Dear Sirs,


Ernst & Young Global Limited, the central entity of the global Ernst & Young organization, welcomes the opportunity to offer its views on the European Commission’s Green Paper, “Audit Policy: Lessons from the Crisis” (the Green Paper).

Recognizing the challenge in summarizing a large number of lengthy responses to any public consultation, we have deliberately kept our responses at a high level. We would be happy to expand our response to any of the questions in the Green Paper if that would be helpful to European Commission staff.

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

We appreciate the Commission’s intent to examine the role of various capital market participants in the context of increasing investor confidence and promoting financial stability. We recognize that the Green Paper is but one element in a “holistic approach” being undertaken by the Commission and believe such a broad, comprehensive examination is appropriate. We also appreciate the significance of the issues that the Commission raises in the Green Paper, not just for the audit profession but also for companies and investors both in the EU and around the world. Therefore, as it considers these issues, we believe the Commission should keep in mind the inter-connectedness of global markets, the need for consistent high quality global standards, and the importance of global regulatory coordination.

The Green Paper raises many questions about the role of the auditor, the structure and regulation of the audit profession, and other core elements of the audit process. Many of the issues discussed relate to three broad topics: (i) the current role of the audit profession and whether it should change; (ii) auditor independence; and (iii) concentration in the audit market. As it considers how to address those topics, we encourage the Commission to make audit quality the benchmark against which all proposed approaches are assessed.

While we provide specific responses to each of the Commission’s questions, we offer here in summary form an outline of a number of measures that we believe should be considered in response to these three key areas of focus in the Green Paper.

Role of the profession

We appreciate the Green Paper’s recognition of the important role of the audit in furthering market trust and confidence, investor protection, and reduced cost of capital. We agree with the
Commission on the need for a comprehensive discussion about the role of the audit, and how it interacts with and complements the role of others such as management, boards, Audit Committees, analysts, rating agencies, and regulatory authorities. In this respect, we believe it is important to distinguish between a company’s responsibility to report its results to the market and the responsibility of the auditor to provide assurance on that information. While we provide more detail below in response to the Commission’s specific questions, as a general matter we believe the following proposals should be considered:

- Strengthening the role of Audit Committees to include issuing a report to investors providing greater transparency into key financial statement risks and critical judgments and estimates discussed with management and the auditor;
- Expanding corporate reporting by developing standards that require companies to provide investors with information that goes beyond historical financial statements and management analysis to include improved and more relevant disclosures (e.g., business model, risks, controls, management estimates and judgments, and sustainability); and
- Requiring the auditor to provide some level of assurance or attestation on -- or have other involvement with -- certain information outside the financial statements, including, for example, a company’s narrative reporting (e.g., MD&A) and the disclosures made in an Audit Committee report. If this were to move forward, consistent standards would need to be developed.

Independence of the profession

We believe that independence is the cornerstone on which confidence in the audit profession rests. Much has been done over the past decade to strengthen the profession’s independence, including the development of strong and robust independence standards (including the IESBA Code of Ethics), increased involvement of Audit Committees to varying degrees around the world, and independent regulatory oversight. We believe empowered and independent Audit Committees with a clearly defined role are critically important and would urge the Commission not to take any action that could result in Audit Committees having less responsibility or playing less of a role in a company’s corporate governance framework. As the Commission looks at this issue, we recommend that the following measures be considered:

- Enhancing the role and responsibility of Audit Committees in all aspects of financial reporting and audit processes;
- Giving Audit Committees clear responsibility for appointing the auditor and negotiating the audit fees on behalf of the company’s shareholders;
- Requiring Audit Committees to be independent of management, with highly qualified, competent members who are actively engaged in all aspects of the financial reporting and audit process, and able to challenge management and auditor judgments as appropriate;
- Encouraging Audit Committees to conduct periodic evaluations of audit quality in determining whether there is a need to re-tender the audit, and to explain why they have not re-tendered the audit after more than a set period of years; and
- Encouraging Audit Committees to pre-approve significant permissible non-audit services, and to disclose the nature and amount of such services provided to the company by the audit firm.

Concentration of the market

There is clearly a need for diverse audit firms of various size and scale available to match the scale and needs of a wide range of companies. In addition, there must be an absence of bias in choice of
service providers and robust market competition. To foster these objectives, which we believe contribute to audit quality, the public interest is best served by maintaining public company auditing as a private sector enterprise, subject to external oversight by independent audit regulators who cooperate and share information with each other.

In the context of the public company audit market, the three issues of concentration, choice and competition are quite distinct, though often confused. There is concentration in the upper end of the global public company audit market. In addition, the number of audit firms from which to choose may only be limited for the very largest companies where the global reach and capacity of the very largest audit firms are essential. Nevertheless, most companies around the world do not face this constraint because they are not as global or complex in scale. Importantly, even within the upper segment of the market, the level of competition among accounting firms is intense, with firms competing fiercely based on accounting expertise, audit quality, industry knowledge, firm culture, price and productivity, and other factors. In other words, concentration has not led to an absence of competition. Nor does concentration in any way diminish audit quality.

We support efforts to increase choice of auditor, provided that such measures would not impair audit quality or erode the Audit Committees’ responsibility to appoint the auditor and oversee the audit process. We recommend the Commission consider the following:

- Implementing measures that would increase the visibility of firms outside the largest networks, and give them the incentive to make the investments necessary to serve larger and more globally complex companies;
- Prohibiting contractual restrictions that prevent companies from appointing audit firms outside the largest networks; and
- Encouraging Audit Committees to reflect upon their audit needs, taking into account the necessary breadth and depth of audit resources, and to consider a wider universe of audit firms when re-tendering the audit.

In addition, the Commission is understandably concerned about concentration and the effects on markets and investors if a large audit firm were to fail. We believe it is important to reduce the likelihood that one of the large firms could be forced to exit the audit market. Therefore, we suggest the Commission consider the following:

- Encouraging audit firms to work with their regulators to develop contingency plans; and
- Developing reasonable limitations on an auditor’s liability which, in many countries, is the single largest threat to the sustainability of uninterrupted audit services to the market, due to the unlimited and uninsurable nature of the risk.

While we believe much of what is needed in terms of an audit policy framework exists today in the EU, we hope our responses will help identify potential improvements that could be achieved. We also encourage the Commission to consult widely with stakeholders beyond the EU, as the issues raised in the Green Paper are global issues with significant ramifications for global investors and global companies.

(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.
There has long existed an “expectation gap” between the reality of the role and responsibility of an auditor and the public perception of the auditor’s role and responsibility. As a result of the financial and economic crisis, this expectation gap is being appropriately highlighted and challenged again.

When considering potential changes to the audit governance framework or the role of the audit, it is instructive to compare the recent economic crisis with the crisis at the beginning of this decade. The earlier crisis was characterized by a large number of financial restatements and could quite rightly be called an accounting and auditing crisis. The recent crisis is quite different. It was not prompted by a failure of accounting or auditing, but rather was an economic crisis replete with credit and housing bubbles coupled with dramatic fluctuations in asset values. Financial statements generally were not required to be restated. But since some financial institutions later ran into operational difficulty or peril, it is legitimate to ask about the value to the market of companies’ historical financial statements and the audits of those statements.

This highlights the important point that an audit properly conducted in accordance with current standards and requirements may well fall short of what some desire in terms of value obtained from audit. We encourage the Commission to consider this carefully as it evaluates responses to the consultation. There is a gap between what an audit of historical financial statements actually produces compared to what some expect, or perhaps desire. In this regard, we believe the debate around the public interest role of audit must be approached from the perspective of all participants in the corporate reporting system -- companies, boards, Audit Committees, auditors and regulators – and each of their roles and responsibilities should be clearly defined. Ultimately, any outcomes must be supported by the adoption of requirements and standards that specifically delineate the nature of responsibilities of all participants.

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

Yes, and on a continual basis.

Audit quality is a process of continuous, incremental improvement pursued in the dynamic context of changing economic trends and business practices. It is central to Ernst & Young and is encapsulated in our tagline “Quality in everything we do.”

We believe that there has been a significant improvement in audit quality across the profession in recent years, bolstered by the introduction of independent auditor oversight in many jurisdictions.

Having said that, we know that audit quality can be further improved. This is why we continue to devote significant amounts of time and investment to further integrating our global organization, and in investing in the right kind of competencies to further enhance the quality and value of our audits as well as in recruitment, training, technology, methodology and infrastructure. It is also why we are persistently vocal about the need for consistent audit and accounting standards around the world as that will enable the profession to improve the quality and consistency of its work, and the ability of our regulators to oversee us.

As we have considered our responses to each question in the Green Paper, our baseline question at Ernst & Young has been, “Will this concept if implemented contribute positively to the profession’s ability to deliver seamless, consistent, high quality audits worldwide.” If the answer is yes, then we support the full consideration of the ideas surfaced in the question. Where, however, we believe that a concept if implemented would detract or interfere with the ability to deliver seamless, consistent, high quality audits worldwide, we express our concerns.
(4) Do you believe that audits should provide comfort on the financial health of companies? Are audits fit for such a purpose?

Yes, subject to the following comments.

The current audit was designed to provide reasonable but not absolute assurance on a company’s financial situation at the date of its balance sheet and of its results for the period ended on that date. In that regard, we do believe the audit is “fit for purpose.”

However, particularly as a result of the financial and economic crisis, some have asked whether an audit opinion should (or could) provide a greater level of assurance as to a company’s ability to continue in business, beyond the issue of “going concern,” perhaps by increasing the auditor’s focus on a company’s business model, including its future risks and its future prospects.

The current audit could evolve to provide a greater level of assurance on future prospects if this is what the market requires. But there are two essential preconditions for this to occur. First, the Board of Directors of a company would have to make the necessary additional disclosures in their company’s financial statements in accordance with an established, preferably globally consistent, set of standards. Auditors could then provide a degree of assurance on those additional disclosures, again in accordance with standards specifically set for this purpose by the IAASB. Second, individual directors would need some form of safe harbour to protect them against the significantly increased risk of litigation that any future-based information entails. Such safe harbours should equally be applied to the auditors.

Finally, the role of statutory audits regarding the financial health needs to be carefully assessed in order not to confuse it with the work of rating agencies or equity analysts.

(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?

We do not think that further explanation of methodology would be particularly beneficial but we are certainly not opposed to it if users believe it would be useful.

There already is a degree of disclosure about the audit process and audit methodology in the auditors’ report. However, the language tends to be boiler plate, and some investors have expressed a desire for more information than the standard language provides. For this reason, we support the IAASB project that is already under way to consider how the audit report may need to evolve, including the possibility of more information about the audit methodology employed.

Adoption of International Standards on Auditing (ISAs) for all statutory audits across the EU would enhance understanding of the auditors’ work as well as improve consistency in audit approach and audit oversight. Adoption of ISAs also would provide users with a single reference to a consistent framework under which audits are performed.

However, in our discussions and interactions with investors, we find that some of them are looking for enhanced disclosure of financial statement risks, judgments and estimates, more than additional information about the audit methodology. These are the topics of greatest discussion between auditors and Audit Committees and attract the highest degree of audit focus. Management or Audit Committee reporting of this information (perhaps with auditor attestation) could perhaps be more beneficial in bridging the expectation gap.
Should "professional skepticism" be reinforced? How could this be achieved?

A variety of actions could be taken to support the profession’s skepticism -- adopting ISAs, requiring strong, independent Audit Committees, and continuing to enhance independent auditor oversight. All of these contribute to the auditor’s ability to remain focused on being professionally skeptical.

Professional skepticism is one of the key requirements of an audit performed under ISAs, and is fundamental to a quality audit. While several audit regulators have questioned the application of professional skepticism in some instances, we are not aware that any regulator has identified a systemic absence of professional skepticism, either before, during, or after the financial crisis. Accordingly, we do not believe that auditors need to perform their work based on a new, more stringent interpretation of professional skepticism.

Rather, we believe there is a need to reinforce existing requirements for professional skepticism continually to promote consistent application. The adoption of ISAs for all statutory audits would help. ISAs define professional skepticism 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.

Existing rules on auditor independence also help to mitigate many of the external pressures that can undermine auditors’ objectivity and cause them to be less skeptical. Key to the effectiveness of those rules in practice is the presence of strong, independent, competent Audit Committees, who are able to challenge management and auditor judgments as appropriate.

Audit quality requires an effective process of regular dialogue and challenge among the auditor, management and the Audit Committee. Much of this process remains private and unreported, which causes some stakeholders concern.

There is a need to improve the visibility of the challenges made by auditors of management and Audit Committees, and for Audit Committees to provide information in their reporting about the key areas discussed with auditors during the course of the year. This would not only provide enhanced transparency to shareholders on complex and judgmental issues arising in the preparation of the accounts but in doing so it will reinforce the value of the audit. For further details, please see our response to Question 8.

Finally, external oversight and inspections also help both to support and reinforce objectivity and the application of professional skepticism.

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1 ISA 200, ‘Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing’.

2 The recently issued clarified ISAs include many revisions which emphasize the importance of skepticism in key areas such as the presumed risk of management override, related party transactions, confirmations, representation letters and fair value estimates. These standards are effective imminently (periods ending on or after 15 December 2010) and any further changes should only be made after their effectiveness has been assessed.
(7) Should the negative perception attached to qualifications in audit reports be reconsidered? If so, how?

No, with some comments.

A qualified audit report sends a clear and important message to the marketplace -- that the financial statements are not presented in accordance with the required accounting standards. We believe that a “negative perception” should continue to exist in such circumstances.

However, we also recognize that in some cases an audit report with an emphasis of matter paragraph, for example in situations where a doubt is raised about a company’s ability to continue as a going concern, can become a self-fulfilling prophecy. Perhaps if the markets were better informed about the factors that could give rise to doubts about a company’s ability to continue as a going concern, a going concern related emphasis paragraph could still send the appropriate negative signal without causing an exaggerated market reaction.

For example, the FRC's guidance on going concern was helpful in preparing the UK market for an increased incidence of audit report references to going concern. The FRC guidance was subsequently shared with other EU regulators, thereby contributing to a common approach and expectation across the EU.

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

From what we hear from investors, we think more transparency around the issues that are debated among management, the Audit Committee and the auditors is what the market most desires. Therefore, consideration should be given to requiring a report to shareholders from the Audit Committee describing the key financial statement risks and critical judgments and estimates discussed with management and the auditors.

In our view, Audit Committees are best placed to provide such information. The auditor could then be asked to attest to the disclosures made in such an Audit Committee report, based on globally consistent standards that would need to be developed. In this regard, we support the work of the IAASB to look at the audit report and we continue to call for the adoption of ISAs for all statutory audits in the EU.

In addition, the crisis has prompted questions about whether additional information should be provided by the company to enhance external stakeholders’ understanding of an entity. The challenge is in identifying which information should be provided, who should provide it, and how it can avoid becoming boilerplate. The costs and benefits of each choice would need to be considered explicitly. In our view, there should be a robust debate with all the relevant market participants – preparers, Audit Committees, investors, regulators and auditors – to be able to answer these questions fully. As part of this discussion, it is important to distinguish between a company’s responsibility to report its results to the market and the auditor’s responsibility to provide assurance on that information.

Consideration should be given to whether corporate reporting could be enhanced by requiring companies to provide investors with information that goes beyond historical financial statements and management analysis to include improved and more relevant disclosures in areas such as the business model, risks, controls, management estimates and judgments, as well as more information
relating to debt covenants, working capital, and sustainability. Clear global standards pursuant to which such information should be reported also would need to be developed.

Auditors could potentially be required to provide some level of assurance or attestation on – or have other involvement with – certain information outside of the financial statements, including, for example, a company’s narrative reporting (e.g., MD&A), and any enhanced corporate reporting that may evolve. If this were to move forward, consistent standards and forms of reporting would need to be developed. Safe harbour provisions for both preparers and auditors also should be considered to encourage expanded reporting and avoid boilerplate.

(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?

To perform a quality audit, there should be regular dialogue between the external auditors, internal auditors and the Audit Committee. While we strive for this to be the case always, we are certain there is room for improvement.

Key to improving the communication, debate, and dialogue are strong internal and external audit teams, and empowered and appropriately-resourced Audit Committees with highly qualified and competent members who are fully independent. Audit Committees’ role and responsibility in all aspects of the corporate reporting and audit processes should be enhanced and clearly defined. The European Commission should remove the existing Member State option in the Statutory Audit Directive that exempts Public Interest Entities other than listed companies from the legal obligation to establish an Audit Committee.

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

Yes.

Today the standards for such corporate reporting are inconsistent and voluntary, as are the requirements for any audit of such information. That cannot be good for the public interest as it creates an environment for investors of “buyer beware.”

Accordingly, we support initiatives to develop a uniform, consistent global standard for CSR reporting. This is why we are participating in the recently formed International Integrated Reporting Committee (IIRC), which aims to create a uniform, globally accepted framework for accounting for sustainability that brings together financial, environmental, social, and governance information.

As the trend for disclosing environmental and social information increases and it becomes more integrated into financial reporting, there will be a corresponding increase in the expectations of stakeholders as to the quality and robustness of the non-financial information being disclosed. As such, the need for external review of this non-financial information will grow as well.

The assurance brought by an independent auditor brings several benefits including enhanced transparency and mitigation of reputational risk of reporting. This can prove to be a valuable source of help in leading to more efficient management of the organization overall. Assurance is key to the credibility and reliability of sustainability information. As methodologies related to financial and non-financial information are based on the same principles, and as more non-financial information is being integrated in the annual report, sustainability assurance, pursuant to a globally consistent standard that would need to be developed, would be a logical extension of the auditor’s role.
(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?

Auditors currently report on a company’s annual financial statements. In addition, they may review interim, six monthly or quarterly reports if engaged by the company or required by regulation to do so in particular countries or jurisdictions where the company’s securities are listed.

While there is no question that there could be more regular communication by auditors to stakeholders, there needs to be a discussion with investors and other capital market participants as to whether they really would find this of value. What we have heard from some stakeholders, as indicated in our response to Question 8, suggests they may find it more valuable for the Audit Committee to report on key financial statement risks and critical judgments and estimates discussed with management and the auditors, and for the auditor to attest to such disclosures, based on consistent standards that would need to be developed.

With regard to the timing of the audit opinion, this is generally driven by the deadlines of corporate reporting established by securities and other market regulation. We would support an open discussion of how financial reporting and the audit report could be more timely, subject to careful consideration of potential adverse affect on the quality of such reporting and the audit process itself.

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

In addition to the issues discussed in our response to Question 8, we believe it would be valuable to engage in a broad global discussion with stakeholders – investors, preparers, Audit Committees and regulators – about the importance of internal controls, not just over financial reporting but also over other operational aspects of an enterprise. With more and more information of relevance to the market coming outside of the traditional audited financial statements, the importance of internal controls to reliable information is likely to increase.

Moreover, in the future companies are going to be able to produce, and investors are likely to be increasingly interested in receiving, a wider range of information, perhaps on a nearly as-needed basis. Much of this information may not be directly connected to financial reporting, and much of it may not be subject to auditing either. Building trust in the reliability of such information will be a challenge, and to do so companies will need to maintain rigorous internal controls.

We should therefore have a robust debate about just what those controls should look like, how they can be implemented, and the circumstances under which there should or should not be a role for auditors in attesting to them. As we consider the value of audits going forward, in our view this needs to be part of the discussion.

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

We believe that ISAs should be adopted for all statutory audits in the EU. This also would increase the momentum toward global adoption.

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

The IAASB has recognized the unique characteristics of small and medium-sized entities (SMEs) through including guidance on how specific requirements can be applied in their circumstances.
A failure to adopt ISAs for all statutory audits within the EU would have a number of disadvantages:

- It would create confusion regarding the nature and level of assurance being provided given that different standards are being used but the same audit opinion is being provided. This could lower the level of confidence in the reliability of financial reporting;
- It could impair harmonization in EU financial reporting because of differences in the audit regimes not only throughout the EU but within Member States;
- It could create further barriers to choice in the audit market due to perceived differences between audit firms and networks that conduct audits of larger and/or listed entities and auditors of smaller entities; and
- It would add complexity and cost to audit oversight.

Based on responses to the EC’s Consultation on ISAs, there is clear evidence of 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 accepted for audits of foreign listed entities by many of the world’s capital markets.

We believe that a single set of global auditing standards is one of the key cornerstones in providing investors and lenders with consistently high quality financial information to make investing and lending decisions across capital markets by providing:

- Greater comparability and transparency of audited financial information;
- A clearer understanding of auditors’ responsibilities and work;
- Greater cross-border investment;
- Increased credibility of financial information reported on by auditors;
- Lower cost of capital;
- A basis for mutual recognition of audits by regulators; and
- Reduced cost of complying with multiple or different standards.

(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)?

Yes, ISAs should be adopted for all statutory audits in the EU. We believe a Regulation is the most appropriate legal instrument because this will improve the consistency of ISA adoption across the EU. This is also consistent with the way in which IFRS were adopted in the EU.

As with IFRS, the adoption of ISAs will help to underpin investor confidence in the EU capital markets by improving the consistency of the statutory audit. As such, the way both sets of standards are set raises policy implications that impact a wide range of stakeholders. However, because ISAs contain basic principles and essential procedures that are only relevant to statutory auditors in fulfilling, inter alia, their statutory audit mandate, ISAs have a narrower focus.

For this reason, whilst an ISA endorsement process should reflect elements of the endorsement process established for the adoption of IFRS, we believe a “lighter touch” is appropriate. In particular:
• ISAs should be endorsed “en bloc” rather than “standard by standard;”
• National audit standard-setters and auditor oversight bodies should be requested to identify any local add-ons to the extent these are required by local law;
• Add-ons should be permitted at a Member State level providing separate disclosure is made of these in the auditor’s report;
• Consideration should be given to “sunset provisions” that limit the application of a Member State add-on to a defined period of time;
• Carve-outs should not be permitted under any circumstances; and
• The Auditing Regulatory Committee is the likely body to approve any proposed Regulation before it is passed to the European Parliament and European Council.

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

No.

Concerns have been expressed that adoption of ISAs will increase the amount of audit work that must be done on audits of SMEs. If ISAs were to cause an increase in audit work, it would mean that an increase was needed and warranted. However, as a general matter, we don’t believe these concerns are well founded.

We believe that ISAs are scalable depending on the size of the entity being audited. This means that the amount of audit work required will be in proportion to the size and complexity of the company being audited. In addition, a number of the ISAs are unlikely to apply to small company audits with no cross-border aspects.

The IAASB staff has also issued a document entitled “Applying ISAs proportionately in the audits of SMEs.” In addition, the IFAC Small and Medium Practices Committee issued the “Guide to using ISAs in the audit of SMEs,” which provides comprehensive guidance to small and medium-sized practitioners with respect to the application of ISAs.

We strongly 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. This will be a significant benefit not just to investors in the capital markets but also to a wider group of stakeholders including banks and fiscal authorities as well as entities being subjected to an audit performed in accordance with ISAs.

(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?

We recognize the potential conflict but have not seen evidence that suggests a need for change to the existing model. Rather, we believe the existing model should be strengthened.

Over the past decade measures have been put in place to mitigate the potential conflict in an auditor being appointed and remunerated by the entity being audited. For example, potential conflicts are addressed by the existing strict auditor independence requirements, and we believe that enhancing their global consistency would improve to enhance investor confidence. The independence requirements are further reinforced in many countries through oversight by independent audit regulators. Another key element that helps foster auditor independence is the Audit Committee.

We see a clear need for strengthening and better defining the role and responsibilities of the Audit Committee in all aspects of the financial reporting and audit process, not just the appointment and
determination of the remuneration of the auditor, which themselves are important factors in mitigating the concern about potential conflict. In order to better equip Audit Committees to perform an expanded role, guidelines should be prepared at the EU level that help them to evaluate the performance and independence of the auditor. Consideration also should be given to requiring Audit Committees to conduct periodic evaluations of audit quality in determining whether there is a need to re-tender the audit, and to explain why they have not re-tendered the audit after more than a set period of years. Regulators should make sure that management is not pressuring auditors to cut fees to such an extent that audit quality could be compromised. Independent Audit Committees are also an important factor in that equation.

In addition, the disclosure in the financial statements of audit and non-audit fees, as required by the Statutory Audit Directive, improves transparency and helps to mitigate concerns about the appearance of independence. This is reinforced by Member State auditor oversight bodies which support the application of professional standards, including independence standards, through their inspections of audit firms.

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

No.

There may be specific circumstances where a prudential supervisor or stock market regulator may need to appoint an audit firm to perform specific procedures in relation to the audited entity. However, as a general rule, we believe Audit Committees and shareholders are best placed to decide which firm is best equipped to perform the annual audit and they should be responsible for that decision.

Appointment of auditors by a third party, such as a regulator or government-appointed panel, would undermine the responsibilities and duties of Audit Committees and shareholders. It could also expose the regulators to a much greater level of risk because they would be held accountable by shareholders for every perceived audit failure. In addition, if the audit function became an inspection function carried out on behalf of the regulator or government authority, it could result in the auditor having less access to information than is currently the case.

(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?

No, we do not believe this should be mandated by law.

Companies and their shareholders should be free to appoint the audit firm that best meets their needs at the time they believe appropriate. The European Commission has suggested there is a need to inject some “dynamism” into the audit market. However, experience in Italy has shown that enforced limitations on audit tenure have had the opposite effect: they have resulted in greater concentration. Research performed by Bocconi University, one of Italy’s leading business schools, in 2001 and 2004 showed that the Italian listed company audit market is one of the most concentrated in the EU. Bocconi attributes this phenomenon to mandatory audit firm rotation.

The Bocconi research also showed that changes of auditor will increase the overall cost of the audit while threatening audit quality. Even if the incoming auditor accepts a lower audit fee than the predecessor auditor, there will be a significant extra time commitment from senior personnel at the audited company to help explain their business, internal control environment, processes and
corporate structure to the new auditor. While audit firms obviously can and do manage transitions effectively, this is not without cost or risk.

Audit partner rotation, coupled with independence requirements and effective regulatory oversight, better address the concerns raised by the Commission. In addition, as noted above in response to Question 16, we believe that Audit Committees should perform a periodic assessment of the quality of service provided by their statutory auditor. They also could be required to explain in an Audit Committee Report how they have assessed audit quality and why they have not re-tendered the audit after more than a set period of years. We do not believe, however, they should be forced to sever these relationships by law or regulation.

(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?

No, audit firms should not be prohibited from providing permissible non-audit services either to their audit clients or to their non-audit clients.

Over the last ten years there has been a robust debate about the range of non-audit services an audit firm may provide to an audit client and Member States have adopted detailed laws in this regard. In our view, delivering the most complete range of permissible services increases a firm’s knowledge of the company, its risks and processes, all of which contribute to audit quality. Moreover, an “audit-only” firm could be detrimental to audit quality as such firms would encounter difficulty in hiring high quality specialists (e.g., in tax and valuations) that are fundamental for a quality audit. Existing professional standards and regulations set appropriate parameters for the scope of permitted non-audit services to audit clients.

The decision as to which permissible non-audit services are obtained from a company’s auditor should remain with the Audit Committee. In many countries, the Audit Committee already plays a key role in this regard. Policy makers should consider requiring Audit Committees to pre-approve significant permissible non-audit services. By enhancing pre-approval and various disclosures, such as the nature and amount of permissible non-audit services and fees provided by the auditor, Audit Committees can best select the firms and permitted services that are most appropriate for the entities in which they serve.

The objectivity of the auditor is not compromised by providing permissible non-audit services to audit clients or non-audit clients, provided that auditors and companies comply with the existing robust independence standards. In addition, audit firms and the networks with which they are affiliated have a strong system of quality control and are subject to significant independent oversight by audit regulators.

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1 In its Recommendation 2002/590/EC of 16 May 2002 entitled “Statutory Auditors’ Independence in the EU – A set of Fundamental Principles,” the European Commission endorsed the “threats and safeguards” approach to preserve auditor independence whilst recognizing that some types of non-audit service should be prohibited. A further discussion took place leading to the adoption on 9 June 2006 of Directive 2006/43/EC on Statutory Audit. Articles 22 and 24 of this Directive provided further clarity around the provision of non-audit services whilst Article 42 introduced stricter obligations for the audits of Public Interest Entities. Recital 12 of the Directive on Statutory Audit made it clear that it “should not lead to a situation where Member States have a general duty to prevent statutory auditors or audit firms from providing non-audit services to their audit clients.”
(20) Should the maximum level of fees an audit firm can receive from a single client be regulated?

Yes, on a percentage of “overall fees of the firm” basis.

We support the new IESBA Code of Ethics which provides for public interest entity audit clients that if the total fees from any one client and its related entities exceed 15% of the total fees of the audit firm for two consecutive years, a special review of the second year’s audit is needed.

However, care needs to be taken to make certain that such a regulation does not disadvantage smaller audit firms. In addition, a fixed threshold of 15% does not take account of the different audit markets in the EU and could have unintended consequences (e.g., increased concentration in the audit market).

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

No. Existing European requirements, debated and passed as Article 40 of the EU 8th Directive within the last few years, provide for adequate transparency.

In most Member States audit firms already prepare financial statements that are filed with a public registrar. In this way, financial statements are available for inspection by the public. In the majority of these Member States these financial statements are also subjected to an external audit. Audits of the Big 4 firms are most frequently conducted by audit firms in the middle tier. This helps to address potential concerns about confidentiality and competition.

Following our EMEIA integration,4 we have prepared consolidated financial statements covering those entities that are controlled by Ernst & Young Europe LLP, a UK-registered audit firm. These consolidated financial statements are subject to external audit and available for public inspection at UK Companies House.

We are also fully transparent with our independent audit oversight bodies where they exist. Financial and litigation risk information that is important to assess the stability and sustainability of an audit firm are available for inspection by regulators.

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

The recently introduced UK Audit Firm Governance Code (the UK Code) contains many positive features, at least some of which could be applied at the EU level. This includes both the general principles and the Code itself which has sections on important topics such as the accountability of management, and the values of professionalism, integrity and objectivity.

We support, in particular, the UK Code’s requirement for larger audit firms to appoint Independent Non-Executive directors (INEs) and believe that this could help reassure the wider public on an audit

4 In 2008, Ernst & Young announced the decision to integrate its 87 country practices in Western and Eastern Europe, the Middle East, India and Africa into a new EMEIA Area. The EMEIA Area operates as a single unit, led by a single executive team and, where allowed by laws and regulations, underscored by formal combinations of practices.
firm’s commitment to strong governance, and to uphold the independence standards and deliver high quality audit services.

Although the UK Code technically applies only to our UK business, as the most globally integrated organization in our profession, we have decided to appoint INEs to our Global Advisory Council, the most senior advisory body of the global Ernst & Young organization. Similarly, we believe that some flexibility should be allowed in how the INE requirement is applied across the EU. For example, audit firms should not be expected to appoint INEs in every EU member state. The needs of stakeholders will be best met if audit firms are allowed to choose the structure that is most appropriate for their business model.

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

Yes.

We commend the European Commission for having liberalized the audit firm ownership rules in the Statutory Audit Directive. However, we note that there are still a number of Member States that have ownership limits well in excess of the 50% level of ownership by statutory auditors suggested by the Directive. We believe they should be encouraged to align their laws with the Directive.

One concern with an external investor model is that it could increase pressure on the need for short-term returns at the expense of investment in longer-term measures to improve audit quality. External capital might also attract higher value claims for damages arising from perceived audit failures.

Nevertheless, we believe alternative structures to the current EU requirements on ownership and management of audit firms should be explored, providing those structures are purely voluntary, any external capital may be invested in the business as a whole (not just the audit function), and effective safeguards aimed at promoting auditor independence and audit quality are also established.

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

Yes.

We agree with the European Commission that arrangements need to be in place to allow group auditors to assume their role and responsibilities pursuant to Article 27 of the Statutory Audit Directive and under the new clarified ISA 600. We believe it would be helpful for the European Commission to identify any impediments (legal or otherwise) that still exist across the EU that either undermine the role of the group auditor or restrict the group auditor’s ability to perform a high quality audit. At the international level, a similar work stream could be performed by the International Forum of Independent Audit Regulators (IFIAR).

A number of the concepts discussed in the Green Paper, if ultimately enacted as legislation, would not be consistent with this goal. For example, compulsory joint audits or mandatory firm rotation would have a fundamental impact on the ability of the group auditor to manage the group audit on a coordinated basis. If this were to be enacted on a piecemeal basis around the world, the negative impact on audit quality could be even more severe.
(25) Which measures should be envisaged to improve further the integration and cooperation on audit firm supervision at EU level?

We believe that the European Group of Auditor Oversight Bodies (EGAOB) should be at least upgraded to a “Level-3” committee and, ideally, become a statutory authority in the European legal framework.

The EU needs a strong, well resourced, pan-European Auditor Oversight Body in order to engage on an equal footing with its non-EU counterparts. This will further reinforce cooperation both between the Member States and with third countries. Another priority should be greater alignment of national oversight systems and a consistent approach to both cross-border supervision of larger audit firms as well as local supervision of smaller audit firms whose activities are solely domestic.

The Statutory Audit Directive introduced the requirement for independent oversight of audit firms. We are strong advocates for independent oversight because we recognize the positive contribution it has made to investor confidence and audit quality. However, that Directive was only adopted in 2006 and has still not been fully implemented consistently across the EU.

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

In our view, there is a need to reinforce the dialogue between regulators of systemically important financial institutions and their auditors. We believe this dialogue should be a two way process so that these regulators also alert auditors regarding particular areas of concern. Trilateral discussions among the regulator, the financial institution and the auditor would also be helpful. We support and participate in the discussions in the UK to develop a framework for dialogue with the Bank of England and believe such an approach is worth considering in other EU Member States.

This two way dialogue is important first and foremost for systemically important institutions. We believe a process should be developed and tested in practice for those institutions before expanding it to all listed companies.

The European Commission might also consider a mechanism whereby auditors of large, multinational companies (not necessarily just those of systemic proportions) could contribute to discussions of the newly created European Systemic Risk Board. The recent initiative of NIVRA to prepare a “management letter” for the Dutch insurance industry has been well received. The European Commission should explore this concept and its application at an EU level, but again, only once a communication framework is put in place and tested for systemically important financial institutions.

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

No.

The large global audit firms do not pose a systemic risk. “Systemic risk” is generally defined as the risk of collapse or severe disruption to an entire financial system or entire market, as opposed to risk associated with the failure of any one individual entity, group, or component of a system. The ripple effect of the disruption is typically driven by inter-linkages across institutions and markets.
Audit firms are service providers. They are not interconnected economically like large financial institutions. As a result, audit firms don't create a risk of systemic market failure similar to systemically significant financial institutions.

However, and as stated by the London Economics study for the European Commission, the failure of one or more of the largest audit firms could cause disruption in the global capital markets, particularly depending on the timing within an audit cycle of such collapse.

For this reason, we appreciate the Commission’s concern about concentration and the effects on markets and investors if a large audit firm were to fail. We believe it is important to reduce the likelihood that one of the large firms could be forced to exit the audit market. Therefore, the European Commission could consider encouraging audit firms to work with their regulators to develop contingency plans to address concerns of a disorderly failure.

The Commission also should continue to explore reasonable limitations on an auditor’s liability, which, in many countries, is the single largest threat to the sustainability of uninterrupted audit services to the market, due to the unlimited and uninsurable nature of the risk.

(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, the principle of mandatory joint audits or audit consortia would not be an effective catalyst for making the audit market more dynamic. It also would not contribute to audit quality or the ability of smaller firms to serve as the principal auditor for the largest global companies.

Most importantly, mandating joint audits would mean that the board or Audit Committee, acting on behalf of the shareholders, would not be making the decision as to whether a joint audit is appropriate for a particular company. Joint audits also have other disadvantages.

Risks from joint audits include the challenges of coordinating between two audit firms and the costs of duplication or risk of gaps. Dividing responsibility for the audit between two firms could cause difficulties in obtaining a proper understanding and supervision of the work performed by the other audit firm which may in turn reduce the overall quality of the audit. These risks are increased for audits of global companies.

Mandatory joint audits also would restrict choice by reducing the pool of audit firms from which a company can select their auditor as the number of non-conflicted firms that are able to compete in a tender situation is lower. This is particularly true in certain industries where the availability of skilled auditors is limited (e.g., banking, extractive industries).

Nothing prevents a company today from commissioning a joint audit, including joint audits using a large and small firm. However, this is rare, as there are significant disadvantages. For example, smaller firms would have to make a substantial investment in resources and expertise to be able to audit the largest global companies. An analysis of audit firms of the French CAC40 (France is the only EU (or G20) country where joint audits are required) shows that 70% of the companies are audited by two Big 4 firms because large listed companies have chosen to have access to the geographical reach and resources of such firms.
(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?

No, mandatory audit firm rotation and mandatory retendering unwisely remove decision-making from where it rightly belongs in the corporate governance system. Audit Committees, company Boards and their shareholders should be free to challenge the quality of their audit provider and decide if and when to change, or seek to change, auditors.

As set forth in our response to Question 18, mandatory audit firm rotation has been proven to have significant disadvantages. As a tool to address the issue of audit market concentration, experience in Italy clearly shows that mandatory audit firm rotation has little to no effect. Instead, to address concerns about concentration in the audit market, we would recommend that the Commission consider the following:

- Reducing barriers to entry to the listed company audit market such as by eliminating “Big 4 only” clauses in loan agreements;
- Implementing measures that would increase the visibility of firms outside the largest networks, and give them the incentive to make the investments necessary to serve the largest and most complex companies;
- Introducing statutory limits on auditors’ liability that are sufficiently flexible to encourage smaller audit firms to increase their penetration of the listed company audit market; and
- Empowering Audit Committees to re-evaluate the auditor relationship on a periodic basis and reflect upon their audit needs, taking into account the necessary breadth and depth of audit resources, and consider a wider universe of audit firms when re-tendering the audit.

Moreover, while mandatory rotation is also seen as a means to foster auditor independence, we believe there are better approaches. These include strong corporate governance (including highly empowered independent Audit Committees) and audit partner rotation, coupled with robust independence requirements and effective regulatory oversight. Rotation of key audit partners, as required by the Statutory Audit Directive, coupled with natural turnover of client personnel keep relationships between the audit firm and the audit client fresh, thereby eliminating potential independence concerns while retaining the knowledge of the company important to a high quality audit. CEOs and CFOs in large listed companies tend to rotate more frequently on average than the audit partner rotation requirements.

As mentioned in our response to Question 24 on Group Audits, the interplay of compulsory audit firm rotation or re-tendering combined with joint audit, especially if applied on a piecemeal basis, could have serious negative consequences for audit quality and choice.

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

In many ways. The goal should be to provide smaller firms with the incentive to invest in creating greater breadth and global scale to meet the needs of the market they wish to serve.

Institutional investors and Audit Committee chairmen need to be better informed about the scale, geographical reach and competencies of audit firms outside the largest firms. Moreover, as noted above, contractual restrictions that prevent companies from appointing audit firms outside the largest networks should be prohibited.
Ernst & Young, together with the other large audit networks, have tried to tackle the issue of Big 4 bias by writing collectively to the OECD in October 2009. We observed that in certain countries including the US, UK, Germany, Spain and Finland we have encountered clauses or requirements in contractual agreements between companies and their banks or underwriters that state that only the Big 4 audit firms may provide audit services to the company. In some cases, higher interest rates will be applied if these clauses are breached.

The six-firm letter stated:

“These contractual limitations can distort the market for audit services by excluding certain audit firms from competing in this market segment even if these firms have the necessary size, sector-specific skills and geographical coverage to perform the audit in question. Such clauses could also create the perception that only the largest audit firms have the necessary attributes to audit financial services companies or large corporations, thereby potentially limiting competition.”

Big 4 bias also could be addressed by audit oversight regulators considering the publication of inspection results of all audit firms above a certain size in a manner that also would allow them, where appropriate, to continue to communicate with firms confidentially about certain areas of their inspections. If the quality of the audit work of smaller firms is good, that fact should be disclosed to the general public. Then companies and Audit Committees should have the responsibility to assess whether the firm has the global breadth and scale to match the breadth and scale of the company’s needs.

Unlimited liability continues to be a barrier to middle-tier audit firm expansion. More importantly, the absence of limitations on auditor liability will disproportionately favour the Big 4 firms by virtue of their financial size. A cap, perhaps tied to the audit fees of the entity being audited regardless of which firm is conducting the audit, would actually level the playing field.

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

Yes as to contingency plans; no as to living wills.

It is a fact that the biggest risk to the survival of an audit firm or to members of a network of audit firms is catastrophic and irreversible damage to their reputation. As such, we agree that this is an issue that needs to be addressed, not just at the EU level but in a comprehensive manner at the international level.

As explained in our response to Question 27, we do not believe it is correct to refer to the Big 4 audit firms as “systemically important.”

The living wills that are currently being debated for systemically important banks are intended, inter alia, to encourage the simplification of corporate structures as well as reducing the risk of future government bail-outs. As such, they do not appear to be appropriate for audit firms which are essentially based on a partnership model and for which government bail-outs have never been considered.

We would however support further reflection with regulators on possible contingency plans, aimed at helping prevent the failure of an audit firm or covering any unplanned demise of an audit firm, with a view to rapidly resolving any significant disruptions in the provision of audit services. These
types of plans should be considered for all audit firms that audit public interest entities, not just the largest firms.

(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?

Yes.

The broader rationale behind the consolidation in the accounting profession over the past two decades is surely even more relevant today than it has ever been. Any reversal of prior consolidations would pose a threat to audit quality and not be in the public interest.

The largest audit firms have grown to their current size over a significant period of time. This has been due to natural evolution and consolidation in order to be able to perform audits of large, complex, multi-jurisdictional companies.

The huge investment needed to perform these audits to a consistently high standard worldwide - in technology, intellectual property, infrastructure, training, methodology, independence monitoring and compliance – has required larger audit firms to grow and merge their businesses both to fund this investment and to maximize possible economies of scale. Thus, the broader rationale for consolidation is even more relevant today than it has ever been.

Breaking up the largest firms would diminish rather than enhance audit quality for companies whose audits require the depth and breadth of resources offered by the largest audit firms. For Ernst & Young in particular, we believe our highly integrated global organization strengthens the ability of Ernst & Young firms to deliver seamless, consistent, high quality service worldwide. A break-up or “reverse consolidation” as the EC terms it, would in our view go in the wrong direction, increasing risk and reducing audit quality, to the detriment of investors and companies.

It is also important to note that a reversal of past consolidation in the audit sector is not a realistic option because it would confront a number of highly challenging practical and legal barriers.

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

We support the European Commission’s focus on accelerating the internal market for audit services. The mobility of audit professionals is an important topic for debate given that existing levels of mobility across the EU, as evidenced by statistical data, are poor.

There are a number of significant barriers to mobility which cannot be removed overnight, not least of which is the existence of 21 official languages in the EU. However, there are some aspects which can be addressed in the shorter term to simplify the mobility process such as:

- Closer alignment of the syllabuses that underpin professional examinations;
- Adoption of international standards (e.g., IFRS, ISA, IESBA Code of Ethics) which will remove national differences between the Member States; and
- Approximation of company law and tax systems across the EU.

We also believe the aptitude test process could be simplified in the short term by allowing tests to be taken in any of the official EU languages, not necessarily the language of the host Member State.
(34) Do you agree with "maximum harmonization" combined with a single European passport for auditors and audit firms? Do you believe this should also apply for smaller firms?

Yes. We fully support the concept of a single passport for auditors and audit firms and believe it would be of equal advantage to smaller firms.

We believe Ernst & Young to be the most integrated of the Big 4. In part, our EMEIA integration has been driven by EU legislation that has helped to liberalize audit firm ownership rules. Inevitably, our EMEIA integration has identified issues of diverging national requirements which, in some cases, have been difficult to deal with as we seek to establish uniform processes across all countries. So we believe in harmonization to the extent, practical.

Having said that, we understand that “maximum” harmonization can be difficult to achieve, and that there are sensible reasons that the 8th Directive is based on “minimum harmonization.” It recognizes the disparity in markets and the consequences of maximum harmonization. However, because of the shortcomings of minimum harmonization, notably in allowing flexibility in implementation which can undermine the single market, we believe that maximum harmonization should be the ultimate goal.

(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?

Yes, for companies beneath the existing thresholds set out in the 4th Company Law Directive providing different terminology can be found so that such differences are clear to investors.

The EU 4th Company Law Directive on annual accounts already contains a number of criteria (i.e., turnover, total assets and number of employees) beneath which a company is not required to have a statutory audit. However, primarily due to differences in size of national markets across the EU, a large number of member states have disregarded these thresholds and required statutory audits for much smaller companies. Member State governments should be encouraged to apply the existing exemptions in the 4th Directive.

Care needs to be taken when using the word “audit” as part of a new definition such as “limited audit.” Investors could be confused into thinking that a “limited audit” delivers a greater level of assurance than is actually the case. This could create another expectation gap.

The European Commission has considered removing the statutory audit requirements for SMEs as a way to reduce the costs of smaller businesses. However, one consequence of this would be to reduce the amount of audits performed by audit firms outside the largest networks. As one of the goals of the European Commission is to encourage the growth of such firms, careful consideration needs to be given to find an appropriate balance both for SMEs and their SMP auditors.

We believe that in situations where a statutory audit is no longer required (either as mandated by the EU Company Law Directives or by Member State law) then a “limited audit” may be a sensible idea and should be addressed by the IAASB. It would preserve the businesses of middle tier audit firms but also provide the public and other stakeholders with a degree of assurance over company financial statements.
(36) **Should there be a "safe harbour" regarding any potential future prohibition of non-audit services when servicing SME clients?**

No. As more fully discussed in Question 19, we do not believe the financial crisis has provided evidence of any systemic concerns about auditor independence that warrant a complete prohibition of non-audit services.

If further restrictions on non audit services were to be imposed, as a general principle we do not believe that audits of SMEs should receive any specific treatment. Auditors need to be independent when issuing an audit opinion, irrespective of the nature or size of the reporting entity.

(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?**

Consideration should be given to requiring only a limited audit (subject to better terminology) or statutory review for companies falling beneath the audit thresholds in the EU 4th Company Law Directive. This would provide investors with some limited degree of assurance (while not rising to a level of reasonable assurance) about the reliability of private company financial reporting. It would also support the lower end of the audit market.

However, care needs to be taken when using the word “audit” as part of a new definition such as “limited audit.” As noted above, investors could be confused into thinking that a “limited audit” delivers a greater level of assurance than is actually the case, which could result in another expectation gap. Having said that, because the degree of public interest in audits of smaller companies is lower than in audits of large listed companies, a lighter approach might be warranted. This could also include a proportionate approach on oversight. Oversight of auditors in this segment of the market could be performed by local professional bodies.

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

Increasing international cooperation among audit regulators and mutual reliance could enhance the quality of oversight.

We believe there is a clear need for a greater level of mutual reliance between audit oversight bodies within the EU. This would improve inspection efficiency and avoid duplication and overlap for the mutual benefit of both audit firms and inspectors. The promotion of the EGAOB to a “Level 3” Committee is a necessary next step to achieving this goal.

In order to enhance comparability between EU countries and improve the consistency of public reporting, an empowered EGAOB should initiate a process for identifying differences across the EU with a view to eliminating these differences over time.

Greater cooperation and information exchange among regulators in the EU also would contribute to improved oversight. We support the approach taken by a number of European audit regulators who have formed a “college of regulators” to share information and meet collectively with Ernst & Young firms in their respective countries. This is a particularly important development in light of our level of global integration and EMEIA integration in particular.
At the international level, the focus of improved cooperation between regulators in the oversight of global audit firms should concentrate on the audits of multi-national, listed companies. To bring about more consistency and quality in oversight, auditor oversight bodies need to agree on common oversight frameworks to the fullest extent possible and with a particular view toward mutual reliance. This concerns, inter alia,

- Agreed sets of updated registration information;
- Inspection practices and both public and private reporting of inspection results; and
- Adequate regular exchange of information and cooperation, including in the case of cross-border audit failures.

In our view, IFIAR provides an important venue for regulators to share information and best practices, and in this way contributes to higher quality oversight.

**Concluding Remarks**

We would be pleased to discuss our comments with European Commission staff at your convenience and we appreciate the opportunity to engage on these matters of importance. Please address any correspondence regarding this letter to Beth Brooke, Global Vice Chair of Public Policy, Sustainability and Stakeholder Relations, or Jeremy Jennings, EMEIA Regulatory and Public Policy Leader.

Yours faithfully,

Ernst & Young Global Limited