

**International Federation of Accountants**545 Fifth Avenue, 14th Floor, New York, NY 10017 USA
Tel +1 (212) 286-9344 Fax +1 (212) 286-9570 www.ifac.org

December 8, 2010

Michel Barnier
European Commissioner for Internal Market and Services
European Commission
BERL 10/034
B-1049 Brussels
Belgium
Delivered electronically: markt-greenpaper-audit@ec.europa.eu

Dear Commissioner Barnier,

Re: European Commission's Green Paper, *Audit Policy: Lessons from the Crisis*

The International Federation of Accountants (IFAC) has carefully considered the questions posed in the European Commission's Green Paper, *Audit Policy: Lessons from the Crisis* (the Green Paper), and welcomes the opportunity to respond to the questions raised by the Commission. IFAC's response has been developed in the context of our work as an international organization—one that recognizes that the accountancy profession, including auditors, is a public interest profession. The profession contributes to economic growth and stability across a wide range of activities—contributing to the efficient operations of capital markets and the public sector, supporting the growth of small- and medium-sized enterprises (SMEs), providing strategic and financial direction through professional accountants working within entities, protecting the interests of shareholders and the investing public, and enhancing financial stability.

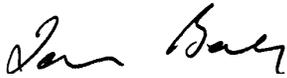
IFAC believes that the experience gained during the recent financial crisis presents a historic opportunity to improve the global financial system. Organizations must work together to reduce the risks that ultimately resulted in a widespread loss of public confidence in many elements of the financial sector. In this respect, we take very seriously the Commission's invitation to consider all matters presented in the Green Paper and urge that this exercise results in a constructive dialogue among the Commission and all relevant stakeholders.

IFAC's response represents a wide range of perspectives including those of the auditing profession, professional accountants in business, small- and medium-sized practices (SMPs), and public sector accountants. Our response also reflects insights from the different regions of the world. While our response has been prepared with input from many of our constituent member organizations (professional accountancy organizations), it does not necessarily reflect the totality of their views. In this regard, this document has been prepared to reflect IFAC's unique perspective as a global organization. Accordingly, IFAC's member organizations, both inside and outside of the European Union, may elect to provide their own responses.

It should also be noted that three of the independent standard-setting boards that operate under the auspices of IFAC and that are independently overseen by the Public Interest Oversight

Board¹—the International Auditing and Assurance Standards Board (IAASB), the International Ethics Standards Board for Accountants (IESBA), and the International Accounting Education Standards Board (IAESB) —plan to submit their own responses to questions pertaining to their mandates.

Sincerely,



Ian Ball

Chief Executive Officer

¹ For a comprehensive understanding of the shared regulatory arrangement that was established in 2005 in respect to the independent standard setting boards of IFAC, please see IFAC's Policy Position Paper #3, *International Standard Setting in the Public Interest*, December 2008.

**EUROPEAN COMMISSION'S GREEN PAPER,
AUDIT POLICY: LESSONS FROM THE CRISIS**

IFAC RESPONSE

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

- 1.1 IFAC welcomes the Commission's approach to present the Green Paper as an opportunity to solicit feedback and gather information from stakeholders worldwide. The accountancy profession believes that every part of the economic system must be examined to learn from the financial crisis. Enhanced dialogue between regulators, policy makers and the accountancy profession, which is a core aspect of the Green Paper, is essential to maintain macro-economic stability and can help prevent future crises.
- 1.2 We present our responses in the context of several prevailing considerations:
- (a) Today, audit is a truly global service, contributing to all sectors of the economy, including the public sector. Its providers, users and markets are increasingly of a transnational scope. Therefore, any actions taken by the Commission are likely to have implications for jurisdictions outside of the European Union. The resulting action (or inaction) by such jurisdictions will be critical in determining whether the marketplace for audit will continue to grow and develop on a truly international basis. Accordingly, the perspectives of stakeholders both inside and outside of the European Union should be carefully considered.
 - (b) The SME sector is at the core of all national economies and is a key engine of future, sustainable economic growth. This makes the health of the SME sector a public interest priority and, therefore, the relevance and impact of any legislation, regulation or standards must be carefully considered to avoid placing unreasonable burdens on SMEs.
 - (c) IFAC believes that further strengthening audit as a high-quality professional service should be the key objective when evaluating proposals for further consideration. This is especially true of those questions presented in the context of exploring new approaches to market structure and dynamics. All of the approaches described in the Green Paper should be carefully assessed in terms of whether or not they would improve audit quality.
 - (d) The Company Law Directive 2006/43/EC on Statutory Audit (the Directive) has only recently been implemented in most of the European Union Member States and is still in the process of implementation in other Member States. The Commission should allow the necessary time to analyze and observe the extent to which the Directive achieves the intended outcomes. At this date, significant additional legislation, or modifications to the Directive, may not allow markets and their respective governments the time necessary to gauge such outcomes.
 - (e) There is much that the regulatory community can learn from the recent history of the auditing profession, both in terms of failures and successes. As we attempt to consider the full scope of problems and solutions, IFAC encourages the Commission to employ scientific approaches to policymaking, recognizing that the

EUROPEAN COMMISSION'S GREEN PAPER, *AUDIT POLICY: LESSONS FROM THE CRISIS*—IFAC RESPONSE

clearest insights for the future can be gained only from a diligent, balanced, and empirical assessment of the auditing profession in past and present.

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 Yes, IFAC believes that there is a need to more effectively set out the societal role of the audit. Ultimately, the value of the audit is dependent upon the quality and usefulness of the audited financial statements.
- 2.2 We believe that there is a need for greater public awareness with respect to the objectives and scope of the audit. Any lack of public awareness could result in unreasonable expectations of the audit and consequently in the widespread disregard for other factors that contribute to the core systemic risks (e.g., weak internal control processes and corporate governance arrangements) the Commission seeks to address. It is a public awareness challenge for the accountancy profession, its stakeholders, and political leaders to articulate this to the public at large.
- 2.3 The trustworthiness of financial statements is critical for all major institutions of society, including governments. In June 2010, IFAC submitted a letter to the G20 focused on the need for reforms in public sector finances as a response to sovereign debt crises in several countries. In this respect, we believe that the trustworthiness of financial statements is a public interest priority for both private and public sector institutions, and that the societal role of audit should cover both sectors.
- 2.4 We would note that in many countries the societal role of the audit has been set out through legal provisions that define, and in some countries protect, the auditor or reporting accountant by stipulating their role in safeguarding the public interest (e.g., by the use of expressions such as “representing the public interest”).

3. Do you believe that the general level of “audit quality” could be further enhanced?

- 3.1 Yes, IFAC believes that the quality of most services (public or private) can be enhanced. Our mission explicitly states IFAC’s commitment to the public interest through contributing to high-quality practices by professional accountants and audit quality is fundamental to this commitment.
- 3.2 Considerations of audit quality should take into account stakeholder needs. There has to be a balance between the costs of an audit and the corresponding benefits to shareholders, investors, and other stakeholders. Audit quality is not enhanced by the performance of work where the related costs exceed the benefits. This applies similarly to services throughout the financial reporting supply chain.
- 3.3 Finally, establishing the meaning of, and uniformly assessing, audit quality is a complex endeavor. The perspectives and expectations of financial statement users and preparers, auditors, audit committees, professional accountancy organizations, regulators, and standard setters may not be fully aligned and therefore enhanced dialogue among these groups is essential to progress in this area. Furthermore, the expectations of stakeholders change over time. It is therefore important that the audit

EUROPEAN COMMISSION'S GREEN PAPER, *AUDIT POLICY: LESSONS FROM THE CRISIS*—IFAC RESPONSE

is continuously refined to meet stakeholder expectations. This commitment to continuous improvement is an important aspect of audit quality.

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

4.1 Within the framework of the International Standards on Audit (ISAs), the current function of the audit is to provide assurance that the financial statements of companies properly disclose their financial condition and to express any appropriate cautions regarding going concern. The nature and extent of disclosures in the financial statements are driven by management's assessment of an entity's ability to continue as a going concern, along with the disclosure requirements of the applicable financial reporting framework.²

4.2 Subject to appropriate cost/benefit considerations, enhancements to the current framework might include expanded disclosures by those charged with governance on the going concern assumptions used in the preparation of financial statements and the key risks associated with the company's longer term business model. Auditors could provide assurance on these elements in addition to their audit opinion on the historic financial statements. However, this would not replace the analyses currently done by rating agencies and equity analysts which are based on their own expectations concerning the future financial health of a company.

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 IFAC believes that measures to reduce the expectation gap are desirable, and suggests that at least two levels of research would help shed greater light on this question: 1) Determination of exactly what types of information would be useful and understandable to users and, 2) Determination of the costs (for both the preparer and auditor) that would be required to produce the information needed to supplement the existing audit opinion. Measures that would incur considerable time and expense, especially for small- and medium-sized entities and their auditors, should be avoided unless it is demonstrable that the benefits to stakeholders outweigh the costs involved.

5.2 The Commission notes several approaches to address this issue, including more concise reporting, public justification of the audit opinion, disclosure of any and all information of public interest, and increased frequency in the dissemination of such information. Some additional areas where stakeholder awareness could be enhanced might include:

- (a) A greater understanding of the role of the auditor and the implications of the auditor's work;
- (b) Enhanced disclosure about critical areas of risk which may occur in discussions between the auditor and the audit committee;

² International Auditing and Assurances Standards Board, *Audit Considerations in Respect of Going Concern in the Current Economic Environment*, January 2009
web.ifac.org/download/IAASB_Staff_Audit_Practice_Alerts_2009_01.pdf

