit but should recognise that the primary responsibility for communication with stakeholders rests with the management of a company. The auditors' communications should be part of the wider corporate governance framework.

11.2 The timing of the issue of auditors' opinions is in general driven by the deadlines for corporate reporting imposed by securities markets, or other regulations. Given the complexity of financial reporting, any proposed changes to the deadline requirements should be subject to extensive consultation and give due consideration to the additional burden that this would place on the companies, and others affected, and the resulting effect on the quality and reliability of financial information.

Question 12: What other measures could be envisaged to enhance the value of audits?

12.1 The value of the audit is determined to a significant extent by the relevance of the reporting model. The reporting model is of critical importance to modern business and is fundamental to providing transparency, understanding of business and confidence in investment.

12.2 Financial reporting has become extremely complex and aspects of it require a greater number of judgements concerning estimates of fair value. The expectation gap between the perceived and actual responsibilities of auditors has arguably widened, as auditors offer assurance on information that is inherently imprecise.

12.3 Creating an integrated reporting and assurance model could offer opportunities for audit to add value by offering assurance on areas such as climate change impact, reporting on specific disclosures around a company's business model, key performance indicators of the business and risk information provided by the company. Any changes would have to include an assessment of the capabilities of auditors, and others, to provide this assurance and the cost effectiveness of doing so. Expanding the scope of audit will also reopen the debate on the need for change in the various liability regimes.

12.4 Improved communication both about the company's financial reporting judgements and related matters, as well as the audit process and reporting could be helpful to users and also add value to the audit.

12.5 Additional information about the risks faced by the company and the judgements made by its management in preparing the financial statements could be made in an enhanced audit committee or directors' report and the audit report could offer some form of assurance on this.

12.6 The scope of audit might also be expanded to address aspects of risks and controls in corporate governance and the narrative reporting which typically accompanies the audited financial statements in most annual reports.

International Standards on Auditing (ISAs)

Question 13: What are your views on the introduction of ISAs in the EU?

13.1 We support the adoption of ISAs for all statutory audits in the EU and believe that the IAASB, in promulgating the standards, has taken cognisance of the unique characteristics of small and medium entities through its inclusion of guidance on how specific requirements can be applied in their circumstances.

13.2 As principles-based standards, ISAs allow for the audit to be scaled appropriately for both small and large entities through the exercise of professional judgement by the auditor.

13.3 We believe that a single set of global auditing standards is essential to providing investors and lenders with consistently high quality assurance when contemplating investing or making lending decisions across capital markets.

13.4 The responses to the Commission's own Consultation in this area indicate that there is broad international acceptance of ISAs by regulators, national auditing standard setters, and the audit profession both globally and for use in individual jurisdictions around the world.

ISAs are already accepted for audits of listed entities by many of the world's capital markets and enjoy widespread acceptance as the appropriate standards for private sector medium and large company audits.

Question 14: Should ISAs be made legally binding throughout the EU? If so, should a similar endorsement approach be chosen to the one existing for the endorsement of International Financial reporting Standards (IFRS)? Alternatively, and given the current widespread use of ISAs in the EU, should the use of ISAs be further encouraged through non-binding legal instruments (Recommendation, Code of Conduct)?

14.1 Yes. We believe that ISAs should be made legally binding for statutory audits throughout the European Union.

14.2 We accept that there is a need for an endorsement process for ISAs as they are set by a private sector body, albeit with considerable public interest oversight, including by the Commission through its membership of the PIOB.

14.3 The endorsement process selected should recognise differences between ISAs and 'IFRS' set by the International Accounting Standards Board ('IASB'). Whilst the application of both sets of standards helps to strengthen investor confidence in the EU capital markets, the application of ISAs has a narrower focus as they contain basic principles and essential procedures to be performed by *statutory auditors* in fulfilling an audit mandate.

Accordingly, we would favour a streamlined endorsement process for ISAs incorporating a 'block adoption' of Clarified ISAs and all revised/new standards, the permitting of add-ons at national level, provided they are fully disclosed, and the prohibition of all carve outs.

14.4 We believe that a legally binding instrument should be used to ensure that the standards applied to all statutory audits are consistent across the EU and there is minimal scope for non-implementation or variation in individual Member States. To rely on a Code of Conduct, a Recommendation or other 'soft instrument' is to leave the door open to Member States to delay implementation of all or individual ISAs, or to vary them to such an extent that the benefits of a homogenous set of standards are lost.

Question 15: Should ISAs be further adapted to meet the needs of SMEs and SMPs?

15.1 We believe that adoption of ISAs for all statutory audits across the EU will improve the quality and consistency of audit without a disproportionate cost for the SME/SMP sector. We have noted concerns about the cost impact on SMEs of being required to have a statutory audit under ISAs, but observe that the Member States already have the possibility to vary the thresholds at which such audits become mandatory. Member State governments are able to adapt the threshold as appropriate to exclude or include the SME constituency as best benefits the circumstances in that country.

15.2 As ISAs are scalable depending on the size of the entity being audited, the amount of audit work required will be in proportion to the size of the company being audited. The IAASB has issued significant guidance in this regard seeking to reiterate the scalability of these standards.

15.3 BDO has successfully applied ISAs to company audits of all sizes in its audit methodology.

Governance and Independence of Audit Firms

Question 16: Is there a conflict in the auditor being appointed and remunerated by the audited entity? What alternative arrangements would you recommend in this context?

16.1 We believe that there are significant safeguards in place, particularly in public interest entities, to safeguard against any threats to independence that might be perceived to arise from the auditor being appointed and remunerated by the audited entity.

16.2 Statutory auditors are generally appointed by the general meeting of shareholders of the audited entity. The statutory auditor reports to the general meeting of shareholders and is remunerated by the audited entity on behalf of the shareholders, as the company's owners

16.3 In the case of public interest entities, the board proposal to the shareholders to appoint an auditor is invariably based upon a recommendation by the audit committee. The role and composition of the audit committee serves to safeguard against potential conflicts of interest which the statutory auditor may have in its interactions with management.

16.4 We support greater involvement of shareholders in the appointment of auditors, possibly through an expanded audit committee that includes independent non-executive directors and possibly additional representatives of shareholders. As mentioned elsewhere in this submission, we would also support the issue of more extensive guidance to audit committees, setting out their role and responsibilities particularly in enhancing audit quality.

16.5 Given the involvement of the audit committee (possibly enhanced by specific involvement of shareholders in the appointment process, as suggested above), we believe that the final decision to appoint an auditor should remain with the general meeting of shareholders, as owners of the company and as primary users of the audited financial statements.

16.6 The appointment of the auditor in some countries by a Supervisory Board made up entirely of non-executive directors, is also worthy of consideration. Germany and the Netherlands are two notable examples. The Supervisory Board's role in such instances should not be a mere confirmation of a management selection but involve all aspects of auditor appointment, including selection for tender, fee negotiation, final appointment and signing of the engagement letter

Question 17: Would the appointment by a third party be justified in certain cases?

17.1 As noted above, we believe that the current arrangements for the appointment of auditors are appropriate and that auditors should in general be appointed by the audited entity with input from shareholders. We would be concerned that if auditors were to be appointed by a third party, this may have a fundamental effect on the relationship between the auditor and the audited entity. This could in turn affect audit quality, as the

effectiveness of an audit is affected by the nature of the relationship between the auditor and the audited entity.

17.2 However, we recognise that there may be public interest reasons to justify the third party appointment of auditors to certain large companies, for example those companies in the financial services sector deemed to be of systemic importance. We would, however, urge that any such third party appointments be the rare exception and not extended to all audit appointments.

17.3 There may also be a case for regulatory enquiry in connection with auditor appointments to public interest entities where there has been a significant reduction in the audit fee without apparent good business cause or other obvious explanation.

Question 18: Should the continuous engagement of audit firms be limited in time? If so, what should be the maximum length of an audit firm engagement?

18.1 For public interest entities, the appointment and re-appointment of an auditor is approved by the shareholders at the Annual General Meeting, based upon a recommendation by the audit committee. As the auditor's primary duty and reporting obligation is to the shareholders, fundamentally we believe that it should be for the shareholders to decide whether they wish to reappoint a firm of auditors or not.

18.2 The experience of BDO (and others) in Italy, where mandatory rotation of audit firms due to the expiry of a fixed mandate period is a long-established principle, is that such practice has resulted in a more pronounced concentration in the audit market, to the detriment of firms outside the largest four firms.

18.3 The original intention of this practice was focused on ensuring auditor independence, but since the Italian law was enacted there have been many other developments which better serve to safeguard an audit firm's independence from its client. These include the EU Statutory Audit Directive, the IESBA Code of Ethics which recommends partner rotation, the arrival of independent oversight of the profession and the application of heightened corporate governance practices across Europe. We believe that mandatory partner rotation as set out in the above code along with these other developments, provides adequate independence safeguards

18.4 Accordingly, we are unable to support proposals to limit the duration of an audit mandate to a maximum period of time.

18.5 Studies by Bocconi University in Italy have identified increased concentration and other disadvantages arising from mandatory rotation which we are aware are known to the Commission. As indicated above, the experience of BDO in Italy has been that mandatory firm rotation has, over time, resulted in increased concentration in the audit market for larger companies/public interest entities.

18.6 We would note also that we do not support mandatory retendering as we believe that the decision to put the audit out to tender should be at the discretion of the shareholders, working through the audit committee.

18.7 However, we support the issue of guidance by regulators recommending, on a 'comply or explain' basis, the periodic placement of the audit for tender by public interest entities. This would help to avoid the situation, found in certain countries, where the audit of large listed entities rarely go out to tender and where it is thus difficult to classify such audit markets as competitive. Companies should be free to decide whether, and how often, they wish to put their audit out for tender but, as a matter of good corporate governance, they should be required to explain why the board/audit committee feels that it continues to be appropriate not to put the audit out to tender. Such mandatory disclosure should be confined to public interest entities.

Question 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?

19.1 In principle, BDO believes that a multi-disciplinary practice providing a variety of audit and non-audit services (subject to appropriate independence rules) to a variety of clients offers an environment where a sustainable audit profession can attract the best talent. In this way a firm can offer clients the range of services they require and at the same time ensure the long-term enhancement of audit quality. We do not support any proposal to move towards a situation of 'audit-only' firms, which we believe would damage the sustainability of the profession.

19.2 The ability to provide non-audit services to both audit and non-audit clients in a multi-disciplinary firm environment offers a number of advantages, such as:

- a) A range and depth of skills that enhances the quality and efficiency of both audit and non-audit services and better meets the needs of clients.
- b) Auditor objectivity not being compromised by providing 'non-audit' services to audit clients, provided that auditors comply with the strict independence standards applied.
- c) The ability to develop and supply multi-disciplinary skills which encourage the recruitment and retention of high quality professionals. These are essential for the future attractiveness and viability of the profession and the quality of practitioners
- d) Mid-tier audit firms being able to develop their brand recognition and exposure to the largest listed entities by initially supplying non-audit services to these companies. This could lead to an increased possibility of such firms eventually being able to supply audit services to such companies. Prohibiting auditors from providing any non-audit services (i.e. requiring such firms to be audit-only firms) would eliminate this possibility.

19.3 We do not believe that there is any necessity or public interest imperative to further restrict the possibility of non-audit services being provided to private audit clients. In the absence of any identifiable failure of independence rules in this segment of the market, we do not see this as a necessary or proportionate policy proposal.

19.4 We believe that any additional restrictions deemed necessary should be universally applied to all audit firms and not directed at any group or tier of audit firms. We would also call for the application of the same independence rules across the 27 Member States of the EU in order to avoid unnecessarily complex rules. This would also be more conducive to supporting the Single Market aspirations of the Commission as alluded to in this Green Paper, but also in the *Europe 2020 strategy* and the recent Monti Report to President Barroso, *A New Strategy for the Single Market*.

19.5 In the case of large public interest entities, our experience is that companies often select a firm other than the incumbent auditor to provide non-audit services in order to avoid any independence considerations or extended dialogue with audit committees. As audit committees have an important role to play in this regard, we believe that they should be allowed to do so until empirical evidence suggests that they are failing to fulfil this role.

19.6 In many situations, the incumbent auditor is best positioned to provide certain additional services to a company because of its knowledge of systems and the company's business. Some of these services can contain an assurance element which can fall to be disclosed in financial statements as 'non-audit services' but which are, in practice, part of an auditor's role.

If there were to be greater transparency around such 'non-audit services' provided by the incumbent auditor, it could eliminate confusion and unnecessary disquiet around the provision of such services when these are best provided by the auditor.

19.7 Whilst we support the general concept set out above we recognise that there may be a public interest in having stricter rules in the case of systemic financial institutions in order to enhance general confidence in the audit of such companies. Accordingly, we would support a review of the position in respect of 'systemic companies' as part of a comprehensive set of measures addressing this segment of the market. We also note that the complete prohibition on the provision of non-audit services to a 'systemic company' could make it easier for a wider range of firms to provide non-audit services to this market, thereby potentially increasing the scope of such firms to provide audit services to this sector of the market ultimately.

19.8 We also note it is important to ensure that audit services remain a significant part of the overall service provision of any firm in order to ensure there is an appropriate 'tone at the top'. It is vital that the pursuit of profit, which may be the primary motive for certain non-audit services, does not override the importance of audit quality.

Question 20: Should the maximum level of fees an audit firm can receive from a single client be regulated?

20.1 An audit firm should not be permitted to be over-reliant on a single client in order to protect its independence. Ethical standards have long recognised this but also allowed for transitional maximum levels of fees from individual clients in the case of newly established audit firms.

20.2 We support limits on the maximum level of fees that an audit firm can receive from any one audit client and related entities compared to the total of fees it receives from all clients. The new IESBA Code of Ethics provides that for *public interest entity* audit clients, if the total fees from one client and its related entities exceed 15% of the total fees of the audit firm for two consecutive years, then a special review of the second year's audit is needed. Given the continued perceived conflict of interest resulting from excessive reliance on a single client, there may be a strong argument for lowering this threshold.

20.3 Before introducing such an independence restriction, policy makers should take cognisance of the possible disproportionate impact of such a provision on the development of small and medium sized audit firms.

20.4 It is important that any such restrictions relate to the total fees, and not just the audit fees, received from any one client.

Question 21: Should new rules be introduced regarding the transparency of the financial statements of audit firms?

21.1 Within the European Union, audit firms with PIE audit clients comply with the requirement to prepare Transparency Reports under Article 40 of the Statutory Audit Directive. In many Member States audit firms have now prepared Transparency Reports for two consecutive years, providing the information sought by the transposed Article 40 or, in some cases, additional information where the local law so requires.

21.2 We would propose an assessment of how the Directive has operated in this regard before consideration is given to introducing new transparency rules.

21.3 At a global level, in common with many other networks, BDO has produced a Transparency Report within its Annual Statement, inspired by the principles of Article 40.

21.4 Functioning independent audit oversight bodies now exist in almost all EU jurisdictions. BDO firms wholly support being fully transparent to those bodies and already provide copious data to them. Financial and litigation risk information that is important to assess the stability and sustainability of an audit firm are already available for inspection by regulators.

21.5 Many audit firms in Europe prepare audited financial statements because of their legal form, e.g. LLP or LLC/LTD. Such financial statements are subjected to external audit and published in accordance with the legal requirements for such legal entities. In the case of the audit networks, however, these are invariably not legal entities as such. Preparing some form of combined meaningful financial statements for a network would be difficult, if not impossible, due to the different accounting principles applying in each constituent member firm, as well as the varying legal forms and financial year ends its independent members adopt. We are also concerned that it might give a misleading impression as it may suggest that a legal group exists. Most large networks, including BDO, voluntarily prepare aggregated global financial summaries of revenues.

Question 22: What further measures could be envisaged in the governance of audit firms to enhance the independence of auditors?

22.1 The requirement for larger audit firms to appoint Independent Non-Executives (“INE”), as found in the recent UK Audit Firm Governance Code, is an interesting one.

BDO was the first firm in the UK to appoint such INEs, having made these appointments before the Code was developed. We believe that they have a positive influence on the governance of audit firms and enhance perceptions of auditor independence. However, given the different legal structures in Member States, there would need to be some flexibility as to how this might be applied across the EU.

22.2 Other aspects of the UK Code, and of the situation in Germany and the Netherlands, with their non-executive Supervisory Boards, could have wider application across the EU and should be explored.

Question 23: Should alternative structures be explored to allow audit firms to raise capital from external sources?

23.1 BDO has, in its previous submission to the Commission on its study of ownership structures in audit firms, indicated its openness to the possibility that audit firms could select appropriate structures to raise capital or better facilitate the operation of the practice.

23.2 We continue to support this liberalisation of ownership rules and related structures although we recognise that any changes will need to address independence and possible conflict of interest issues. Thus we believe in principle that audit firms should be free to choose the optimal financing structure to support their business.

23.3 However, given concerns over liability and the current returns available to all other than the dominant four firms in the market, we do not believe that liberalisation of the ownership rules would provide significant additional funding, nor result in any appreciable improvement in the concentration found at the large company end of the audit market, nor facilitate the arrival of any significant ‘new players’ in the listed company audit market.

Arguably, any available capital would flow to the currently dominant audit firms thus exacerbating the concentration issue.

23.4 We note that BDO firms have not articulated any need for external capital nor expressed a belief that having access to additional capital would accelerate growth or better enable them to compete with the four dominant firms.

Question 24: Do you support the suggestions regarding Group Auditors? Do you have any further ideas on the matter?

24.1 We fully support measures that enable the unhindered application of ISA 600 in relation to the role of group auditors, including the elimination of local legal or other impediments.

24.2 We recognise the practical and legal difficulties involved in transmitting auditors' files to certain other countries but believe that these can be addressed over time.

Supervision

Question 25: Which measures should be envisaged to improve further the integration and cooperation on audit firm supervision at EU level?

25.1 We support the need for the continued existence of effective national auditor oversight bodies working in close collaboration with each other and operating to harmonised standards, but they alone may not be an adequate oversight mechanism in today's globalised world where companies, and increasingly audit firms, operate internationally.

25.2 We suggest therefore that the European Union consider establishing a well-resourced, pan-European body to promote harmonisation and cooperation among the national auditor oversight bodies in member states and enable the EU to engage on an equal footing with its non-EU counterparts.

25.3 The Commission-convened European Group of Auditor Oversight Bodies (EAOB) could also play a valuable role in coordinating the supervision of audit firms at EU level, given that it is already a functioning group with representatives from all existing national regulators.

25.4 The Commission (or new authority or EAOB) should ensure that formal and regular contacts are also maintained with IFIAR and its constituent members, in order to maintain awareness of developments in the area of audit supervision outside Europe.

25.5 Any pan-European auditor oversight authority could also be tasked with developing standards and principles of effective oversight, including in the areas of effective composition of oversight boards and inspection teams, resources, market coverage and focus (e.g. auditors of PIEs or all registered auditors). We note the existence of the IOSCO Principles for Auditor Oversight and recent efforts by IFIAR to develop principles in this area.

Question 26: How could increased consultation and communication between the auditor of large listed companies and the regulator be achieved?

26.1 We agree with the Commission observation that there is a need to reinforce the dialogue between regulators of large listed entities, particularly financial institutions, and auditors. We would add that extending the requirement for such dialogue to all listed companies and their regulators may also be desirable.

26.2 We agree that this dialogue should be a two way process so that supervisors also alert auditors regarding particular areas of concern or information available to them and assist in the direction of the audit in that regard. Trilateral discussions between the regulator, the company and the auditor would be helpful in certain circumstances, as would periodic gatherings of all of these parties with respect to a particular sector. Scheduling of quarterly meetings, flash reports and agreed lines of communication between the auditors and regulators should be incorporated into any such consultative process.

26.3 Through dialogue between audit firms and regulators, it should be possible to promote greater consistency in practice in this area across the European Union. Revival of the disbanded *Committee on Auditing* could offer a mechanism for regulators generally to engage with the audit profession in a constructive manner.

26.4 The protocols developed for non-financial entities should, where relevant, mirror those set for banks and other financial institutions.

Concentration and Market Structure

Question 27: Could the current configuration of the audit market present a systemic risk?

27.1 We believe that the current configuration of the audit market is unhealthy. More choice in the market for the audit of the largest companies is necessary and its absence could prove to be a financial stability concern. Should one of the four dominant audit networks leave the market for any reason, e.g. due to catastrophic litigation, there is a real likelihood of severe disruption in the audit and capital markets resulting in some of the largest companies being unable to find a suitable auditor in the short term, with a consequent adverse effect on the capital markets. In a situation where one of the four largest networks left the market, it is likely that the effect would be greater than previous mergers or withdrawals from the market.

27.2 Previous studies on market concentration, notably by the US General Accounting Office and Oxera, suggest that the marketplace is already too concentrated and it is generally accepted by everyone, including the four dominant firms, that the withdrawal of one of these dominant firms would create significant issues. Thus, whilst we would not regard any audit firm as systemic in the generally accepted sense of the word and as one might regard a large financial institution, we do believe that any of the four dominant firms is potentially 'too big to fail'.

27.3 In these circumstances there is a significant concern over 'moral hazard'/'regulatory capture' as it would be difficult, if not impossible, to take action against a dominant firm for a poor quality audit if the consequences might be the collapse of that firm or its withdrawal from the audit market.

27.4 Accordingly we believe that it is vital that action is taken to reduce the dominant position of the largest four firms and to create a situation where no firm is too large to fail. If this cannot be achieved then it will be necessary to regulate the dominant firms in the marketplace more tightly. This would profoundly affect the nature of the audit profession. The four highly regulated firms could find it more difficult to continue to attract high quality people into a more highly regulated environment. Other firms could also be disadvantaged as they would be regarded as less significant than the regulated, dominant firms and this would also affect their ability to recruit high quality people. This would create a significant risk to audit quality. We believe that every effort should be made, by all market participants (including the four dominant firms), to avoid such a situation.

Question 28: Do you believe that the mandatory formation of an audit firm consortium with the inclusion of at least one smaller, non systemic audit firm could act as a catalyst for dynamising the audit market and allowing small and medium-sized firms to participate more substantially in the segment of larger audits?

28.1 As the Commission indicates in section 5 of the Green Paper, being an auditor of large listed companies seems to create a reputational endorsement which up to now has largely benefitted the four largest networks. This dominance is continually reinforced by an inappropriate market perception that firm size always directly correlates to higher quality.

28.2 Regulatory intervention mandating 'audit firm consortia', joint audits or similar arrangements should increase the likelihood of firms outside the four dominant firms, being able to participate more fully in the audit of large listed companies and of public interest entities in general. This would take some time to achieve and would depend on the nature of the arrangements.

28.3 We are concerned that a proposal based on a consortium that includes 'a smaller non-systemic firm' would result in permanent 'second-class' status being conferred on the firm occupying that role. In many countries, BDO Member Firms and other non-dominant audit firms are capable of handling all but the largest audits in their own right and would not want to be denied the possibility to be the primary auditor. Indeed, an arrangement on this basis would impose a ceiling on the ambitions of these firms that would be even more invidious than the current institutional prejudice and would permanently secure the dominance of the four largest firms.

28.4 However, we believe that joint audits, based on the model currently used in France, might be an appropriate arrangement. It is important that any such proposal is carefully considered and is designed in such a way as to ensure the full and active participation of both firms in the joint audit. If joint audits are to be introduced on a wider basis, we believe they

should require that the total audit fees are shared equally between both audit firms. We appreciate this may be difficult to achieve when such a proposal is initially introduced and suggest that it might be appropriate to permit a period of time over which this equal sharing of fees is achieved. However, we believe that *ab initio* the minimum share of the fees should be at least 25%.

28.5 We believe that, over a period of time, the introduction of joint audits on this basis could facilitate the recognition that additional firms are capable of auditing the largest companies. This should also reduce the risk of the failure or withdrawal from the audit market of one of the four dominant firms.

28.6 We understand that it has been suggested that joint audits have not reduced concentration in the audit market in France. We agree that it appears that concentration has increased in the large listed company segment of the market in France, but this reflects the acquisition by certain of the four dominant firms of other audit firms that were actively involved in this market. Arguably this demonstrates the ability of such firms to carry out these audits as otherwise the dominant firms would have had no reason to acquire these other firms.

28.7 Non-dominant audit firms provide non-audit services to some of the largest listed companies in EU Member States where they are currently unable to secure the statutory audits of such companies. It is important to ensure that the introduction of joint audits does not impede the ability of such firms to continue to secure non-audit work from these companies. This should not be an issue unless significant changes are made to regulations regarding the supply of non-audit services to audit clients.

Question 29: From the viewpoint of enhancing the structure of audit markets, do you agree to mandatory rotation and tendering after a fixed period? What should be the length of such a period?

29.1 As stated in our answer to Question 18, we do not support mandatory audit firm rotation as an instrument to promote greater audit firm choice.

29.2 The study carried out by Bocconi University in Italy offers the most relevant and comprehensive research in this area and it clearly indicates that mandatory firm rotation (as opposed to partner rotation favoured under the IESBA Code of Ethics), has many disadvantages. The Bocconi University study demonstrated that the Italian listed company audit market is one of the most concentrated markets in the European Union and they also concluded that this was a direct result of mandatory audit firm rotation. The study revealed that, on average, audits tended to either switch between the largest auditors or switched from a smaller auditor to a larger auditor but rarely the other way around. This reflects the experience of BDO in Italy and in other jurisdictions where there is or has been, mandatory rotation.

29.3 As explained in our answers to Question 18, we do not support mandatory retendering as a policy tool to encourage greater competition because, in our experience and opinion, it suffers from many of the same disadvantages as mandatory rotation.

29.4 However, again as explained above, we support the issue of guidance by regulators recommending, on a 'comply or explain' basis, the periodic placement of the audit for tender by public interest entities. Companies should be free to decide whether, and how often, they wish to put their audit out for tender but, as a matter of good corporate governance, should explain why the board/audit committee feel that it continues to be appropriate not to put the audit out to tender. Such mandatory disclosure should be confined to public interest entities. We believe that this could assist, combined with other measures, in helping to change the unhealthy structure of the market.

Question 30: How should the "Big Four bias" be addressed?

30.1 There is no panacea for addressing the 'Big Four' bias. This bias has evolved over time and been fuelled by a variety of factors including a flawed belief that 'big is better'. In addition, the impact of a significant 'Big Four' alumni network, many of whom are in positions of influence on audit committees and in corporate management, together with a sense that 'no one was ever fired for buying IBM', should not be underestimated.

30.2 Regulators should do more to acknowledge the quality of non-'Big 4' firms, thus countering the bias that has evolved. They could also actively encourage PIEs and large private sector companies to appoint qualified non-'Big 4' firms and include them in their tenders.

30.3 Public procurement policies should set the tone for private sector audit appointments and actively seek to establish a more competitive landscape by weighting the procurement rules towards qualified non-'Big 4' firms with the necessary skills and expertise. Public procurement has been used extensively to drive innovation in other areas both within Europe and beyond, and with the total public procurement market of €2 trillion in the EU also dominated by a number of the 'Big 4' firms, there is scope for the Commission itself to drive change in this regard through more enlightened EU procurement practices. We have seen statistics which suggest that the European Commission awards over 70% of its procurement contracts to 'Big 4' firms.

30.4 Using public procurement practices to foster a more competitive marketplace would also send a message to the corporate community that non-'Big 4' audit firms are capable and have the dedication to quality to carry out complex assignments to a high-quality level.

Furthermore, such positive discrimination would also justify the investment necessary by non-'Big 4' firms to recruit further appropriate expertise and invest in methodologies, systems and training. Such investments are difficult to justify when endeavouring to secure audits in the large company market that is so dominated by the 'Big 4' firms.

30.5 The invidious practice of restrictive clauses requiring the use of a 'Big 4' audit firm, as found in lending covenants of financial institutions and in some elements of the public sector, should be outlawed as they reinforce the perception among borrowers that the lenders are aware of qualitative advantages in appointing 'Big 4' auditors. They reflect and perpetuate concentration without regard to the quality or expertise of other audit firms and represent an unacceptable third-party intervention in the appointment of the statutory auditor. The prohibition of the written clauses themselves would be an excellent starting point in the elimination of the behavioural bias underlying the practice, but verbal imposition of these requirements, however expressed, should also be prohibited.

We have found these clauses evident in at least 15 countries across the European Union and neighbouring countries, although documentary examples are difficult to secure for obvious reasons. BDO firms have lost audit clients in various jurisdictions who were forced by lenders to switch to 'Big 4' auditors when seeking enhanced borrowing facilities. Our firms have also failed to win prospective clients due to express or implicit application of such bias by lenders, despite the borrowers expressing their preference to appoint BDO.

30.6 BDO has always favoured market redress of the concentration phenomenon and participated actively in the UK Market Participants Group and its deliberations in 2007.

Regrettably, the market has been unable for various reasons, including inertia and the pervasive influence of the largest four firms, either to reduce the concentration found or increase the choice of auditors available to the largest companies, particularly listed companies. We believe therefore that some form of intervention is now required. As explained in our answer to Question 27, we are concerned that in the absence of intervention, and a resultant reduction in concentration, it will be necessary to regulate the dominant firms in the marketplace more tightly. This would adversely affect the nature of the audit profession.

We have indicated possible areas of intervention in our various comments above, including:

- a) The outlawing of all artificial intervention by third parties, e.g. lenders, in the appointment of statutory auditors through restrictive clauses or lending processes which discriminate in favour of borrowers appointing particular audit firms or members of a particular group of audit firms. The 2010 OECD report on Competition and Regulation in the Auditing and Related Professions is particularly insightful in this regard and comments on the distortive effect of such clauses and practices
- b) The establishment of mechanisms to facilitate the involvement of shareholders in the appointment of auditors. The publication of guidance to audit committees on the need to be objective in the appointment of auditors and, specifically, to make it clear that active consideration should be given to appointing a non-'Big 4' auditor. Such guidance could also set out qualitative factors which the audit committee should consider when contemplating an auditor appointment.
- c) The possible introduction of joint audits with suitable regulations to ensure these are designed in such a way to ensure the full and active participation of both firms in the joint audit.

30.7 It might also be appropriate to consider the licensing of audit firms by a regulatory body to audit particular types of entity, particularly PIE and large corporates including 'systemic' entities. We note that the Chinese Ministry of Finance are proposing such an approach as part of their efforts to ensure that there are a significant number of firms that can effectively compete with the 'Big 4'. It is important that any such licensing arrangement is carefully considered as in certain cases where the licensing standards were inappropriate, it appears to have reinforced concentration.

Question 31: Do you agree that contingency plans, including living wills, could be key in addressing systemic risks and the risks of firm failure?

31.1 We would agree that some form of contingency planning is necessary to address the consequences of a possible failure of an audit firm or the failure by a systemically important company to secure an auditor. In this regard, it will be necessary for the Commission to define 'systemic risks' and 'systemic audit firm'.

31.2 The biggest risk to the survival of an audit firm or to an audit network is catastrophic circumstances (e.g. litigation) which irreparably damage its reputation with resultant loss of clients and staff. We do not believe that a living will would address this.

31.3 We would oppose any contingency plans that protected a 'systemic audit firm', presumably one or more of the dominant four firms, whilst allowing a 'non-systemic audit firm' to collapse. This would present an even greater moral hazard than the current situation.

31.4 We believe that in the medium term, the best protection against the risks presented by an unhealthy concentration in the market is to de-concentrate it by facilitating the introduction of additional players. This will also introduce greater price competition and innovation and reduce the current significant risks to the capital markets should an audit firm leave the marketplace.

It is important to be realistic about the number of additional firms that could ultimately participate in the audit market for large PIEs, and the time it will take to achieve the necessary change. Nevertheless, it is important that this matter remains under scrutiny for the foreseeable future and that remedial policies are brought forward by policy makers.

Question 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?

32.1 We do not share the view that the consolidation of the large audit firms over recent decades was necessary for the purposes of synergies, nor for providing a global service offering. We believe that, at least in recent years, the consolidation of the largest audit firms was primarily driven by the desire of those firms to achieve greater profitability and not necessarily driven by the needs of their clients. We note that in many cases the largest mergers were prompted by concerns over the level of claims against firms and a need to 'catch up' with the size of their competitors.

32.2 Notwithstanding the above, we do not think that a reversal or break up of the largest networks is practical and even if achievable, might lead to unintended negative consequences on the functioning of the audit market and temporarily on audit quality.

32.3 However, we do think that the Commission should consider how best to prevent the 'Big 4' from becoming even larger by acquiring member firms from the largest non-'Big 4' networks, including in countries outside the EU. We continue to see, in many countries, the smaller of the 'Big 4' firms in those countries seeking to acquire the larger non-'Big 4' audit firm in that country. We have commented above on the concentration in France arising from the acquisition of three significant non-'Big 4' firms by the four dominant firms. We also note the very recent acquisition in Brazil of the Grant Thornton firm (which was the largest non-'Big 4' firm) by one of the 'Big 4' firms. We suspect that such an acquisition would not have been permitted in many other countries. It is important that non-'Big 4' networks are able to develop and grow their businesses in emerging as well as other countries if they are to be able to provide greater choice in the audit market. We would urge the Commission to engage with regulators and competition authorities in G20 and significant emerging economies to take appropriate measures to prevent the 'Big 4' firms taking advantage of their dominant market position at the expense of other market participants.

Creation of a European Market

Question 33: What in your view is the best manner to enhance cross border mobility of audit professionals?

33.1 There has not been as much mobility of audit professionals as is desirable in the single market, possibly due inter alia to language issues, differing legislation and restrictions on ownership of audit firms.

33.2 Greater alignment of training syllabuses and adoption of uniform international standards in the areas of international accounting standards, international standards on auditing, as well as educational and ethical standards, would help.

33.3 Finally, greater harmonisation of tax and legal codes would also encourage greater mobility, as would progress on pension and social insurance cohesion for migrant/mobile workers.

Question 34: Do you agree with "maximum harmonisation" combined with a single European passport for auditors and audit firms? Do you believe this should also apply for smaller firms?

34.1 Yes. However we note that the 8th Directive was based on the principle of 'minimum harmonisation' and reflected the realities of what could be achieved politically across the EU during its adoption. As the two last Member States to implement the 8th Directive only notified the Commission recently of its transposition into their domestic law, we think it sensible for there to be a period during which the Directive is fully operational across the EU before there is any further 'harmonisation'.

34.2 After this period, a study of the impact of the Directive should be carried out. Areas where maximum harmonisation would be beneficial to the single market could then be identified and legislative measures proposed. The endorsement of ISAs is one such area, as would be the adoption of the IESBA Code of Ethics by the EU.

34.3 The 'single passport' is one practical area where the Commission could facilitate and accelerate closer integration and we would welcome more detail on this in order to develop an informed opinion. Where smaller firms met qualifying thresholds, they should be allowed to take advantage of any such passport system but we would not support a passport system that facilitated regulatory arbitrage by allowing registration in a jurisdiction with relatively weak oversight to then enable an audit firm or auditor to work in any other EU Member State.

Simplification: Small and Medium Sized Enterprises and Practitioners

Question 35: Would you favour a lower level of service than an audit, a so called "limited audit" or "statutory review" for the financial statements of SMEs instead of a statutory audit? Should such a service be conditional depending on whether a suitably qualified (internal or external) accountant prepared the accounts?

35.1 Yes. We support the option of a lower form of assurance such as either a 'limited audit' or 'statutory review' to be available for companies falling beneath the statutory audit thresholds in the EU Company Law Directives. The relevant EU law facilitates the setting of these thresholds at national level, thus enabling appropriate levels to be determined on a country by country basis. Currently many Member States require many smaller companies to have a statutory audit when perhaps a lesser form of assurance would be appropriate.

35.2 We believe that all 'statutory audits' carried out on entities exceeding those thresholds, i.e. medium and large companies as defined in EU law, should apply Clarified ISAs as the applicable audit standards.

35.3 We believe that for the avoidance of confusion in the marketplace, only an audit carried out under Clarified ISAs should be termed an 'audit' and other terms should be applied whenever a lower level of assurance is provided.

35.4 We do not believe that the preparation of the financial statements by a 'suitably qualified' person is an appropriate basis for considering whether a company's financial statements should be subjected to an audit or to a lesser form of assurance.

Question 36: Should there be a "safe harbour" regarding any potential future prohibition of non-audit services when servicing SME clients?

36.1 No. If further restrictions on non-audit services were to be imposed, we do not believe that auditors of SMEs should be subject to different or softer rules than the auditors of large companies. Auditors should be independent when issuing an audit opinion, irrespective of the nature or size of the reporting entity. To apply different rules to the auditors of SMEs would be confusing and possibly damage the credibility of the independence rules.

36.2 However, were specific additional prohibitions and restrictions with a public interest purpose to be proposed on the auditors of certain public interest entities, e.g. prohibition of the provision of non-audit services to 'systemic audit entities' with a view to promoting greater competition in the larger PIE audit market, then these additional rules would be unnecessary in the case of other entities.

Question 37: Should a "limited audit" or "statutory review" be accompanied by less burdensome internal quality control rules and oversight by supervisors? Could you suggest examples of how this could be done in practice?

37.1 As indicated in our response to Question 35, we support a lower form of assurance, such as either a limited audit or statutory review, for companies falling beneath the audit thresholds in the EU Company Law Directives.

37.2 We would be concerned with the use of the term 'audit' as part of any new definition, for example 'limited audit', as this would confuse financial statement users not familiar with the distinctions between these terms and a 'full audit'. We believe that Clarified ISAs allow for a scalable audit for all sizes of entity and that any assurance service that does not apply Clarified ISAs should not contain the term 'audit'.

37.3 We understand the rationale and intention behind lighter touch oversight of review-type assurance engagements. This could be performed by local professional institutes, as is the case in some EU Member States and the US. Most firms would, however, have a mix of assurance clients, some requiring 'full audit' and some opting for other forms of assurance. This could therefore entail oversight by two bodies, with consequent costs and other burdens on firms.

37.4 We are unclear as to the relevance of 'burdensome internal quality control rules' as SMPs would, in common with SMEs, typically have internal quality control systems appropriate to their scale, often involving and dependent upon the close involvement of the owners/partners. It is difficult to see how such a system of internal control could be less burdensome as it evolves to meet the specific needs of the entity involved.

37.5 We would recommend exploring the possibility of applying the lower forms of oversight to those firms not significantly engaged in the provision of services to public interest entities, provided that this did not present an unwitting barrier to entry to the market for offering services to PIEs.

International Cooperation

Question 38: What measures could in your view enhance the quality of the oversight of global audit players through international co-operation?

38.1 In our opinion, a greater level of mutual reliance between audit oversight bodies both within the EU and further afield would enhance the efficiency and quality of oversight of global audit networks. In particular this would improve efficiency in the area of inspections and registration of audit firms, avoiding duplication of effort for the benefit of audit firms, their clients and the relevant oversight authorities.

38.2 As indicated in our answer to Question 25, we support the establishment of a European audit oversight authority. Such a body could also play a role in improving the consistency of public reporting of inspection results and initiate a process for identifying fragmented oversight practices across the EU, with a view to eliminating these as quickly as possible. It could also serve as a single representative oversight authority for national oversight bodies in engaging with non-EU oversight bodies. We also draw attention to other possible roles indicated in our earlier response.

38.3 We believe that any European auditor oversight authority should only be concerned with the auditors of multi-national public interest entities.

We hope our responses above are self-explanatory and clear. Should the Commission wish to discuss our responses or require further detailed comments, it should contact the BDO Global Head of Regulatory & Public Policy Affairs, Noel Clehane, at our International Executive Office in Brussels.

Yours faithfully



Jeremy Newman
Chief Executive Officer
BDO