

Mairead McGuinness
Commissioner in charge of Financial
Services, Financial Stability and Capital
Markets Union
European Commission
Rue de la Loi 200
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23 July 2021

Dear Ms McGuinness,

In my capacity as Chair of the « Haut Conseil du Commissariat aux Comptes » (H3C), the French supervisory authority for auditors and audit firms, I read with great interest the speech you gave on 27 May 2021 at the European Policy Centre.

The quality of financial information disclosed by Public Interest Entities (PIEs) and by other entities, of which the statutory auditor is the guarantor, is essential for the vitality of the European economy as it facilitates the financing of these entities, which fosters their development, makes them more resilient to crises and is beneficial to all stakeholders. However, as you pointed out in your speech, recent financial scandals, some of which relating to listed entities, send strong signals that the choices that have been made with regard to the supervision and audit of financial information should be re-examined.

As regards statutory audit, based on our experience, enhancements are necessary in the following five areas:

1. Extending joint audit by making it mandatory for certain categories of entities

The joint audit establishes an emulation between the statutory auditors, which is favourable to the quality of the audit and consequently to the strengthening of the quality of the financial information. The permanent interaction between the two legal auditors, in particular through the cross-review process, makes it possible to compare analyses on major subjects which require assessment and to benefit from a wider range of expertise. The “four eyes” approach resulting from the joint audit

contributes, when the standard is complied with, to improving the quality of the exchange between the statutory auditors, with the management of the entity, as well as with the audit committee. It strengthens the authority of statutory auditors vis-à-vis the management of the company and its governance bodies. In times of crisis or difficulty, this “four eyes” approach strengthens the governance by reducing the risk of insufficient independence vis-à-vis the entity.

Moreover, making joint auditing mandatory would help improving market supply and its diversity, as observed in the French market, where it has been in place since 1966. The H3C notes that the level of concentration on the statutory audit market in France is significantly lower than in other countries. While it has to be acknowledged that the concentration of the audit market continues in France, it is however evolving at a much slower pace than in other countries. About 250 audit firms are involved in the statutory audit of PIEs in France.

For these reasons, the H3C considers that joint audit shall become mandatory at European level for certain categories of entities.

Based on our experience, the following elements are key for successful joint auditing:

- Joint responsibility of the two auditors on the audit opinion issued on the entity’s financial statements or its group’s financial statements;
- Allocation of audit engagements in the group’s subsidiaries to allow each joint auditor to have a sufficient knowledge and understanding of the group, based on a maximum ratio of 70%-30% determined at the level of the group;
- The allocation of audit engagements within the group, combined with the jointly audit preparation phase and the cross-review of the audit files of each auditor at the end of the audit, allows according to our experience to limit redundant work while ensuring better audit quality;
- Incentives, such as an extension of the maximum duration of the audit engagement with the entity (as it has been retained in the extant Audit Regulation) are necessary. Such a measure is also justified by the higher degree of independence in joint audits.

2. Harmonising the rules applicable to audit at European level

The Audit Regulation provides for a number of options to accommodate the needs expressed by the Member States. The existence of multiple options is an obstacle to harmonisation at European level and leads to complexity in carrying out audits. As such, the H3C wishes that the announced revision result in a reduction in the number of available options, particularly as regards the list of non-audit services which are authorized, and the requirement, or lack thereof, to set-up an audit committee.

3. Strengthening European influence on international auditing and ethics standards

In June 2021, the CEAOB has finalised a study on the auditing standards applied in the Member States. This study identifies the differences between European and international auditing standards (ISAs) provisions as well as those resulting from provisions of certain Member States, resulting from national choices.

In the perspective of the Capital Markets Union, establishing a European regulatory framework would make it possible to limit the gaps within the European Union, promote greater consistency in the conduct of audits, would facilitate the harmonisation of supervision and would improve its effectiveness, thereby contributing to better audit quality. The aim must be to establish a mechanism for adopting auditing standards applicable in Europe which would strengthen Europe's voice and increase its influence in the development of international auditing standards (ISA). This mechanism should build upon a process allowing the EU to develop a common vision on auditing standards that would meet the needs of the internal market, thus making the European level the first relevant level of convergence. This vision would then be used within an international standard-setting governance context to allow the EU to co-construct the standards with those who are committed to applying them.

4. Strengthening internal quality control requirements for audit firms

Audit quality and statutory auditors' behaviour are intrinsically linked to the effectiveness of internal quality control systems of audit firms. However, as you have noted, recurring failures are observed in the audit sector, including among the "Big Four". These findings show that audit firm management has not implemented all the necessary quality control measures on its activities.

To strengthen the commitment of audit firm management and its involvement at the highest level in its internal quality control system, the H3C recommends introducing an annual requirement for audit firm management to confirm to its national competent authority and the controlled entities on:

- The effectiveness of the internal quality control system of the audit firm;
- Its responsibility for documenting the effectiveness of the internal quality control system of the audit firm.

The internal quality control system of audit firms should be adapted under the principle of proportionality by taking into account the profile of the audit firm (size, organisation, activities) and the portfolio of controlled entities.

5. Streamlining the scope of the requirements of the Audit Regulation and the Audit Directive

The appropriate definition of the scope of the different requirements of the Audit Directive and the Audit Regulation and their articulation are crucial to achieving the desired objectives. We have encountered certain difficulties in applying them, and even, in some cases, we have had doubts about their relevance.

The H3C considers that the Audit Regulation and the Audit Directive should be reviewed to ensure that the provisions related to the statutory auditor (do they apply/should they apply to the statutory auditor, the audit firm or the network?) and to the audited entities (do they apply /should they apply to the entity or to the group to which the entity belongs?) apply to the most appropriate scope.

Furthermore, beyond these five topics, we would like to draw your attention to three measures that would contribute to improving the quality of the audit by strengthening the supervision of statutory auditors:

1. Strengthening the role and powers of the CEAOB

The CEAOB has recently (in June 2021) decided to review the wording of its mission which until now was limited to the tasks assigned to it in the Audit Regulation. The revised formulation highlights the objectives that the CEAOB aims to achieve: « *The CEAOB fosters convergence of practice by European audit regulators and the improvement of audit quality in Europe in order to further trust in informative, reliable, and independent audit reports* ».

Under the extant rules, the CEAOB issues non-binding guidelines and provides expert advice to the Commission and the competent national authorities, at their request. These extremely limited powers do not live up to the European Union's ambitions for the Capital Markets Union. To contribute to a more harmonised audit supervision, the CEAOB should be entrusted with the task of establishing common guidelines that national competent authority would have to comply with or to inform of the reasons if they decide not to comply with.

In view of the importance of these challenges and the rapid evolution of techniques and tools faced by statutory auditors (increased amount of data to be audited, increased risk of cyber-attacks, assurance work to be performed in the future on sustainability reporting) the CEAOB and the competent national authorities should be given greater powers and additional resources to adapt supervision without delay to respond to these new challenges.

Moreover, it is necessary to give the CEAOB its own capacity for initiative to follow these complex issues over the long term (in support of its members).

The implementation of these proposals would require to amend the extant European legislation (with regard to the powers of the CEAOB in particular), as well as a financial effort on the part of its members. The pooling of financial resources by the members of the CEAOB would make it possible to set up a central team and central tools complementing those made available by the Commission or by our German counterpart, and would limit the funding to be sought from the Commission.

2. Increased transparency on the results of inspections carried out by the audit oversight bodies

There is a wide range of practices amongst the audit oversight bodies regarding the transparency of the results of audit inspections reports. This information is particularly useful for the shareholders of the audited entities and for their audit committees. Furthermore, greater transparency on this area would be a highly effective way of contributing to a better application of the regulatory framework by audit firms and thus to the strengthening of the quality of the audit.

The H3C recommends at least to require at the European level the communication of the results of the individual inspections carried out on the statutory auditors (legal entities and natural persons) by the audit oversight bodies to the relevant audit committee, or the results of the individual inspections carried out on the engagement, if the latter has been selected during the inspection.

3. Harmonising and strengthening the investigative and sanctioning powers of audit oversight bodies

Article 23(2) of the Audit Regulation provides that *“Member States shall ensure that the competent authorities have all the supervisory and investigatory powers that are necessary for the exercise of their functions under this Regulation in accordance with the provisions of Chapter VII of Directive 2006/43/EC”*. Without calling into question the prerogatives of the Member States in this area, we believe that this mechanism needs to be harmonised and strengthened. The Audit Regulation shall provide for mandatory coercive measures when a firm restricts the access of the audit supervisors to information or, when a lack of cooperation is observed during an investigation.

In addition, the improvement of the system of sanctions (in particular monetary sanctions) should be further examined, particularly as recent situations seem to indicate negligence in the application of standards, or ethics provisions by statutory auditors. Increasing the penalty ceilings would strengthen the credibility of the European system. Broadening the range of sanctions would also be useful, for example by drawing inspiration from provisions adopted by some audit supervisors which temporarily prohibit a statutory auditor from intervening for the benefit of a given sector of activity.

Finally, the H3C would like to draw your attention to an element that could contribute to the quality of audit within the European Union: in the event that the revision of the Audit Directive and Audit Regulation would result in transitional measures, it is important to ensure clarity in their wording to facilitate their proper application.

This letter articulates our preliminary views on these topics. I would be pleased to meet you to explain them in further detail and to further contributing to the future revision of the Audit legislation in Europe.

Please accept, Madam Commissioner, the assurances of my highest consideration.

Florence Peybernès
Chair