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Onze referentie  
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Uw referentie

Datum  
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Dear Commissioner BARNIER,

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

After having carefully considered the numerous questions posed in the Green Paper, the *Information Centre of corporate audit* (ICCI) <sup>(1)</sup> (Belgium) is pleased to provide you below with its comments on the European Commission Green Paper on Audit Policy.

ICCI welcomes this initiative of the European Commission to respond to the questions raised by the Commission.

The answers have been approved by the board of directors of the private foundation, consisting of, on the one hand, university professors in the field of auditing, accountancy and company law, who form the majority within the board, and, on the other hand, registered auditors and honorary auditors. ICCI believes that the added value of its answers lies precisely within this unique mix of perspectives, and therefore it has decided to respond only those questions of the Green Paper where this added value can be fully reflected.

For further information or to discuss any of our comments in further detail, please contact ICCI via email at [info@icci.be](mailto:info@icci.be).

Yours sincerely,

Paul PAUWELS  
Vice-President ICCI

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<sup>(1)</sup> ICCI is a Belgian private foundation that was established in 2006. It provides support to Belgian company auditors when, in the performance of their professional duties, they are confronted with problems of a legal or technical nature. The private foundation also publishes periodicals and books and provides objective, scientific information about issues that are of interest to corporate auditors.

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## Responses to Questions

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

The ICCI welcomes the European Commission Green Paper: Audit Policy: Lessons from the Crisis and appreciates the approach and purposes of this Green Paper.

A general remark at this point can be made by saying that this Green Paper does not distinguish between on the one hand the auditing issues that have already been discussed for a long time and in a lot of European consultations (*i.e.* auditor independence issues) and on the other hand the auditing issues that are relatively new (*i.e.* ISAs). The Green Paper mixes them rather randomly.

A second general remark is that the consultation round on this Green Paper is relatively short, seeing there is a set of 38 questions to be answered, with a lot of fundamental ones that touch the very core of the auditing profession.

### 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?

The current purpose of an audit is to enhance the degree of confidence of intended users in the accounts of financial statements. This is achieved by the expression of an opinion by the auditors as to whether the accounts or financial statements give a true and fair view ( $\Leftrightarrow$  *veracity*) in accordance with the relevant financial reporting framework <sup>(1)</sup>.

However, ICCI wants to point out, following academic literature <sup>(2)</sup> on the audit expectation gap <sup>(3)</sup>, that the latter consists not only of a reasonableness gap (*i.e.* society's unreasonable expectations of auditors) (34 %), but also a performance gap (*i.e.* deficient standards (50 %) and deficient performance (16 %)).

Therefore, ICCI feels that there is not only a need to change the societal *perception* of the role of an auditor (*cf.* making clear that an auditor is not a fraud examiner <sup>(4)</sup>), an auditor

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<sup>(1)</sup> Article 51a of the Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies *OJ L 222*, 14.8.1978, p. 11-31 and article 37 of the Seventh Directive 83/349/EEC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts, *OJ L 193*, 18.7.1983, p. 1-17.

<sup>(2)</sup> B. PORTER. 1993. An empirical study of the audit expectation-performance gap, *Accounting and Business Research*, 24 (93), 49-68.

<sup>(3)</sup> Audit expectation gap: difference between auditors' understanding of their function and investors', creditors', and other users' expectations of the auditor's role.

<sup>(4)</sup> See T. L. COENEN. Why didn't our auditors find the fraud?, *Wisconsin Law Journal*, 25 January 2006.



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cannot check every single transaction *i.e.* explaining the notion of materiality), but also maintaining the evolution towards high quality standards.

Thus, the expectation gap can be partly bridged by for example user/public education and the expansion of assurance services.

Also, ICCI feels that those charged with governance of the company (*i.e.* the board of directors, and, when applicable, the audit committee) should consider doing more to explain and disclose matters beyond what is reported in the financial statements, because they have much more knowledge about their own company and its business model.

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

In general, ICCI supports the requirements set out in the Statutory Audit Directive <sup>(5)</sup> because it largely contributed to enhancing audit quality following the introduction of several auditor requirements (*cf.* independence, public oversight).

Second, we do not believe that making inspection reports publicly available would enhance the general level of “audit quality” because, as already seen in the United States, audit clients do not perceive that the PCAOB’s inspection reports are valuable for signaling audit quality <sup>(6)</sup>.

Academic literature on audit quality indicates that, in publicly listed companies, outright audit failure rates are infrequent, far less than 1 % annually, and audit fees are quite small, less than 0.1 % of aggregate client sales. This suggests there may be an acceptable level of audit quality at a relatively low cost <sup>(7)</sup>.

However, ICCI would like to point out that, according to academic literature, financial statement quality <sup>(8)</sup> significantly depends on the enforceability of legal rules covering protection of corporate shareholders and creditors <sup>(9)</sup>.

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<sup>(5)</sup> Directive 2006/43/EC of the European Parliament and of The Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC, *OJ* 9.06.2006, L157, p. 87-107.

<sup>(6)</sup> C. LENNOX, and J. PITTMAN. 2010. Auditing the auditors: Evidence on the recent reforms to the external monitoring of audit firms, *Journal of Accounting and Economics* 49 (1-2), 84-103.

<sup>(7)</sup> J. R. FRANCIS. 2004. What do we know about audit quality, *The British Accounting Review* 36 (4), 345-368.

<sup>(8)</sup> Note that in academic literature this is not exactly the same as “audit quality”.

<sup>(9)</sup> R. LA PORTA, F. LOPEZ-DE-SILANES, A. SHLEIFER, and R. W. VISHNY. 1998. Law and finance, *Journal of Political Economy* 106(6), 1113-1155; C. LEUZ, D. NANDA, and P. WYSOCKI. 2003. Earnings management and investor protection: An international comparison, *Journal of Financial Economics* 69 (3),



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

In the view of ICCI doing business is a trade-off between risk and return: the more risk one takes, the more potential return one could make, but the more uncertainty within financial statements (*cf.* necessity of estimates and assumptions). Therefore, it is mainly the management of a company that should provide comfort on the financial health of companies (*cf.* IAS1 states that if management has significant concerns about the entity's ability to continue as a going concern, the uncertainties must be disclosed).

The function of an auditor is to certify the financial statements (true and fair view), which in turn is a reflection of historical numbers (exception: prospectus [forecasting] in PIEs). Thus, an auditor cannot certify the future financial health of companies (*cf.* auditor provides assurance and not insurance).

However, ICCI feels that if society feels that if an auditor should provide comfort on the financial health of companies, and therefore should take on a higher level of responsibility, society should compensate the auditor for this extra risk accordingly.

Professor Dr. Marleen WILLEKENS (KULeuven) documented in a study about the added value of audit <sup>(10)</sup> that *“the survival score is on average times 8,16 times higher in firms with an auditor as compared to firms without an auditor.”* And: *“Overall, the evidence provided in this study suggests that the quality of financial reporting is significantly higher for private companies that appoint a financial statement auditor, and that financial reporting quality also increases in audit intensity. Furthermore, it appears that small firms that adopt a limited disclosure schedule of financial reporting are financially healthier when they appoint an auditor.”*

**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?**

Please also see the answer to question 2 on audit expectation gap.

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505-27; J.R. FRANCIS, and D. WANG. 2008. The joint effect of investor protection and Big 4 audits on Earnings Quality around the World, *Contemporary Accounting Research* 25 (1), 157-191.

<sup>(10)</sup> M. WILLEKENS. 2007. *The effects of external auditing in privately held companies: Empirical evidence from Belgium*. Report. KULeuven and Tilburg University. This study was extended and has been published by ICCI, *De toegevoegde waarde van de audit – la valeur ajoutée de l'audit – the added value of audit*, nr. 2008-1, Bruges, die Keure, 2008, 128 p.



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Academic literature in Belgium and abroad has proven the real existence of an expectation gap<sup>(11)</sup>.

#### **6. Should “professional skepticism” be reinforced? How could this be achieved?**

ISA 200, paragraph 13 (1)<sup>(12)</sup> defines 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.

ICCI wants to point out that this attitude can only be achieved by maintaining the high demands of the professional training and the permanent education of the profession, with special attention to professional judgment training. On top of that, auditing experience contributes significantly to the audit judgment<sup>(13)</sup> (*i.e.* professional skepticism).

#### **7. Should the negative perception attached to qualifications in audit reports be reconsidered? If so, how?**

ICCI recognizes that qualifications in audit reports indeed have a significant negative perception.

However, the proposition of a change in approach from “clean-or-non-clean” audit statement (with or without matter paragraph) to a more nuanced audit statement and the application of ratings to the various risk levels of audit clients would result in a major decrease of audit statement standardisation and harmonisation, which would in turn lead to increased uncertainty of the stakeholders of the audited company.

#### **8. What additional information should be provided to external stakeholders and how?**

First, ICCI would like to point out the fact that in Belgium, the financial statements are publicly available for free on the website of the National Bank of Belgium, together with

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<sup>(11)</sup> I. DE BEELDE, S. COOREMAN, and H. LEYDENS. 1999. *Expectation of Users of Financial Information with Regard to the Tasks Carried Out by Auditors*. Working paper. University of Ghent, Belgium; M.A.G. BENAOU, C. HUMPHREY, P. MOIZER, and S. TURLEY. 1993. Auditing Expectations and Performance in Spain and Britain: A Comparative Analysis, *The International Journal of Accounting* 28, 281-307; M. EPSTEIN, and M. GEIGER. 1994. Investor Views of Audit Assurance: Recent Evidence of the Expectation Gap, *Journal of Accountancy* 177 (1), 60-66.

<sup>(12)</sup> The IESBA Code of Ethics for Professional Accountants also adopts the term “professional skepticism” several times.

<sup>(13)</sup> M. ABDOLMOHAMMADI, and A. WRIGHT. 1987. Experience and task complexity on audit judgments, *The Accounting Review* 62 (1), 1-13.



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the audit report. This entails that a lot of financial information of an audited company is already made available to the stakeholders for free.

In general, ICCI feels that it should still be the choice of the company to make any additional disclosure (voluntary disclosure), mainly for reasons of better financing and lower cost of capital.

However, from an objective point of view, ICCI would find it very useful if the level of materiality would be disclosed in terms of confidence intervals per account.

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

For several years entities have been disclosing considerably more non-financial information (NFI) that provides additional information of financial information or that deals with completely different matters, such as sustainability, corporate social responsibility, internal control, corporate governance, or even more specific information, which is often the case in the public sector, such as the number of passengers carried, *etc.*

Just as financial information, non-financial information has to be qualitative and correctly drawn so that the readers aren't on the wrong track. Consequently, this information should also be checked by an independent expert. In this respect, based on his experience and his independence that is guaranteed by legislation, the auditor can play an important role.

A study conducted by FEE <sup>(14)</sup> shows that there is no uniformity as to the legal requirement for external audit of non-financial information; several companies recognise the importance of "Assurance" of their NFI and opt, on a voluntary basis, for the provided information to be certified.

Therefore, the question arises to what extent it is appropriate that this non-financial information is also certified by an independent professional, *i.e.* an auditor.

It must be said that the recent financial crisis has taken away the last spontaneous belief in transparency. External control can be a solution to convince the stakeholders of the credibility of reported information.

Such external audit should be conducted in a competent and independent manner. This can certainly be claimed by the statutory auditor. He also has experience with NFI, as

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<sup>(14)</sup> FEE, *Discussion Paper Sustainability Information in Annual Reports – Building on Implementation of the Modernisation Directive*, 5 December 2008, 62 p.



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already stated, he has to comment on the annual report.

In Belgium there has recently been an expansion of reporting requirements of NFI in the annual accounts of listed companies. The law of 6 April 2010 on corporate governance of listed companies, provides, *inter alia*, that, the annual report of these companies should provide a declaration on good governance and a remuneration report. The fact that the audit of such information was entrusted to the statutory auditors can be seen as a recognition of their competence and independence.

The attitude of the auditor towards non-financial information is ambivalent<sup>(15)</sup>.

On the one hand, the auditor, in his capacity of supervisor, is increasingly expected of society to evaluate, in an objective and relevant way, the quality of all information provided to the shareholders, stakeholders and society. Therefore, the assessment of non-financial information would also belong to the range of his tasks.

On the other hand, auditor is strictly bound by objectivity and independence standards towards all forms of interference in the business management itself.

Regarding financial information, the auditor is backed by a strongly developed methodology in which the supplied figures and data should be framed. This enables him to solve, on the one hand, the detachment, and, on the other hand, the ambivalence of the evaluation.

However, given the fact that non-financial information largely concerns informal information, and, regardless of a few exceptions, it is provided outside the framework of laws and regulations, the danger exists that each quality reporting and financial information provision would lead to a judgment of the information itself, which is not the task of the auditor.

As a consequence, towards the audit of non-financial information, the auditor has clearly defined tasks<sup>(16)</sup>.

When legislation or regulations imposes the provision of non-financial information, the auditor has to verify within the information provided annually whether this obligation was met.

Second, the auditor has to verify whether the numbers, provided in the context of non-financial information, can be traced back and are in fact correct. This task is

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<sup>(15)</sup> A. NUTTENS, and L. ACKE, in ICCI (ed.), *De bedrijfsrevisor en de niet-financiële informatie – Le réviseur d'entreprises et l'information non financière*, nr. 2010-3, Antwerp, Maklu, 2010, p. 8 and p. 14.

<sup>(16)</sup> P. KINDT in ICCI (ed.), *De bedrijfsrevisor en de niet-financiële informatie – Le réviseur d'entreprises et l'information non financière*, nr. 2010-3, Antwerp, Maklu, 2010, p. 205 and p. 211.



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complementary to his task in respect of financial information, which is provided by the client.

Third, the auditor also has to verify the consistency of the methodology used to reach the numbers. It is, however, evident that the debate on the relevance of the methodology is not the province of the statutory auditor.

Finally, the auditor has to rule an opinion on the continuity of every methodology so that the numbers can also be historically evaluated or qualified in a correct way.

It is thus clear that the competence of the auditor regarding non-financial information – for lack of a clear legal framework – is residuary and is limited to evaluating the four aspects mentioned above. By correctly completing these tasks, the auditor will, also for non-financial information, fulfill his role as a public supervisor of corporate information without risking to get involved in the social debate on the amount and content of non-financial information.

**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?**

In a recently conducted study on employee satisfaction towards the auditor <sup>(17)</sup> the university professors Z. GALLEZ (UCL) and G. VAN GYES (KULeuven) concluded that, according to more than 70 % of the employee and employer representatives, the auditor always, or most of the time, understands the specific needs of the employees and employers, and, on top of that, that the auditor delivers readable and useful reports. Furthermore, they feel that auditors honor their obligations and that their answers are bright and clear.

An overwhelming majority of the representatives is convinced that the auditor delivers a substantial contribution to the discussion of the economic and financial information in the workers' council.

Concerning the regularity of the communication between, on the one hand, the auditors, and, on the other hand, the employees and the employers (within the workers' council) the study also shows positive results.

Regarding the possible reduction of the time interval between the year end and the date of the audit report, ICCI believes that this question is an issue since ISA 560 already

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<sup>(17)</sup> ICCI, *De rol van de bedrijfsrevisor ten opzichte van de ondernemingsraad – Le rôle du réviseur d'entreprises à l'égard du conseil d'entreprise*, nr. 2010-2, Antwerp, Maklu, 2010, 315 p.



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provides several rules the auditor has to live by in the time interval between the year end and the date of publication of the audit report.

However, as possible solution to reduce this time interval, ICCI suggests that the periodical peak of audits (end of December) can be addressed.

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

See in this regard the answers to questions 3 and 4.

## **13. What are your views on the introduction of ISAs in the EU?**

In Belgium, following a decision of the High Council for Economic Profession and the Minister of Economic Affairs, the audit profession is obliged to use the ISAs as from 2012 for statutory audits of public interest entities and for all audits as from 2014.

ICCI is in favour of the adoption of ISAs and ISQC 1 for all audits of financial statements in the EU for the reason that it believes that these standards are robust auditing standards that would harmonize the audit methodology on a European scale. Furthermore, the benefits of the adoption of ISAs are viewed as contributing to the credibility and quality of financial statements and to audit quality<sup>(18)</sup>.

Finally, ICCI feels that the adoption of ISAs in the EU would make it possible to have a more uniform education on audit standards in the EU, which would in turn significantly benefit the mobility of auditors throughout Europe.

## **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)?**

As the ISAs are internationally considered to be the common framework for auditing, ICCI is of the view that they should be made legally binding throughout the EU for all entities.

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<sup>(18)</sup> University of Duisburg-Essen, Markt/2007/15/F – *Study on International Standards on Auditing, Evaluation of the Possible Adoption of International Standards on auditing (ISAs) in the EU*, Final Report, 12 June 2009, p. 174, [http://ec.europa.eu/internal\\_market/auditing/docs/ias/study2009/report\\_en.pdf](http://ec.europa.eu/internal_market/auditing/docs/ias/study2009/report_en.pdf).



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For reasons of avoiding vagueness in auditing standards <sup>(19)</sup> throughout the EU, ICCI would like that a similar endorsement approach is chosen to the one existing for the endorsement of IFRS, where endorsement is done on a sufficiently high level by the EGAOB to then make a binding recommendation.

### 15. Should ISAs be further adapted to meet the needs of SMEs and SMPs?

The IAASB provided arguments showing that, after completion of the Clarity Project, ISAs can be applied proportionately with the size and complexity of an entity. This Paper states that IAASB was mindful of the importance of setting requirements that would be generally applicable in virtually all engagements <sup>(20)</sup>.

The study of the University of Duisburg-Essen commissioned by the EC, on the Evaluation of the Possible Adoption of International Standards on Auditing (ISAs) in the EU <sup>(21)</sup>, evaluated the possible cost increase of the introduction of ISAs in middle-sized unlisted companies (assuming that companies below the thresholds defined in Article 11 of the Fourth EU Directive <sup>(22)</sup> can be exempted from auditing by Member States legislation). The study acknowledges lack of data to conclude on the cost and benefits for smaller audits. However, when concluding that it is likely that the benefits of ISA adoption are worth the costs for smaller audit firms, the study implicitly recognises that the standards are equally applicable in a smaller firm environment.

The Summary Report of the European Commission on its consultation on the adoption of ISAs <sup>(23)</sup> shows that an overwhelming majority (81 %) of respondents supports the adoption of ISAs in the EU. A very large majority would support such application for all statutory audits in the scope of the Fourth EU Directive. The only issue open to discussion is the timetable for the introduction of such requirement.

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<sup>(19)</sup> M. WILLEKENS, and D. SIMUNIC, Precision in auditing standards: Effects on auditor and director, *Accounting and Business Research* 37 (3), 2007.

<sup>(20)</sup> IAASB Staff Audit Practice Alert, *Applying ISAs proportionately with the size and complexity of an entity*, NY, August 2009.

<sup>(21)</sup> University of Duisburg-Essen, Markt/2007/15/F – *Study on International Standards on Auditing, Evaluation of the Possible Adoption of International Standards on auditing (ISAs) in the EU*, Final Report, 12 June 2009, p. 174: [http://ec.europa.eu/internal\\_market/auditing/docs/ias/study2009/report\\_en.pdf](http://ec.europa.eu/internal_market/auditing/docs/ias/study2009/report_en.pdf).

<sup>(22)</sup> Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies, *OJ L 222*, 14.8.1978, p. 11–31.

<sup>(23)</sup> DG Internal Market and Services, *Summary of comments - consultation on the adoption of the ISAs*, March 2010, [http://ec.europa.eu/internal\\_market/auditing/docs/isa/isa-final\\_en.pdf](http://ec.europa.eu/internal_market/auditing/docs/isa/isa-final_en.pdf).



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**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?**

ICCI feels that there is no conflict in the auditor being appointed and remunerated by the audited entity. Therefore, we also do not recommend any alternative arrangements in this context.

Following the agency theory <sup>(24)</sup> there is no conflict in the auditor appointed and remunerated by the audited entity (the annual meeting of shareholders, *i.e.* the principals, owners). By appointing and remunerating an auditor to audit the financial statements that management (the board of directors, *i.e.* the agents) has prepared to justify their policies, information asymmetry is reduced between management and the owners. The owners of the firm have better monitoring of activities that management executes, which decreases the opportunity of management to act upon self-interest.

On top of that, the Belgian Company Code (BCC) states that the auditor is appointed for three years by the general meeting of shareholders (AGM) (Art. 130, first paragraph BCC) upon proposal of the candidate by the board of directors and after approval of the workers' council (on condition that there is one) (Art. 156 BCC). His term may be renewed. The Board makes these proposals for appointment upon the recommendation of the audit committee (on condition that there is one) which has been presented with the candidate (Art. 130, second paragraph BCC).

The theory behind this is that directors cannot intimidate auditors with the threat of replacement or bribe them by offering reappointment.

Finally, ICCI would like to point out prior research suggests that client fee dependence does not appear to compromise auditor objectivity both for publicly listed companies and private client firms in institutional environments in which auditors face low or high litigation risk <sup>(25)</sup>. Further evidence on this can be found in the study of Prof. Dr. Marleen WILLEKENS <sup>(26)</sup>: “*earnings management is significantly lower in*

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<sup>(24)</sup> C. DE KETELAERE. 2006-2007. *Type auditor en de verklaring by de jaarrekening*. Final paper, University of Ghent; M. JENSEN, and W. MECKLING. 1976. Theory of the firm: managerial behavior, agency costs and ownership structure, *Journal of financial economics* 3, 305-360.

<sup>(25)</sup> M.L. DEFOND, K. RAGHUNADAN, and K.R. SUBRAMANYAM. 2002, Do Non-Audit Service Fees Impair Auditor Independence? Evidence from Going Concern Audit Opinions, *Journal of Accounting Research* 40 (4), 1247-1274; A. CRASWELL, D. STOKES and J. LAUGHTON. 2002, Auditor independence and fee dependence?, *Journal of Accounting and Economics* 33, 253–275; A. SEETHARAMAN, F.A. GUL, and S.G. LYNN. 2002. *Litigation Risk and Audit Fees: Evidence from UK Firms Cross-Listed on U.S. exchanges*, Working Paper. Saint Louis University, Monash University Sunway Campus, City University of Hong Kong (CityUHK).

<sup>(26)</sup> ICCI, *De toegevoegde waarde van de audit – la valeur ajoutée de l'audit – the added value of audit*, nr. 2008-1, Bruges, die Keure, 2008, 128 p.

*companies that appoint an auditor, and further also decreases in the level of audit demand intensity.”.*

### **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?**

Besides the fact that academic literature suggests that mandatory external rotation does not enhance auditor independence<sup>(27)</sup> nor improves audit quality<sup>(28)</sup>, the key problems of mandatory audit firm rotation, which concur with the main findings in academic literature, are:

- The total loss of client-specific knowledge and expertise<sup>(29)</sup>, which is crucial to performing an efficient audit<sup>(30)</sup>
- The significant loss of audit quality<sup>(31)</sup>
- Increase of switching costs (*i.e.* the start-up costs incurred by the client for a new audit engagement) and total costs of audit<sup>(32)</sup>
- Increase of costs imposed to capital markets<sup>(33)</sup>

On top of that, of all the G20 economies, only Italy has mandatory firm rotation on a continuing basis and the aforementioned approach on rotation stated in the IESBA Code is followed in more than 100 countries for listed company audits, including in the UK and the USA.

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<sup>(27)</sup> M. CAMERAN, D. DI VINCENZO, and E. MERLOTTI, 2005. *The audit firm rotation rule: A review of the literature*. Working paper. SDA Bocconi School of Management Italy, 68 p.; E. RUIZ-BARBADILLO, N. GÓMEZ-AGUILAR, and N. CARRERA. 2008. *Does mandatory audit firm rotation enhance auditor independence? Evidence from Spain*, Working paper, University of Cádiz Spain, Instituto de Empresa Business School Spain, 39 p.

<sup>(28)</sup> M. CAMERAN, A. PRENCIPE, and M. TROMBETTA. 2006. *Auditor tenure and auditor change: Does mandatory auditor rotation really improve audit quality?* Working paper. SDA Bocconi School of Management Italy, Università Bocconi Italy, Instituto de Empresa Business School Spain, 61 p.

<sup>(29)</sup> F. BEERENS, and I. DE BEELDE. 2003. *De “Sarbanes-Oxley” wet en haar impact in Europa*, Thesis, 1-58.

<sup>(30)</sup> R. PETTY, and S. CUGANESAN. 1996. Auditor rotation: Framing the debate. *Australian Accountant* (May), 40-41.

<sup>(31)</sup> P. SCHELLUCH, and S. THORPE. 1995. Perceptions of auditor independence, *Perspectives on Contemporary Auditing* 1, 32-54; American Institute of Certified Public Accountants, SEC Practice Section, 1992, Statement of position regarding mandatory rotation of audit firms of publicly held companies, New York, NY: AICPA.

<sup>(32)</sup> B. ARRUNADA, and C. PAZ-ARES. 1997. Mandatory rotation of company auditors: A critical examination, *International Review of Law and Economics* 17 (1), 31-61.; J. BLOUIN, B.M. GREIN, and B.R. ROUNTREE. 2007. An analysis of forced auditor change: The case of former Arthur Andersen Clients, *Journal of Accounting and Public* 27(2), 115-132.

<sup>(33)</sup> S. MANSI, W. MAXWELL, and D. MILLER. 2004. Does auditor quality and tenure matter to investors: Evidence from the bond market, *Journal of Accounting Research* 42 (4), 755-793.



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Therefore, ICCI believes that mandatory rotation of firms is unnecessary and may even reduce audit quality.

**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?**

First, ICCI believes that prohibiting the provision non-audit services by audit firms would not be beneficial to the general development of the auditor. As a consequence, young graduates would no longer search for a career in auditing. Having audit-only firms would result in a “ticking the box” approach and a rule book approach rather than the principles based approach that Europe enjoys today.

Second, ICCI believes that concurrent audit and advisory services do not have to be viewed as critical per se, rather only to the extent that it could have a negative impact on audit quality. However, this risk only exists in relation to advisory services that lead the auditor to audit his or her own work (self-review threat). ICCI notes that some services are already prohibited pursuant to the current Belgian company code.

Furthermore, the entity may benefit from cost synergies from the interaction between audit and advisory services provided by the same auditor (especially companies in the SME sector), which in turn may result in a positive effect on audit quality, since it enhances the auditor’s knowledge of the particular entity.

On top of that, ICCI refers to the report published in January 2010 by The Institute of Chartered Accountants of Scotland: “*The Provision of Non-audit Services by Audit Firms to their Listed Audit Clients*”<sup>(34)</sup>, that concluded the following on page 7:

*“The Working Group concluded following debate, research and communication that there is no benefit to be gained from a complete prohibition on auditors providing non-audit services to their listed clients. [...].*

Further on in the same report (page 33), it is stated in the main findings of the survey:

*“None of the respondents were of the view that a complete prohibition would result in improved audit quality with 52 % of respondents believing that it would not change and 48% believing that it would result in a decrease in audit quality.”.*

ICCI would like to stress the fact that the measures of non-audit services prohibition should be proportionate to the objective of financial transparency required by the

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<sup>(34)</sup> [http://icas.org.uk/site/cms/download/AA/2010/WG\\_Report\\_Non\\_audit\\_services\\_January\\_2010.pdf](http://icas.org.uk/site/cms/download/AA/2010/WG_Report_Non_audit_services_January_2010.pdf).



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European Commission from its Member States (EU Communications of 2004 and 2005 on competition in the liberal professions).<sup>(35)</sup>

Regulations that are disproportionate and would restrict the competition between auditors in favour of other regulated professions providing non-audit services should be avoided both at national and European level. For example, the appointment of auditors by a regulator or another third party, the prohibition on non-audit services and a mandatory external rotation of the firm seem disproportionate to the overall objective of financial transparency.

No distinction should be made between systematic financial institutions and, for instance, SMEs. Both are not in favour of external rotation the auditor being a person of trust.

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

In the view of ICCI only the determination of the percentage of the fee of a client with regard to the auditor's total fee should be regulated and is already stated in IESBA, *Handbook of the Code of Ethics for Professional Accountants*, Edition 2010, paragraphs 290.220<sup>(36)</sup> and 290.221<sup>(37)</sup>.

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<sup>(35)</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2005:0405:FIN:EN:PDF>.

<sup>(36)</sup> When the total fees from an audit client represent a large proportion of the total fees of the firm expressing the audit opinion, the dependence on that client and concern about losing the client creates a self-interest or intimidation threat. The significance of the threat will depend on factors such as:

- The operating structure of the firm;
- Whether the firm is well established or new; and
- The significance of the client qualitatively and/or quantitatively to the firm.

The significance of the threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level.

Examples of such safeguards include:

- Reducing the dependency on the client;
- External quality control reviews; or
- Consulting a third party, such as a professional regulatory body or a professional accountant, on key audit judgments.

<sup>(37)</sup> A self-interest or intimidation threat is also created when the fees generated from an audit client represent a large proportion of the revenue from an individual partner's clients or a large proportion of the revenue of an individual office of the firm. The significance of the threat will depend upon factors such as:

- The significance of the client qualitatively and/or quantitatively to the partner or office; and
- The extent to which the remuneration of the partner, or the partners in the office, is dependent upon the fees generated from the client. The significance of the threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level.

Examples of such safeguards include:

- Reducing the dependency on the audit client;
- Having a professional accountant review the work or otherwise advise as necessary; or
- Regular independent internal or external quality reviews of the engagement.



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Other than that, ICCI would like to stress that article 13 of the Royal Decree of 10 January 1994 concerning the obligations of the statutory auditors also foresees the threat of financial dependence of the statutory auditor. It states that the statutory auditors may not limit their activity in such a way that their professional income is solely dependent on a very limited number of distinct tasks or functions, or of tasks and specific functions that all depend on a single interest group or a single authority.

Also, paragraph 5.2.2. of the Belgian Standards of 30 August 2007 on certain aspects related to the independence of the statutory auditor clearly stipulates that:

*“financial dependence of the auditor is considered when the total amount of fees that an auditor and, where appropriate, the audit firm to which he belongs of a controlled legal entity and the entities associated with this legal entity, for any assignment, receives (/receive) or must receive, during a period of three years, 20 % or more of the total income of this statutory auditor and where appropriate, the audit firm to which he belongs. Such evaluation over the three year period should be carried out annually, taking into account the current year and the two preceding years.”*

**21. Should new rules be introduced regarding the transparency of the financial statements of audit firms?**

According to ICCI, in Belgium, there is already a relatively large amount of disclosure of financial information for audit firms, since they are subject to the same disclosure requirements as other companies with the same form of enterprise (incorporated companies).

On top of that, following the implementation of the Statutory Audit Directive, article 15 of the coordinated law of 22 July 1953 establishing an Institute of Registered Auditors and the organisation of public oversight of the profession of auditor imposes statutory auditors and audit firms that carry out statutory audit(s) of public-interest entities publish on their websites, within three months of the end of each financial year, annual transparency reports.



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

Article 3, 4(b) of the Statutory Audit Directive already introduced the possibility to raise capital from external sources<sup>(38)</sup>.

In the view of ICCI it would not be appropriate for audit firms to be able to raise capital from external sources mainly for the liability risks this would entail.

Also, the independence of an auditor is of paramount importance. Allowing audit firms to raise capital from external sources would, *ceteris paribus*, make collusive and negligent behavior more likely, or at least seemingly, because the audit firm would receive commercial pressures from the external sources (agency problem). This in contrast to an audit firm where the owners are also the managers and would mainly fool themselves if they would for example present better revenues in their financial statements.

On top of that, ICCI feels that with the measure of actually allowing audit firms to raise capital from external sources (for example through the stock market) would allow the big audit firms to become even bigger and more powerful.

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

ICCI would like to point out that article 27 of the Statutory Audit Directive states that the group auditor bears the *full responsibility* for the audit report in relation with the consolidated accounts, and therefore they should indeed have access to the reports and other documentation of all auditors reviewing sub-entities of the group.

As of today, numerous issues arise in various Member States concerning the professional secrecy from subsidiary auditors towards group auditors if both do not belong to the same audit network.

Group auditors need to have access to all underlying documents of the annual accounts of all subsidiaries.

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<sup>(38)</sup> Article 3, 4(b) states that: “a majority of the voting rights in an entity must be held by audit firms which are approved in any Member State or by natural persons who satisfy at least the conditions imposed by Articles 4 and 6 to 12. Member States may provide that such natural persons must also have been approved in another Member State. For the purpose of the statutory audit of cooperatives and similar entities as referred to in Article 45 of Directive 86/635/EEC, Member States may establish other specific provisions in relation to voting rights”.



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

ICCI believes that, giving the know how actually present in the EGAOB and taking into account the time and resources needed to establish a new European Supervisory Authority, one should rather opt for the transformation of the EGAOB in a so-called “Lamfalussy Level 3 Committee”. Moreover, the advantage of the transformation is the continuation of the existing Member States’ representation and involvement.

ICCI feels that, even more important than the improvement of the integration and cooperation on audit firm supervision at EU level, is making legal rules enforceable that cover protection of corporate shareholders and creditors, because this would significantly improve financial statement quality <sup>(39)</sup>.

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

ICCI welcomes the enhancement of cross border mobility of auditors.

In spite of the various EU directives there are still significant differences between member states regarding company, civil, tax and social law. Moreover, there exists various local regulations on the audit profession (e.g. education, training, registration and independence). Moreover, throughout the EU, specific legislation with regard to the use of languages exists.

These differences constitute a burden for cross border mobility.

Cross-border mobility of auditors necessitates further harmonisation of the legal framework.

ICCI is of the opinion that when one individual auditor of an audit firm is registered in one Member State of the European Union, the audit firm itself should be automatically registered in that EU Member State.

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<sup>(39)</sup> R. LA PORTA, F. LOPEZ-DE-SILANES, A. SHLEIFER, and R. W. VISHNY. 1998. Law and finance, *Journal of Political Economy* 106 (6), 1113-1155; C. LEUZ, D. NANDA, and P. WYSOCKI. 2003. Earnings management and investor protection: An international comparison, *Journal of Financial Economics* 69 (3), 505-27; J.R. FRANCIS, and D. WANG. 2008. The joint effect of investor protection and Big 4 audits on Earnings Quality around the World, *Contemporary Accounting Research* 25 (1), 157-191.



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- 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?**

A “limited audit” is considered to be inappropriate according to the principle of “an audit is an audit” in order to obtain the same audit quality of financial statements.

Also, ICCI feels that the existence of a “limited audit” would cause even more confusion amongst the stakeholders of financial statements, which would in turn significantly widen the expectation gap (see answer to question 2).

Furthermore, a Finish academic paper<sup>(40)</sup> that studied the issues related to the reporting behavior and the choices of auditors mainly for small and medium-sized Finnish companies shows that there are no significant differences in the likelihood that the report is modified or the opinion paragraph is qualified between auditors with the lower HTM qualification (*i.e.* lower quality audit) and the higher KHT qualification (*i.e.* higher quality audit).

Moreover, the SME’s themselves are not in favour of abolition or an adaptation of a statutory audit<sup>(41)</sup>.

Finally, concerning this question, ICCI would like to quote the findings of an academic study of Prof. Dr. Marleen WILLEKENS (KULeuven) published in ICCI 2008-1<sup>(42)</sup>: “*it appears that small firms that adopt a limited disclosure schedule of financial reporting are financially healthier when they appoint an auditor.*”.

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<sup>(40)</sup> S. SUNDGREN. 1998. Auditor choices and auditor reporting practices: evidence from Finnish small firms', *European Accounting Review* 7 (3), 441-465.

<sup>(41)</sup> FEE, UEAPME, and EFAA, *Press release: Company law, accounting and auditing: Commission's simplification approach might jeopardise the Single Market, say European SMEs and accountants*, Brussels, 15 November 2007, [www.ueapme.com/docs/press\\_releases/pr\\_2007/071115\\_PR\\_UEAPME-EFAA-FEE.pdf](http://www.ueapme.com/docs/press_releases/pr_2007/071115_PR_UEAPME-EFAA-FEE.pdf), p. 1, UEAPEME, *Position on the consultation paper “Cutting Accounting Burden for Small Business / Review of the Accounting Directives”*, Brussels, June 2009, [www.ueapme.com/IMG/pdf/090609\\_pp\\_accounting\\_final.pdf](http://www.ueapme.com/IMG/pdf/090609_pp_accounting_final.pdf), p. 5.

<sup>(42)</sup> This study was extended and has been published by ICCI, *De toegevoegde waarde van de audit – la valeur ajoutée de l'audit – the added value of audit*, nr. 2008-1, Bruges, die Keure, 2008, 128 p.



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**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?**

See answer to question 35.

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

ICCI feels that public oversight of worldwide audit networks has to be dealt with on an international level mainly for the reason that this would enhance confidence in capital markets globally. Therefore, ICCI welcomes the commitment of the PCAOB to furthering close and active working relationships with the PCAOB’s counterparts <sup>(43)</sup>.

Also, ICCI is of the view that these international measures should be established by a body that has sufficiently high global authority.

Furthermore, following academic literature on this subject <sup>(44)</sup>, ICCI is generally positive on the establishment of a Public Interest Oversight Board (PIOB) within IFAC, which ensures that international auditing and assurance, ethics and education standards for the accountancy profession are set in a transparent manner that reflects the public interest <sup>(45)</sup>.

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<sup>(43)</sup> PCAOB, *Speech Text – Auditor oversight and its implications on the resilience of our capital markets*, Brussels, October 12 2006, [www.iasplus.com/usa/0610olson.pdf](http://www.iasplus.com/usa/0610olson.pdf).

<sup>(44)</sup> A. LOFT, C. HUMPHREY, and S. TURLEY. 2006. In pursuit of global regulation: Changing governance and accountability structures at the International Federation of Accountants (IFAC), *Accounting, Auditing & Accountability Journal* 19 (3), 428-451.

<sup>(45)</sup> [www.ifac.org/About/PIOB.php](http://www.ifac.org/About/PIOB.php).