

Mr. Michel Barnier
Member of the European Commission
Commissioner for Internal Market and Services
European Commission
BERL 10/034
200, rue de la loi
B – 1049 - Brussels

Brussels, 7 December 2010

Subject: **European Commission Green Paper – Audit Policy: Lessons from the Crisis**

Dear Commissioner,

The European Services Forum (ESF) is a network of representatives from the European services sector committed to actively promoting the liberalisation of international trade in services. ESF's main field of activity are the WTO GATS negotiations and the EU's bilateral trade negotiations on services and investments. We are the voice of European Services in international trade.

We are therefore focussing our observations on this important Green Paper to European Union trade obligations and our overall shared goals of promoting open markets and investment, international standards and regulatory co-operation.

The strong principle we support is that businesses and consumers must be free to select the service provider of their choice. In respect of this Green Paper, our services supplier members require a statutory auditor appointed by their shareholders on the recommendation of the Board's Audit committee or Supervisory Board and they will often require other assurance, tax and advisory services that are provided by the accounting firms, other firms within their network and a range of other specialist suppliers. We fully understand and support the need for the framework embodied in the EU 8th Directive on Statutory Audit that provides for independent Audit Committees; an ethical code for auditors and independent regulation of audit firms with full transparency and disclosure. These measures all provide appropriate and proportionate safeguards against compromising independence and objectivity of the audit firm in undertaking or continuing the audit or in providing other services to their audit client. We would be against any measures that imposed an artificial restriction on trade thus distorting the market and further limiting choice for companies.

Q19 : Prohibition on Non-audit Services

A non-audit prohibition, particularly if applied to clients other than audit clients, would be an extreme intervention in the market which could amount to a violation of Article 49 (right of establishment) and/or 56 (freedom to provide services) of the Treaty of the Functioning of the European Union (TFEU) if it is disproportionate to the aim pursued. The general principles of EU law could also render any such move impossible:

- Principle of proportionality: A non-audit prohibition could potentially be contrary to the EU principle of proportionality since it is questionable whether such a prohibition would actually result in more reliable audits. Moreover, numerous less burdensome measures to ensure more reliable audits appear to exist.
- Property and economic rights: The right to property and freedom to pursue an economic activity cannot be restricted by disproportionate measures. Since the test for proportionality in this context would closely resemble that for the principle of proportionality, a non-audit prohibition could also be contrary to these principles.
- The principle of non-discrimination: Application of a non-audit prohibition only to some or a category of firms (as if this category of firms were defined as systemic, a concept originally developed in the specific context of prudential regulation of banking, which it is not justifiable to extend casually to the market for accountancy services) is a potential breach of the EU principle of non-discrimination. Such discrimination does not appear to be objectively justified because there is no evidence that its application would protect against the feared demise of this category of firms.

Under the World Trade Organisation (WTO) General Agreement on Trade and services (GATS), a non-audit prohibition could violate Article XVI GATS which prohibits WTO Members (including the EU) from adopting "measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service."

Further Article 25(1) of the Services Directive specifically concerns "multidisciplinary activities" and provides that:

"Member States shall ensure that providers [of services] are not made subject to requirements which oblige them to exercise a given specific activity exclusively or which restrict the exercise jointly or in partnership of different activities."

However, the regulated professions, in so far as is justified in order to guarantee compliance with the rules governing professional ethics and conduct, which vary according to the specific nature of each profession, and is necessary in order to ensure their independence and impartiality;¹

Although this allows certain restrictions on multidisciplinary practices, it only does so if such a restriction is "*necessary (...) to ensure (...) independence and impartiality*". The wording suggests a strict test requiring that there are no less restrictive means of ensuring independence and impartiality (such as the current triple lock of strong corporate governance with independent audit committees, international standards of ethics setting out a principles-based threats and safeguards approach to non-audit services and strong independent regulation).

In summary, our strong view is that it is possible that there exists no appropriate legal basis to adopt EU legislation comprising a total non-audit prohibition. And any such prohibition may be contrary both to TFEU and WTO GATS obligations.

¹ Article 25(1), Directive 2006/123/EC

Q13 – Adoption of ISAs in the EU

The ESF, in general, believes that the adoption of international standards reduces the barriers to trade both within the EU and between the EU and other economies. It is important that the EU has a single standard for audit to allow for consistency and promote the highest audit quality. ISAs are the accepted international standards most widely used around the globe and have been subject to extensive consultation with business, investors and national standard setters.

Q17 – Appointment of auditors by a Third Party

ESF believes there are high standards for independent auditor appointment in the EU. While there is clearly a case for improved guidance to Audit Committees to explain why they have not re-rendered the audit, what would be totally unacceptable would be for European or national regulators to appoint the auditor. Firstly, this would again represent a restriction on freedom of choice by company shareholders and secondly, it would mean companies had different rules, processes and timescales in different jurisdictions. Even if there were a common EU framework, it would be a major inconvenience for global companies operating in the EU and a disincentive for companies to locate or list in the EU. It would lead to regulatory arbitrage and additional costs for companies which would then have different auditors in different parts of the world.

Q18 – Should auditor appointments be time limited?

Again, this should be a matter for the choice of the company and must be a global consideration; the EU should not act unilaterally. Many countries already have time-limited appointment of auditors because they must be re-appointed by shareholders every year by resolution. There is a case for looking at best practice for good corporate governance advice in this area and adopting a comply or explain approach but any fundamental change by statute must be global otherwise it will mean regulatory arbitrage, additional costs and the inconvenience and threat to audit quality of having different auditors working to different engagement periods in different parts of the globe.

Q28 – Inclusion of a smaller audit firm in an audit consortiums

This should be a matter for the company to determine according to best corporate governance whether it wishes to appoint a single auditor, joint auditors or a separate auditor for some subsidiaries. There are advantages and disadvantages that can be articulated but it would again represent an imposed regulatory intervention in the marketplace adding costs and causing regulatory arbitrage. We do not oppose the principle, but do not believe it is a matter for statute but for the company. There are other means – such as promoting international standards, reducing the costs and complexity of regulation, ensuring a genuine single market, greater transparency on audit quality and professional mobility that will lower the barriers to entry of smaller audit firms wanting to enter the large public company audit market.

Q29 – Mandatory Rotation and Tendering

ESF believes that the mandatory rotation of audit firms would reduce the choice of auditor available to companies and, more importantly, lead to global companies having more than one auditor. Fundamentally, it is a restriction on trade. Again, it would lead to regulatory arbitrage and act as a further disincentive to European listings. Although our preference would be to leave the choice of auditor to the market (i.e. shareholders), we believe that this is a matter where the debate should be global. Retendering should be a matter for constant vigilance by strong, independent Audit Committees who monitor the performance, quality, independence and objectivity of their auditor and should test the market from time to time. However, setting a defined period in statute for re-tendering will again present a Europe-only solution against our G20 commitments and not take account of the circumstances where companies may believe it inopportune to re-tender that year

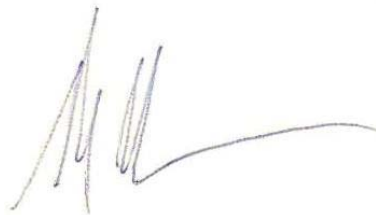
(e.g. a merger, major acquisition etc.). Company shareholders must retain flexibility and be able to operate globally.

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As ESF is principally concerned to promote open markets in services and remove restrictions on trade, we will not comment at this stage on the other questions but in general would support measures that deepen the single market, professional mobility and regulatory co-operation that increases effectiveness and transparency while reducing the ultimate costs to companies.

We hope that this will be useful to the Commission and will be pleased to add more evidence especially in relation to the EU's obligations under its own treaties, directives and international obligations not to restrict trade in services. We would also be pleased to participate in any round tables or seminars following the publication of all the comments on the Commission's green paper.

Yours faithfully

A handwritten signature in blue ink, appearing to read 'R. O'Toole', with a long horizontal flourish extending to the right.

Richard O'Toole
Chairman
ESF Policy Committee

Cc: Mr. Jonathan Faull, Director General, Directorate General for Internal Market and Services

Also submitted via email to: markt-greenpaper-audit@ec.europa.eu