

Question regarding the Green Book of the EU Further Steps with respect to External Auditing Lesson Learnt of The Crises Brussels 13.10.2010

Chapter 1: Introduction

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

Yes.

(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?

Yes, I do see a conflict of interest with respect to statutory order mandate and private alimentation.

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

Yes, bearing that in mind you have to consider the relation between one certified Chartered Accountant and the number of his uncertified staff. From my experience as a CAE in international operating companies for many decades I would say a relation from 1:8 till a maximum of 1:15 could be tolerable with standardized procedures and methods without taking greater risks in quality, but not 1:30 and beyond. However, there is no free lunch. The actual costs of External Auditing which are understood as a mixture of External Auditing and Consulting Orders will then be rising substantially.

2.1. Communication by auditors to stakeholders

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

Exactly, that is the objective to deliver significant statements regarding cash flow, assets und earnings.

(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?

Yes, esp. the difference between auditing a system and auditing detailed transactions should be clarified to the public.

(6) Should "professional scepticism" be reinforced? How could this be achieved?

No, today a Quality Assessment (QA) is obliged so far. The question is misleading from my point of view bearing in mind significant and substantial statements for cashflows, assets and earnings. However, in a QA you only certify the methods (How?), not the substance what have been audited (What?).

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

No, in my opinion there should further be a possibility to limitate statements and to release qualified opinions. Management then are obliged to clarify any deviations from their point of view. Afterwards an external expert could come to its own conclusions. A good example is the German Corporate Governance Codex with the obligation "comply or explain".

(8) What additional information should be provided to external stakeholders and how?

E. g. minutes of the board meetings dealing with year-end reporting explained by the external auditors to the board could be published.

(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?

In Germany the BilMoG (German interpretation of the 8. EU-Rule) calls for this kind of dialogue though a different governance regime.

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

In my opinion this consideration is misleading .
At first the regulators should address and enhance equal level playing fields for CSR through negotiations with the NGO`s.
Step 2 is that the companies implement these new demands, but also allow them to explain where they do not comply.
Step 3 could be a qualified opinion carried out by the External Auditors.

(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?

Every great company must publish quarterly results. Why aren't they are obliged to deliver audited results instead of reviewed one`s. This obligation could even shorten the year-end audits as 9 months have

already been audited.

(12) What other measures could be envisaged to enhance the value of audits?

One could consider to establish the financing of the external audits through mutual private funding of the companies concerned. In Germany this system is already in place with the DPR (Deutsche Prüfstelle für Rechnungslegung).

2.2. International Standards on Auditing (ISAs)

(13) What are your views on the introduction of ISAs in the EU?

Positively, that is common practise within the Big4.

(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)?

The Standard of Quality could be developed through a formal rule for practising alongside the ISA.

(15) Should ISAs be further adapted to meet the needs of SMEs and SMPs?

Yes, because the risk structures and demands for transparency in these companies are often different to big companies.

3. GOVERNANCE AND INDEPENDENCE OF AUDIT FIRMS

(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?

Yes, alternative funding is common practise within the DPR. Main problem from my point of view is, however, the mixture of audit and consultancy, seldom changes of the audit company and the high number of staff per each certified auditor.

(17) Would the appointment by a third party be justified in certain cases?

No. the annual shareholder meeting should decide upon the external auditors on proposal from the board.

(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?

It seems reasonable to terminate the mandate for 4 years per certified auditor and 8 years for the auditing company.

(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?

It could be worthwhile to adopt the SOX establishment for Europe. This confines the possibility of different hire agreements as well as a catalogue of forbidden engagements being the company's external auditor.

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

No, with respect to wide differing risk structures, size of companies' and grades of complexity a general cap of the fees does not seem appropriate. More quality will at least end in higher fees when compensation with consultancy is not allowed any more. The same is with audited quarterly results instead of reviewed ones.

(21) Should new rules be introduced regarding the transparency of the financial statements of audit firms?

No.

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

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

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

4. SUPERVISION

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

In analogy to the U.S. a European Regulatory Body like the SEC (Security Exchange Commission) and related PCAOB (Public Companies Accounting Oversight Board) could be established. So supranational and European regulatory issues could be addressed.

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

In Germany you find such a system within the BaFin (Bundesanstalt für Finanzdienstleistungsaufsicht) which is already applicable for banks and insurance companies.

5. CONCENTRATION AND MARKET STRUCTURE

(27) Could the current configuration of the audit market present a systemic risk?

The turmoil of Arthur Anderson took place without greater shortcomings of the audit market.
With a concentration of only 2 or 3 Audit Companies risk of TBTF (Too big to fail) will escalate.

(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?

No, smaller audit firms should rather adopt self binding standards and strengthen cooperation in international networks.

(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?

4 years per auditor, 8 years for the company.

(30) How should the "Big Four bias" be addressed?

At first terminate the consideration within the companies "to get more with less" is king. In addition more power to get substantial audits instead of formal one's. Obligations should be binding to focus the audits in areas of strategic approaches and business models, see COSO ERM (Committee of Sponsoring Organizations of the Treadway Commission Enterprise Risk Management). These audit could start e. g. with the plausibility check of DCF (discount cashflows) of CGU (Cash Generating units) in assets. Prohibition of evaluations of mark- to- model approaches or substantial audits of risk models of banks would be helpful, a specialization of the auditors in branches und functions of the annual audits could be further steps.

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

No, they only represent a so-called "Plan B" in cases of emergency. It is essential to introduce prophylactic measures in beforehand to avoid such emergencies.

(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?

The increasing globalization is one main reason for the existence of the Big4. In addition to that these companies must yearly bear cost pressure and have to stabilize their results through standardization, internationalization and consultancy products and programs. Likewise to SOX the percentage of consultancy work must be reduced sharply and should only be allowed for special predefined situations. One has to establish a regime of "you get what you pay for" in order to reward respective auditing quality accordingly.

6. CREATION OF A EUROPEAN MARKET

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

Through internationalization within the audit companies and through networks established by smaller companies mobility could be enhanced.

(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?

Not for Germany because the postgraduate exam must be passed by each external auditor either in great or smaller companies. Harmonization in Europe should seek for the best possible quality and not the bottom of unanimous common understanding.

7. SIMPLIFICATION: SMALL AND MEDIUM SIZED ENTERPRISES AND PRACTITIONERS

(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?

This could a solution for companies not going public.

(36) Should there be a "safe harbour" regarding any potential future prohibition of nonaudit services when servicing SME clients?

Yes, see 35.

(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?

The audit quality should be established at an equal minimum level independent from the company in charge. The needs of KMU should better be reflected in the requirements of the regulators.

8. INTERNATIONAL CO-OPERATION

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

1. Establishing an European Authority like the SEC with a relating PCAOB
2. Obligation for all external auditors to report to the new bodies like the BAFin when auditing great international listed companies.