

16 December 2010

European Commission  
Auditing Unit-F4,  
SPA 2/JII – 01/112,  
BE-1049 Brussels,  
Belgium

**By email: [markt-greenpaper-audit@ec.europa.eu](mailto:markt-greenpaper-audit@ec.europa.eu)**

Dear Sir/Madam,

**RE: European Commission ‘Green Paper – Audit Policy: Lessons from the Crisis’**

Accounting Professional & Ethical Standards Board Limited (APESB) welcomes the opportunity to make a submission on the Green Paper – *Audit Policy: Lessons from the Crisis*.

### **APESB’s role**

APESB is governed by an independent board of directors whose primary objective is to develop and issue, in the public interest, professional and ethical standards that apply to the membership of the three Australian professional accounting bodies. A secondary objective of APESB is to provide the opportunity or forum for the discussion and consideration of issues relating to professional standards for accountants. APESB is funded by the three major accounting bodies, but has complete independence in its standard-setting activities.

Our essential function is the setting of standards, and in doing this we incorporate a strong emphasis on the importance of professionalism and sound judgement in those accountants who are obliged to follow our standards. We believe that setting high quality standards with demanding criteria contributes to the professional standing and behaviour of members of the accounting profession.

This month we have re-issued APES 110 *Code of Ethics for Professional Accountants* (The Australian Code) which includes auditor independence requirements. The Australian Code is based on and aligned with the International Ethics Standards Board for Accountants’ (IESBA) *Code of Ethics for Professional Accountants*, which was issued in July 2009.

## **General Comments**

We commend the European Commission on its initiative in publishing the Green Paper *Audit Policy: Lessons from the Crisis* (the Green Paper) and note that you have addressed a wide range of issues which will impact on the role of the auditing profession as well as on audit quality.

## **Australian Legislative Environment in respect of Audits**

In Australia, particularly in relation to audits performed under the Corporations Act, both the Accounting and the Auditing Standards have been issued as legislative instruments and thus have legal enforceability. The Australian Auditing and Assurance Standards Board has also issued an auditing standard which stipulates that auditors must adhere to ethical requirements, which are deemed to be those included in APES 110 issued by APESB. Accordingly, audit firms and auditors not complying with the relevant accounting, auditing and independence requirements can be held to have contravened Australian law and non-compliance may lead to prosecution by the Australian Securities and Investments Commission (ASIC).

## **Specific Comments**

Please refer below to APESB's comments on the following questions raised in the Green Paper:

### **1. Role of the Auditor**

***Q.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?***

#### *Discussion*

We note the reference in the Green Paper to the requirement in Germany for the external auditor to provide a "long form report" to the supervisory board of the relevant entity. We believe that the issues addressed in this report, such as matters pertaining to going concern, future developments and risks faced by the entity, irregularities, accounting methods used by the entity, will assist those charged with governance (Audit Committee or Board) understand the key judgements the auditor makes during the course of an audit.

We note such reports are common in Australia for Listed Entities and considered best practice, although they are not mandated.

### *Recommendation*

We believe that the European Commission should assess the ramifications of mandating the issue of long form reports by external auditors to the those charged with governance of Public Interest Entities and in particular any unintended consequences.

### ***Q.12 What other measures could be envisaged to enhance the value of audits?***

#### *Discussion*

We note that to enhance the value of an audit the European Commission is exploring the possibility of extending the external auditor's role to reviewing and reporting on forward looking information as part of normal audit process.

While there may be merit in extending the auditor's role our main concerns are:

- Determining the nature of the auditor's report on the forward looking information, ( for example, a review report, an agreed upon procedures report of some other type of report), bearing in mind the risks and difficulties associated with assumptions about future events, which by their very nature are uncertain;
- The significant increase in audit costs as well as the auditor's professional indemnity insurance premiums; and
- The potential for confusion amongst stakeholders as there would be different opinions given by the auditor in the same annual financial report (i.e. reasonable assurance on historical financial statements and limited or no assurance on the forecast or prospective financial information).

#### *Recommendation*

We recommend that you carefully consider this option and whether the auditor issuing reports with different levels of assurance in the same annual financial report will cause confusion among stakeholders and further contribute to the audit expectation gap. We also recommend that a cost benefit analysis be carried out assessing the cost of the auditor issuing some form of report on forward looking statements in the annual financial report against the value derived from the assurance given, if any.

## **2. Governance and independence of audit firms**

***Q.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?***

### *Discussion*

We understand your concern that when an audit firm audits the same client for many years it does contribute to the familiarity threat and hence may impact the auditor's independence.

However the requirements of the Australian Code and the IESBA Code dealing with the rotation of key audit partners does in APESB's opinion reduce the familiarity threat to an acceptable level. Moreover, it is common in Australia for those charged with governance of Listed Entities to regularly assess the performance of the entity's auditors, which from time to time results in a change in auditors. There is a significant cost associated with changing auditors of Public Interest Entities and there is some evidence of corporate failures in the first 24 months or so of making the change.

It is important to remember that thousands of audits of Public Interest Entities are undertaken each year without incident.

### *Recommendation*

APESB recommends that the European Commission undertakes thorough research to gather relevant facts to determine the merit of mandating rotation of audit firms, before proposing any change to the existing regime.

***Q.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?***

### *Discussion*

Provision of non-audit services by the auditor in certain instances is cost efficient for the audit client. As the auditor acquires substantial knowledge of the entity, the incumbent auditor is often in the best position to provide certain non-audit services more efficiently than a different firm. However, where significant fees are earned from these non-audit services there is at least the perception of a threat to the auditor's independence.

*Recommendation*

We suggest rather than a complete prohibition on the auditor providing non-audit services that the European Commission consider developing quantitative guidelines that limit the level of fees that can be derived from non-audit services to a percentage of the annual audit fee.

***Q.20 Should the maximum level of fees an audit firm can receive from a single client be regulated?***

*Discussion*

APESB agrees in principle with the proposition to limit the size of fees an audit firm can receive from a single audit client. The Australian Code provides safeguards that are necessary to reduce the threat to Independence to an acceptable level if any audit client makes up 15% or more of total fees receivable by the firm by either performing pre-issuance or post issuance reviews.

The Australian Code further mandates that the audit firm must withdraw or refuse an engagement if the fee receivable from the client forms or will form an unduly large proportion of the audit firm's total fees.

*Recommendation*

APESB supports the view that the maximum level of fees an audit firm can receive from a single audit client should be regulated.

If you would like to discuss further or require any additional information, please do not hesitate to contact me at [kspargo@bigpond.net.au](mailto:kspargo@bigpond.net.au) or Mr. Channa Wijesinghe, Technical Director at [channa.wijesinghe@apesb.org.au](mailto:channa.wijesinghe@apesb.org.au).

Yours sincerely



Kate Spargo  
**Chairman**