

# Position Paper

## UEAPME<sup>1</sup> position on the Green Paper on “Audit Policy: Lessons from the Crisis” COM (2010) 561 final

### 1. Introduction

On 13<sup>th</sup> October 2010 the European Commission launched a consultation on the role of statutory audit as well as the wider environment within which audits are conducted to determine what changes might be needed to audit policy. According to the European Commission the financial crisis “*highlighted certain weaknesses in the audit sector which need to be explored further*”. “*The fact that numerous banks revealed huge losses from 2007 to 2009 on the positions they had held both on and off balance sheet raises not only the question of how auditors could give clean audit reports to their clients for those periods but also about the suitability and adequacy of the current legislative framework*.” With this Green Paper the Commission wants to discuss whether audits provide the right information to all financial actors, whether there are issues around the independence of audit firms, whether there are risks linked to a concentrated market, whether supervision at a European level might be useful and how best the specific needs of Small and Medium Sized Enterprises (SMEs) and Practitioners (SMPs) may be met.

UEAPME welcomes the fact that the Commission “*stresses the need for a differentiated and calibrated approach which is adapted and proportionate to the size and characteristics of both the audited company and its auditor and will seek, in the case of any potential proposal that may emerge as a result of this Green Paper, to modulate any such proposals to take this into account. What may be necessary for large systemic institutions may not be appropriate for other listed companies or for SMEs or SMPs. Any measures which the Commission would propose as a follow-up to the present consultation would be subject to better regulation principles, including cost benefit analyses and impact assessments*.”

However, in our view the publication of the Green Paper is an overreaction of the Commission. Indeed, what went wrong in the financial sector cannot and should not simply be expanded to the whole business community. This feeling is even strengthened by the fact that the Commission announced “*to launch an external study to assess the implementation and impact of current rules as well as to gather further data on the structure of the audit market and of which the results will be available in 2011*.” According to the better regulation principles this study should have been available together with the current consultation.

In general, enterprises are very satisfied about their auditor. For SMEs, it is of utmost importance that the relationship with their auditor based on mutual trust can be kept.

UEAPME is neither in favour of the extension of the auditor’s mandate.

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<sup>1</sup> UEAPME subscribes to the European Commission’s Register of Interest Representatives and to the related code of conduct as requested by the European Transparency Initiative. Our ID number is 55820581197-35.

## 2. Role of the auditor

To give information about the future is quite difficult. Apart from the problem of the liability, the future of an enterprise, the business model and the management decisions to be taken remain in the first place the responsibility of the owner-manager. The auditor has to inform the owner-manager when he has doubts about the continuity of the enterprise, he can in addition comment on the solvability and the profitability of the enterprise. However, it is not the auditor's task to disclose economic and financial outlooks himself.

UEAPME would like to remind that it is in the first place the legislation on the annual accounts that lay down which information has to be disclosed. In addition, there is a clear difference between the information needs of the interested parties of listed companies (investors) and of small enterprises, where the annual accounts are in the first place for internal use, apart from the banks (access to finance), suppliers etc. Dialogue with the enterprise is always necessary given the relationship based on mutual trust between the auditor and the enterprise.

To increase the professional attitude and the professional scepticism of the auditor, it is of first and utmost importance to have experience with the functioning of the enterprise and being familiar with their particular situation and problems. A big enterprise does not function in the way an SME does, the SME family is in addition extremely diverse. Knowledge about enterprises and the way the audited company functions is crucial for every auditor.

### Corporate Social and Environmental Responsibility (CSR)

UEAPME stresses that SMEs conduct their business operations in interaction with their stakeholders on a voluntary basis and this should remain so. Mentioning CSR here in the Green Paper is putting the cart before the horse as DG Internal Market recently launched a consultation on disclosure of non financial information. UEAPME refers to his upcoming position paper on this issue.

### 2.2. International Standards on Auditing (ISAs)

The Commission has noted, as a result of its consultation in 2009, the overall support of EU stakeholders to an adoption of the ISAs at EU level. In our opinion, it is for the achievement of the internal market (comparability of the data of the enterprises) and the possible internationalisation of the SMP more than useful to apply the same standards in all the EU Member States. However, one should take care to provide for sufficient transition periods in order to allow SMPs to adapt to these standards.

In addition it may be clear that an audit of an SME is conducted in a different way and focuses on other issues than an audit of a listed company. We are not in favour of different standards (as this can limit the growth of the SMPs) but we do advocate in favour of a practical application of the standards which is geared to the enterprise that has to be audited. The so-called "scalability" of the ISAs can help in this regard. The requested documentation and activities should be in a reasonable proportion to the scale of the enterprise and the role that the audit fulfils in that enterprise.

## 3. Governance and Independence of Audit Firms

According to the Green Paper, the Commission "*would like to reinforce the independence of auditors and address the conflicts of interest which are inherent to the current landscape characterised by features such as the appointment and remuneration of the auditors by the audited firm, low levels of audit firm rotation or the provision of non audit services by audit firms.*"

In our view the fact that an auditor is appointed by and paid by the audited enterprise is not a threat for the impartiality of the auditor.

It would indeed lead to a reduction of costs for the SME, when auditors are not paid anymore by the enterprise that needs to be audited, but the other side of the coin is that the audit becomes a statutory inspection. In the current situation the auditor is a person of “confidence” with whom also some problems can be discussed (for example in case of fraud). This function will then, by definition disappear, as the auditor will be obliged to make any useful information public. The auditor as a person of confidence has also a role to play in the continuity of the enterprise. The compulsory “rotation” will lead to the fact that the auditor will not be aware anymore of the functioning of the enterprise, and will lose knowledge which is, however key, in order to be able to do his job in a correct way. It will every time take some time to acquainting this knowledge.

For all the proposals in this part, the possible consequences for SMPs should be assessed. The Big 4 or the bigger audit firms in general have indeed more possibilities to split up their activities in separate companies, while SMPs, in general, do not have this possibility.

## 4. Supervision

UEAPME has no specific remarks on this part.

## 5. Concentration and Market Structure

As the Commission rightly states the audit market appears to be too concentrated and especially the position of the Big 4 can disrupt the whole market. SMPs have real difficulties to get big companies as a client, which cannot solely be explained by their sometimes limited capacities to conduct an audit in such companies.

It may be clear that more competition is needed in order to give more opportunities to the SMPs. But this may not lead to an increase of the costs for the audited enterprises, which will be the case with the proposal to work with different auditors.

SMPs should be enabled to grow. The maintenance of the principle “an audit is an audit” and the introduction of uniform control standards are key to achieve this. UEAPME does not support the idea of joint audits or audit consortia. This will not only lead to the increase of the cost for the audited company, but one should also take in consideration the means and possibilities of the SMPs. Cooperation between auditors can only work if there is a level playing field between the partners. Situations where the SMP are obliged to work as a subcontractor for a bigger audit firm should be avoided.

## 6. Creation of a European Market

We refer to point 2.2.

## 7. Simplification: Small and Medium Sized Enterprises and Practitioners.

The fourth accounting directive states clearly that small enterprises are not subject to a mandatory audit. Although we fully recognize the value of an audit, also for small enterprises, in certain circumstances, **UEAPME stresses that this should remain an option.**

In our view small companies should be allowed to choose the control they find most useful from their needs rather than having mandatory auditing. Sometimes an audit of a small enterprise can be needed, for example to have access to finance, but it should remain voluntary. Only under this condition, an audit can provide an added value.

UEAPME<sup>2</sup> also fully support the principle “an audit is an audit” and is opposed to the introduction of a “limited control”. The problem with a “limited control” is indeed the credibility. The question arises if third parties will trust this kind of control. UEAPME fears indeed, that third parties, for example banks, will nevertheless insist on a “real” audit what will lead to additional costs for the small enterprise. In addition it would become even more difficult for the public in general and interested parties to have clear view on the role of an auditor and its limits.

The reduction of the administrative burdens and costs for SMEs can be achieved through a practical application of the ISAs, adapted to the size of the enterprise (“scalability” of the ISAs).

## **8. International Cooperation.**

UEAPME has no specific remarks on this part.

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<sup>2</sup> This paragraph represents the views of UEAPME with the exception of Företagarna.