

# EUROPE AND THE FUTURE OF AUDIT



Hardly has the ink dried on Ireland's transposition of the EU Statutory Audit Directive in 2010, before the European Commission published its final proposals to radically reform the audit profession and the conduct of statutory audits. **Aidan Lambe** summarises these developments.

**30** November 2011 marked the closure of one chapter on the debate of the future of audit and the opening of another as the much anticipated and widely leaked EU Commission's proposals on the future shape of audit policy were officially published. In some respects, the proposals contained little of surprise given that 'bootleg' versions of the Commission documents had been circulating since the previous September, and had already been the subject of much media comment. In summary, the proposals may well result in a radical transformation of the role and structure of the profession, how it is regulated, and the future role of professional bodies.

The Commission's proposals represent a complex package of reforms. In a short article like this, it is possible only to highlight the main provisions of the Commission measures, which run to some 130 pages of legal text. However, the EU Commission contends that;

- there remains a need to bridge the expectation gap between what stakeholders expect of an audit and what auditors actually do;

- there is a need to assure and demonstrate the independence of the statutory audit;
- more needs to be done to address market concentration and choice in the audit market.

There are essentially two strands to the Commission's strategy:

- a Regulation (direct application on Member States, with no need for local legislation); and
- a Directive (in this case amending the Statutory Audit Directive ('SAD'), transposed in Ireland by Statutory Instrument 220 of 2010).

## THE REGULATION

To date, what has prompted most comment has been the content of the proposed Regulation. This is aimed at statutory auditors and statutory audits of so-called public interest entities (PIEs). What constitutes a PIE has been expanded from the definition in the SAD to include investment firms, payment institutions, UCITS electronic money institutions and alternative investment funds (as set out in the Regulation). To complicate matters further, a 'subset' of

PIEs is also defined, namely, 'large public interest entities' ('large PIEs'), meaning:

- a. the 10 largest issuers of shares in each Member State as measured by market cap. on the basis of year end quotes (and all issuers of shares that had an average market cap of €1 billion based on year end market quotes for the previous 3 calendar years);
- b. specified 'regulated' financial institutions (eg credit institutions, insurers, payment institutions, certain UCITS, and asset management entities) with balance sheet totals or assets under management exceeding €1 billion.

This subdivision has particular implications for some of the Commission's proposals that relate to the auditors of such entities.

It is worth reminding ourselves that Chartered Accountants Ireland and, the auditing profession in general agrees that there is a need to review how the current audit framework can be modernised to meet the needs of stakeholders. What is also interesting is that the Commission proposal restates the primary purpose of the statutory audit, namely to enable the auditor to form

an opinion on whether financial statements give a true and fair view. However, it also states that that this does not include assurance of the future viability of an entity nor the efficiency or effectiveness with which management has conducted the affairs of an entity.

Undoubtedly, there are measures contained in the proposals that are inconsistent and will require further clarification and explanation and perhaps even amendment. Nevertheless, they do now represent the official position of the EU Commission which now fall to be considered by other organs of the European Union and negotiated between Member States.

#### **THE PROPOSED REGULATION (APPLICABLE TO PIES AND THEIR AUDITORS)**

While there has been mixed reaction to some of the more controversial proposals in the Regulation, there is much that is also to be welcomed. These include:

- measures aimed at enhancing how audits are conducted;
- adoption by the EU of International Standards on Auditing (ISAs) to apply to all statutory audits;
- developing the role of audit committees, particularly as regards auditor appointment and independence and more detailed reporting by auditors to audit committees;
- more transparency around the governance of audit firms;
- banning so-called 'large firm only' clauses in financing agreements;
- enhanced and better cooperation on oversight at EU level;
- measures to facilitate mobility of auditors within EU Member States.

Other proposals by the Commission have already been progressed in an Irish context. For example, Chartered Accountants Ireland and member firms recently participated in an initiative convened by the Central Bank which resulted in the publication by the Central Bank of the 'Auditor Protocol' aimed specifically at improving two way communication between auditors and the Bank on issues of mutual interest.

Needless to say, other suggested measures have attracted different degrees of support.

Ronan Murphy, FCA, Senior Partner  
PwC



In the aftermath of the financial crisis it is right to consider whether additional reforms should be implemented regarding the

role of auditors. But key to any reforms should be whether they aid the auditor's objectivity, independence and professional scepticism and enhance audit quality.

PwC strongly supports reforms which enhance audit quality and remove artificial barriers to competition within Europe. There are, therefore, many aspects of the EC proposals which PwC supports including, increased transparency arising from more informative audit reports, stronger audit committees, better two-way dialogue between auditors and financial services regulators, improvements to the mobility of auditors within the EU and a review of audit firm ownership restrictions.

PwC also supports the consultations initiated by both the IAASB and PCAOB (the two main international audit standard setting bodies) to look at ways in which auditor reporting might be modified to better meet the needs of investors.

However, some of the measures proposed by the Commission, such as audit-only firms and mandatory audit firm rotation, will not have a positive effect. They will reduce audit quality and raise costs – which businesses have indicated are huge concerns at a time of economic crisis across Europe – and risk putting Europe at a competitive disadvantage. The Commission has not provided any concrete evidence demonstrating any positive impact of these proposals on audit quality. Neither the Commission's own consultation process nor recent independent survey evidence suggest there is widespread support across Europe for proposals such as audit-only firms and mandatory audit firm rotation.

There are lessons to be learnt from the financial crisis and I fully support evidence based legislative reforms that would enhance

audit quality and remove barriers to competition.

In particular, I support measures that will promote high quality audits and a dynamic and vibrant profession and, most importantly, confidence in the financial information being reported to the markets. These include stronger audit committees; auditor 'EU passports', which would increase mobility for suitably qualified professionals in the European Union; removing any artificial barriers to entry for smaller audit firms, such as legal covenants which require the use of a large audit firm; and increased dialogue between the regulators and auditors, which would simultaneously enhance the value of audit whilst addressing other concerns around independence and market structure.

In Ireland, I would encourage publication by CARB and IAASA of annual quality review reports of large and medium sized audit practices. Greater transparency in this area should strengthen public confidence in the profession in the long run and assist audit committees of public interest entities in deciding who their external auditors should be. I would also encourage introducing reform of the unlimited liability regime to facilitate medium sized audit practices to compete in the audit market for larger companies, similar to what has been introduced in other European countries.

We have to ensure that the focus of the debate remains on audit quality and building confidence in reported financial information and to avoid proposals which could, in practice, have precisely the opposite effect for businesses engaging the audit profession. For those companies which operate in a global environment, some of the proposals will add significant costs, increase regulatory complexity and threaten audit quality, all at a time of major financial upheaval and when growth is an imperative. In my view, for a small open economy like Ireland which is heavily reliant on foreign direct investment and export markets, careful attention needs to be given to ensuring that a less competitive business environment is not created. PwC looks forward to playing an active role in the ensuing debate and discussion.



The Barnier proposals seem to have taken us all by surprise. But of course, in reality, they should not have. Right around the world, in the wake of the global financial crisis, questions were being asked about the role of auditors and whether the current audit framework and approach delivered what the capital markets and broader society wants.

The new EU proposals are an answer to some of those questions. But we should first recognise that these issues are probably best dealt with in a global context. One of the challenges for the EU process, when considering the Barnier proposals, is that any reforms should ideally be coherent on a worldwide wide - i.e. with what the PCAOB will be developing in the US, with what might emerge from the current review of 'Competition in the audit market' by the UK's Office of Fair Trading, with what the Japanese regulators will do, with what the global association of audit regulators (IFIAR) will want, etc. As audits of large organisations become more and globally integrated, it is important that any new rules will work globally as well.

Another point to make is that, refreshingly, a key message from the

current debate is to confirm and underline the absolute importance that the world places on the value of a good audit and of the concerns that are raised when audits are not delivering what they're expected to do. As ever, the famous 'audit expectation gap' needs to be narrowed; perhaps it is impossible to eliminate entirely but we should all redouble our efforts at this task.

Going back to the specific Barnier proposals, I believe that the most important issue, or criterion against which we should assess the proposals, is what they do for audit quality. It is clear that what is needed is to have the most effective audits where the risk of audit failure is minimised. This requires a focus on maximising the quality of an audit and that in turns means, I believe, that audit needs to have:

- the best quality people involved in them
- a strong sensible widely accepted accounting framework
- an effective system of oversight, monitoring and other measures which will increase the trust of society in what audit firms are delivering.

So I believe that the following guiding principles should be followed for any changes to the audit regime:

- all changes should promote the integrity and efficiency of the capital markets
- all changes should improve, and at a minimum not impair, audit quality
- all changes should improve, and at a minimum not impair, the public's confidence in the audit profession
- no changes should impair the ability of audit firms to attract high-quality

talent or threaten the sustainability of the profession and

- no changes should harm the accounting firms' significant contributions to employment and business growth unless those negative consequences are outweighed by benefits to the capital markets and audit quality.

Judging the Barnier proposals in the light of those principles, it's clear that one can very much welcome the suggestions that the scope of audit be clarified, that auditors be encouraged to share more of their insights and observations about business models, business risks etc.

It is less clear how proposals around mandatory rotation for Public Interest Entities (PIEs) and the virtual elimination of the provision by auditor of non-audit services to PIEs, match the above principles. There are good arguments to be made that those specific proposals indeed could damage audit quality and business efficiency in a number of ways.

Much has also been made of the apparent thrust of Barnier being to improve competition and widen choice. I believe there's much to be said for letting the market, i.e. audit committees and the wider group of stakeholders, decide when and how PIE auditors should be changed and, within certain limitations, how much and what non audit services should be delivered by their auditors .

The debate however has just begun. It is important that all stakeholders, not just the audit firms and their audit clients, should give their views on these important topics. I welcome the debate and indeed welcome the questioning and prospective strengthening of the audit framework in Europe and across the world.



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Brendan Jennings, FCA, Managing Partner  
Deloitte



“Firms like ours play a very pivotal role in relation to the smooth operation of capital markets. So when something goes wrong the audit profession, together with all other participants in the market, have a very clear obligation to review their role in the market

and to examine whether they could have done more to prevent the issues that subsequently transpired. Therefore, we are very supportive of any steps the European Commission takes to enhance audit quality as it runs right to the core of what we do on a day to day basis. The proposals the Commission have raised in relation to expanding the reporting standards for auditors, having a single set of independence standards across Europe and addressing market concentration issues e.g., banning Big 4 clauses by lenders, are to be welcomed.

My concern, however, is that a number of the other issues that have been raised could distract from the focus on improving audit quality and indeed in some cases may impact quality if they are to be implemented in their current form.

On the quality improvement side more

communication by auditors with financial supervisors around issues such as risk together with enhanced disclosures and reporting will help.

However, other matters such as audit only firms and mandatory rotation could have the unintended consequence of reducing audit quality. The ability of audit firms to attract top talent and the financial strength of the firms are very important issues in reenforcing that quality agenda. Other proposals will, in my view, cause unnecessary disruption in the market and it is not clear to me how these matters positively impact on the whole issue of audit quality. Again, I would reiterate the importance that firms like ours play in capital markets and attention should be focused on improving quality and suggesting changes that will make a real impact on that particular agenda.”

John Glennon, FCA, Managing Partner  
Baker Tilly Ryan Glennon

Auditors did not create the financial crisis but as a profession we cannot deny that the stakeholder confidence in audit has been shaken. There is obviously a lot of work to do in terms of communicating to the users of financial reports what they should expect from an audit. Separate from any communication issues, in my view, as a profession we must engage seriously with the questions raised about financial reporting; and work to enhance the role and scope of an audit. We must also consider how an auditor can provide assurances to all stakeholders on internal governance for regulated and public interest entities. As a firm, we support the external monitoring in respect of public interest audits.

I welcome the EU Commission’s proposals to create a more vibrant, open and less concentrated market for audit of public interest companies and to build trust in the independence of the audit profession through improved competition and greater

choice. Joint audits, which had been favoured by the Barnier team, merits further discussion, obviously joint liability could be an issue and indeed raises the issue of the enormous risk that all auditing firms face in auditing public interest companies.

I think it would be fair to say the Barnier proposals received a cool reception not only from the Big 4 but also from the investment community. In the latest draft of Barnier I understand that they have moved away from joint audits but are still proposing the larger audit firms be broken into separate entities. Ultimately, my view is that that measures faces a tough time within the political processes of the EU, and from all interested parties and will probably be watered down further. Domestically, I think the Irish regulators have a role to play on the ground in reviewing ‘below cost’ audit fees where ‘other work’ is supplied by the same firm, as I think such practices are damaging to the profession.

In relation to mid-market audits (ie non-public interest audits), I personally think we should also review the context and format of the audit report to enhance its quality and its commercial relevance to business. It should become, for instance, a valuable tool for our clients in accessing and reducing the cost of their capital.

Generally, the package of measures being considered is positive for the mid-tier firms. The challenge of course will be for those who are part of international groups, to convince the market that we have the breadth of resources to service clients in areas that have, in the past, been the domain of the Big 4.





The EU Commission's proposals of last November seek to address an issue which has long existed but has been clearly exposed by the events of the Global Financial Crisis. The Commissioner has set the goal of "restoring confidence in financial statements", focusing on auditing and the audit market as a means of achieving this goal. He has concentrated on banks, insurers and large listed companies – collectively the public interest entities. The EU proposals highlight a number of issues as being symptomatic of the acknowledged weaknesses in audit as it is currently practiced; conflict of interest and its counterpart, independence; supervision, diversity in "an overly concentrated market".

In this country, the number of companies directly impacted by the EU Commission proposals will be relatively small. The reality is that the number of such companies can probably be counted in the hundreds and the number of audit firms dealing regularly with such clients is at most ten. In reality, the audit of public interest entities is dominated by the Big 4 participants. Such an analysis informs the public response of the profession in Ireland

to date – the really interested parties are few and disinclined to broaden the debate to properly address the broad scope of what the EU proposals seek to address.

I am on the record as saying that I think a more fundamental consideration is necessary, for the good of the profession as a whole. The question of audit quality is not simply one of increased, to use the Commissioner's term, 'dynamism' in the market. If implemented, the Commission's proposals may enhance audit quality, if they successfully promote diversity and prohibit the provision of non-audit services by the auditor. I believe, however, that the profession needs to examine itself on this issue. What is audit in the 21st century and what should it be? Were we implicitly selling something, the limitations of which were not fully understood? Should those limitations be more clearly delineated or do we dare to challenge whether they can be removed? For too long, the answers to these questions have been dismissed by reference to that quasi-mythical beast, the 'expectation gap' which, to my mind at least, is at best only part of the answer.

The Commission's proposals are strongest on the issue of opening up the market to create a competitive environment. It is very clear that the EU Commissioner is convinced that the current market structure is an impediment to the goal of restoring trust in financial reporting. The proposals are welcome, although I was disappointed to see the negative reaction to the joint audit proposals, which has been

used successfully by companies globally. Mazars supports the principles of joint audit, the proposals regarding tendering and rotation, and the suggestion that auditors will be able to work freely across Europe. Again, I would note that the profession has, in its own interest, little to fear and much to gain from supporting these proposals, and should be working with audit firms and, even more importantly Government, Audit Committee's and Boards, to prepare for a meaningful transition to a new environment.

The Commissioner has set the challenge of "restoring confidence in financial statements". In this country the application of the proposals to the very large, complex organisation (and subsidiaries of international businesses) should differ significantly from the framework for the great majority of the Irish companies who are SME in nature. The Company Law Reform Group has made proposals for the improvement and simplification of company law. We as a profession should follow the lead provided in this regard. As indicated by the Commission's proposals, we should also simplify the audit requirements for small organisations that are currently facing unwieldy audit obligations and red tape.

1. *Restoring confidence in financial statements: the European Commission aims at a higher quality, dynamic and open audit market.* Press release of the European Commission, 30 November 2011.

These include, in particular:

- measures that will effectively create 'audit-only' firms, prohibited from providing any other service;
- further restrictions on the provision of non-audit services to PIEs;
- mandatory rotation of audit firms after 6 years (extendable to 9 years where PIEs opt for 'joint auditors');
- mandatory tendering for statutory audit;
- the level of prescription around the form and length of the statutory audit report

and the scope of issues to be addressed therein, including an assessment of internal control and deficiencies identified, which has been compared to effectively the introduction of a 'Sarbanes-Oxley regime' in Europe.

What is currently an EU Recommendation that 'Quality Assurance' of auditors of PIEs be effected by Member States in a manner that is independent of the profession and professional bodies now becomes a mandatory requirement.

The Regulation also envisages a specific remit for the European Securities and Markets Authority ('ESMA') in developing certain technical standards and guidance that address requirements contained therein.

#### **THE DIRECTIVE**

The Statutory Audit Directive (SAD) (Directive 2006/43/EC) among other matters, established requirements for independent oversight of the audit profession and included measures aimed at PIEs and their auditors. It is now proposed that PIE

In the December 2010 edition of *Accountancy Ireland I* suggested that the appetite for change of our profession was strong and that 2011 was shaping up to be a milestone year for reform of the profession. A year later the EU Commission published the most radical proposals for change auditors have seen in their lifetime, yet many were underwhelmed by the proposals.

The Commission sought to make changes to serve the public interest by:

- ▶ Addressing the expectation gap
- ▶ Improving auditor independence
- ▶ Addressing market concentration

Auditors will not be shocked by many of the proposals around audit quality because they have seen most of them before. Increased information in the audit report and a greater role for audit committees can't cause much angst. Adoption of ISA's and IFRS across the single market clearly make sense if you want to create a level playing field.

The Commission proposals are heavy with bold changes designed to increase auditor independence. Mandatory rotation after 6 years, mandatory tendering for public interest entities, banning non-audit services to audit clients and even the most radical splitting of the largest audit firms from their consulting arms all seek to

address auditor independence. The thesis is that increased independence will lead to increased scepticism and therefore improved audit quality. These are all moves in the right direction and should be welcomed.

Where the proposals fall well short of what was expected is in the area of market concentration. Commissioner Barnier had spoken of dealing decisively with the "too big to fail" problem and increased choice. Perhaps the commissions experience in reforming the rating agencies contributed to the lack of substantial reform in the structure of the audit market, however there are some signs that regulators may now opt to address these issues through US style anti-trust intervention. Whatever the catalyst for change, via the commission or through regulators, genuine choice in the audit market needs to be our goal.

While commentators have had mixed reactions to the Commission proposals some of the responses from the profession seem defensive. The first line of defence for those in favour of retaining the status quo is that the proposals will have the opposite of the intended effect and actually negatively impact on audit quality. This argument is supplemented by claims that the proposals will increase costs. There is no evidence to support this position however. These responses are predictable but still disappointing and owe more to the

protection of current commercial interests instead of genuine public interest and the long term good of the profession. The reaction



to the most radical proposal that the largest firms split with their consulting arms is one case in point; Ten years ago most of the largest firms sold their consulting arms, now it is claimed they are integral to audit quality.

The difficulty that these proposed changes will face in coming to fruition is that they challenge a very successful business model; where audit services are subsidised by non-audit services and artificially low pricing is used as a matter of routine. In many cases the price charged for audits is far too low. Government, regulators and the public all recognise that the status quo lacks independence and these proposals go a long way to improve auditor independence. As auditors we should face up to our role in driving change and reshape our industry structure to be fit for purpose.



The reputation of audit services is extremely important to our industry. Confidence in a robust, independent and regulated audit

industry is critical for the Irish market – and possibly for economic recovery.

It is clear that when it comes to audit, primary consideration must be to ensure an independent, high quality, audit for all listed companies and to provide clear, useful information to investors. In Ireland and beyond, investors have made it clear that they want a more vibrant, open and diverse audit market, specifically for large listed companies. As a result, investors need more companies to use a more diverse range of accounting firms.

Market forces in all major jurisdictions have led to an undesirable market structure, with a concentration of all audits being provided by a small few firms, with little – if ever – rotation. Investors recognise that intervention is needed to change buying patterns in concentrated sectors of the market. Confidence must be restored.

My predecessor as Managing Partner at Grant Thornton in Ireland, Paul Raleigh, published an article last year with regard to auditor independence for listed companies which is, obviously, essential and in the best

interest of both the public and the profession. He set out the three pillars required to transform audit:

1. The need for a ban on non-audit services for auditors of listed entities;
2. The need to introduce mandatory rotation of auditors; and
3. The damaging effect of too few firms doing too many listed company audits.

These issues are addressed to some extent in the recent European proposals.

I support the restriction on the provision of non-audit services by the auditor for listed entities. This will enhance independence and is in the public interest. It might also be used as a tool for addressing market structure by introducing more firms to the market. However, there is a need for clear lines on permitted and restricted services.

I believe that mandatory firm rotation is necessary to enhance independence. It could also be a useful tool to help reduce concentration if accompanied by provisions to change audit buying patterns. However, under the current proposed legislation, that is not the case. Mandatory rotation on its own could very well increase concentration. I support the concept which was included in the leaked proposals where large listed companies were encouraged to use auditors from the “smaller” firms. The retained incentive in the published proposals could be made more meaningful by rotation after, say,

twelve years, and not six years, for large public interest entities that use a “smaller” firm and after, say, eighteen years, and not nine years, for other public interest entities that use a “smaller” firm.

The provisions for an open and transparent tendering process, which should include an invitation for at least one smaller firm to tender, are critical to ensure a level playing field for all. A firm’s audit committee must recommend two audit firms to the shareholders for appointment, shareholders must make the final decision and restrictions as to who can be appointed auditor must be banned.

There have been parties who have suggested that audit quality may diminish as a result of changes to the structure of the market. These suggestions have no basis and are not in the interests of the overall profession. Any such arguments should be countered by Chartered Accountants Ireland. Firms such as ourselves are already delivering quality services in the large listed sector. It is important that this should be clearly communicated to the market.

The market, as it applies to the audit of listed companies, needs to change. The Commission’s stated aims are laudable and some of the proposals should be supported. I strongly believe however that the profession itself (and here in Ireland, our Institute) should be leading and driving the changes necessary to improve the reputation and delivery of audit in the overall public interest.

specific requirements be removed from the SAD given that these will now be dealt with separately by Regulation, thereby having direct and uniform impact throughout the EU. However, the amending Directive introduces further amendments addressing a liberalisation on the ownership rules for audit firms, measures to facilitate cross border audit firms, greater and closer cooperation on an EU basis by audit oversight bodies.

From the perspective of the professional accountancy bodies, a significant proposal included in the amending Directive is that

the role of professional bodies in regulation and quality assurance of all auditors is significant curtailed and will be limited, at most, to approval and registration functions of statutory auditors only. The consensus view of these proposals as currently drafted is that any role for the profession in quality assurance of statutory audit in the future will disappear. Whether such a drastic proposal survives the EU negotiation process remains to be seen. This proposal, in particular, may be quite unpopular among many EU Member States, particularly smaller Members.



MICHAEL BARNIER, EUROPEAN COMMISSIONER FOR  
INTERNAL MARKET AND SERVICES

FEE has argued that this measure represents a 'paradigm shift' which will 'transform what is today a profession into a 'regulated industry' which will affect the values and discipline that a professional body instils in its members.'

Taken as a whole, the proposals impose significant changes to the functions, role, and responsibilities of the so-called 'competent authorities', i.e. those bodies that currently constitute the public oversight mechanisms for the conduct statutory audit. In Ireland's case, this is the Irish Auditing and Accounting Supervisory Authority (IAASA). This was established under the Companies (Auditing and Accounting) Act, 2003, to address specific issues that had been identified in this

country and at a time when the European Union was just beginning to think about a greater role in the regulation of statutory audit. Since then views on how the profession should be supervised and the roles of oversight bodies have moved on. The 2003 Act, while arguably ahead of its time when it was enacted has now endured the strain of having 'shoe-horned' into its provisions the requirements of the Statutory Audit Directive (SI 220 of 2010), a major piece of European legislation. The current proposals from the Commission, namely the Regulation and amending Directive, represent a far greater challenge for domestic legislation. Perhaps now is the time to revisit the 2003 Act in its entirety.

## NEXT STEPS

The next year or so will see negotiation and debate of the Commission's proposals among EU Member States and the European Parliament. It is also possible that during this time, there will be a consultation locally on the proposals by the Department of Jobs, Enterprise and Innovation. The Institute's Future of Audit Group will continue its analysis of the proposals offer views thereon. What is certain is that an interesting time lies ahead.

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When the EU Commission announced its proposals on audit reform on 30th November 2011, it is unlikely that Michel Barnier, the Commissioner responsible, expected the opposition to some of his initiatives to be so universally robust, none more so than to mandatory auditor rotation. In the UK, a recently released survey of FTSE 100 finance directors found that there was no support for mandatory audit rotation and less than 15% support for mandatory retendering. They saw these proposals as retrograde in bringing more and not less concentration to the audit market arising from a combination of shorter engagement periods (the six year term proposed by Barnier), cooling off periods, and the potential preclusion from audit tenders of any other firm providing non-audit services to a public company. Clearly, mandatory audit firm rotation would remove the decision of when and whether to replace

an auditor from the purview of the Audit Committee without reducing concentration or enhancing audit quality. Mandatory retendering would be detrimental to Audit Committee oversight and could threaten audit quality by putting audit firms in perpetual marketing mode. Rather than incentivise greater auditor independence, it would work against it.

There is no doubt that all stakeholders in the audit process – investors, companies and audit committees, auditors, analysts and other financial statement users – support the desire to enhance auditor objectivity and independence. It is just that mandatory audit firm rotation is not the answer. Barnier's assertions that "The lack of regular tendering of audit services and periodic rotation of audit firms has deprived audit of its key ethos: professional skepticism" and that the introduction of mandatory audit firm rotation would enable "higher quality audits" are largely seen to be without foundation and support. The American Institute of Certified Public Accountants (AICPA) in response to similar suggestions from US regulators have said that mandatory audit firm rotation may hurt audit quality because it may limit the auditor's knowledge of the company and

the propensity to build up industry specialisations which they say increase during the audit firm's relationship with a company and are critical to a high quality audit. At their National Conference in early December, they cited research indicating that mandatory audit firm rotation has the unintended consequence of increasing the propensity for fraud. They also believe that it undermines the Audit Committee's ability to select and retain the most qualified audit firm. Even the regulator (PCAOB) has found no correlation between auditor tenure and the number of comments in its inspection reports. Similarly the US Institute of Internal Auditors (IIA) have objected, indicating that they do not see a difference between the scepticism of a new versus an existing audit firm, also citing the steep learning curve and potential loss of knowledge. Instead they propose mandatory rotation when circumstances arise, such as restatements, fraud or other audit failure.

A more optimal solution may be for Audit Committees to conduct periodic evaluations of audit quality in determining whether there is a need to retender the audit, and to have transparent disclosure about their decision-making process