

**DIRECTORATE GENERAL FOR INTERNAL  
MARKET AND SERVICES**

**CONSULTATION ON CONTROL  
STRUCTURES IN AUDIT FIRMS AND THEIR  
CONSEQUENCES ON THE AUDIT MARKET**

**SUMMARY REPORT**

## EXECUTIVE SUMMARY

DG Internal Market and Services received 67 responses to its public consultation on control structures in audit firms and their consequences on the audit market. The consultation was launched in November 2008 with a deadline for the receipt of comments of 28 February 2009. The consultation was a follow up of an independent study on this subject conducted by the consultancy firm Oxera.

### *Need to open the international audit market*

1. In general, respondents agree that there is a need to open up the international audit market and to decrease the market share that is held by the biggest four players or at least to ensure that the current market structure does not deteriorate any further. Respondents approach this issue from different angles: they refer to a lack of choice, a lack of competition, a lack of recognition of the capacities of other firms and a systemic risk of a demise of a large audit firm. Initiatives to encourage new entrants to the audit market for international companies would be welcomed provided that a high audit quality is maintained. This is especially important in the context of the current financial crisis.

### *Need for a more integrated European market and for more integrated audit firms and networks*

2. Respondents stress the need to co-ordinate regulatory policy at EU level in order to encourage better integration of the audit market in the EU. Any action should also take into account the global dimension of this market.
3. Some respondents underline that the current corporate structures, based on loose associations of audit firms in a network, limit the efficiency of the services performed. Moreover, auditors might have difficulties in ensuring high quality in audits based on such loose international structures. The creation of more integrated firms and network should therefore be encouraged.

### *Changing rules on control structures is not the 'silver bullet'*

4. Most of the respondents consider that the lack of access to external financial capital is not the most significant barrier preventing the emergence of new players. Therefore, changing the current rules on control of audit firms would not be sufficient on its own. Nevertheless, for some of the respondents, allowing external investment in audit firms might help smaller firms to grow or at least to contribute to ensuring more sustainability of the current market structure. For other respondents, the risks linked to the external investor model exceed any potential benefits.
5. Even those respondents favouring a model where the financial capital is provided by external investors often believe that some restrictions on control of audit firms should be maintained (such as restricting the maximum voting rights per investor). A majority of auditors are opposed to the external investor model but

some of them underline that the current rules could be amended to include other professionals who work full time in audit firms and are subject to the same ethical rules (such as tax advisors).

#### *Independence of auditors is paramount*

6. A large majority of respondents express concerns over the negative effects that allowing a majority of external investors would have on the independence of auditors. A careful analysis should be carried on whether the existing or additional safeguards would address these concerns in case of a further relaxation of the rules on control of audit firms.

#### *More catalysts should be put in place*

7. 90% of respondents believe that the Commission should strive to reduce all potential barriers to the entry, growth and survival of audit firms in the international audit market. In order to improve the situation on the supply side and to facilitate the growth of alternative firms, respondents identify a need for more harmonisation at EU level concerning independence rules, qualification requirements, liability limitations and auditing standards for auditors. They also call for closer cooperation between public oversight systems and the possibility to provide statutory audit services without multiple registrations across the EU. Many respondents believe that a consistent implementation of the existing Directive on Statutory Audit would already be beneficial even if not entirely sufficient. In this respect, Member States should refrain from introducing stricter national rules (avoid so-called 'gold-plating'). Finally, some respondents are in favour of introducing governance rules for audit firms.
8. On the demand side, respondents also suggest measures to address the lack of recognition by audit clients of the actual audit capabilities existing on the market, especially the services that mid-tier audit firms can provide. These measures include increased involvement of companies' audit committees and of shareholders in the evaluation and tendering of audits, more frequent and transparent tender procedures, more availability of information on the quality of the audits performed. Finally, the respondents proposed other solutions including making joint audits of consolidated accounts mandatory in the EU.

#### *Human capital aspects*

9. On one hand, almost half of the respondents consider that, for an audit firm, human capital is more important than financial capital to expand internationally. On the other hand, less than 20% of respondents consider that the current ownership structures are indispensable in order to retain human capital. Even if the current structures have been successful in recruiting and retaining high quality professionals, examples from other professions show that the same objective can be achieved with different ownership models.

## 1. INTRODUCTION

### 1.1. The aim of the consultation

In November 2008, DG Internal Market and Services launched a public consultation on the control structures in audit firms and their consequences on the audit market. The consultation was a follow up of an independent study on this subject conducted by the consultancy firm Oxera.

The first two questions in the consultation asked respondents to identify the problems on the international audit market.

**Question 1:** Do you see a need for opening up the market for the audit of international companies in order to have more European wide audit service providers compared to the existing situation? Do we need a more integrated audit market? If yes, why?

**Question 2:** Do you believe that the current number and structures of the audit firms' networks are sufficient?

The consultation then put forward two options for changing the current situation:

- de-regulation of the capitalisation of audit firms (unbundling) and
- other catalysts related to human capital of audit firms, fragmentation of legislation, barriers existing on the supply and the demand side.

To this end, the public was invited to respond to the following questions:

**Question 3:** Is access to financial capital a key factor to accelerate further integration of audit firms and emergence of new players? Do you share the view that allowing for competing models (e.g. partnership model, investor model, ...) will create the opportunity for more investments resulting in more global players? Are other models conceivable?

**Question 5:** Should the Commission examine other catalysts accelerating access to the international audit market? If so, which one and why?

Finally, the public was invited to consider the effect that a change of ownership rules could have on the independence of auditors and on the human capital and to identify obstacles related to human capital preventing further integration of audit firms.

**Question 4:** Would models other than the current one negatively affect auditors' independence? Is there a need for additional safeguards at European level to protect independence? If so, what safeguards should be strengthened?

**Question 6:** Are the current partnership forms of ownership indispensable in order to recruit, retain and further develop human capital? Could alternative structures under revised control rules allow audit firms to retain human capital and preserve audit quality?

**Question 7:** Is human capital a factor more important than financial capital to expand internationally? Do you see in the current regulation for the audit profession any obstacles related to human capital preventing further integration of audit firms?

## 1.2. Origin of the respondents

DG Internal Market and Services received 67, often detailed, responses from a wide range of stakeholders from 13 Member States and one third country.

### Respondents

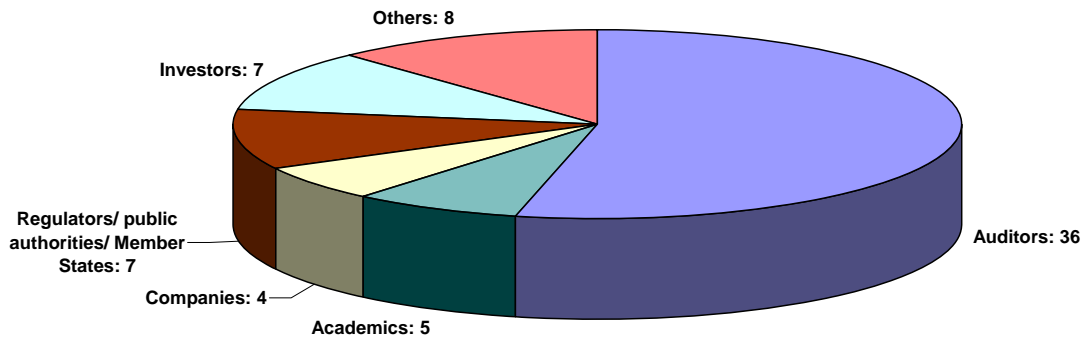


Figure 1: Total number of respondents, divided by category (NB: the category 'Others' comprises respondents such as tax advisors, insurers, individuals or internal auditors).

### Origin of the respondents

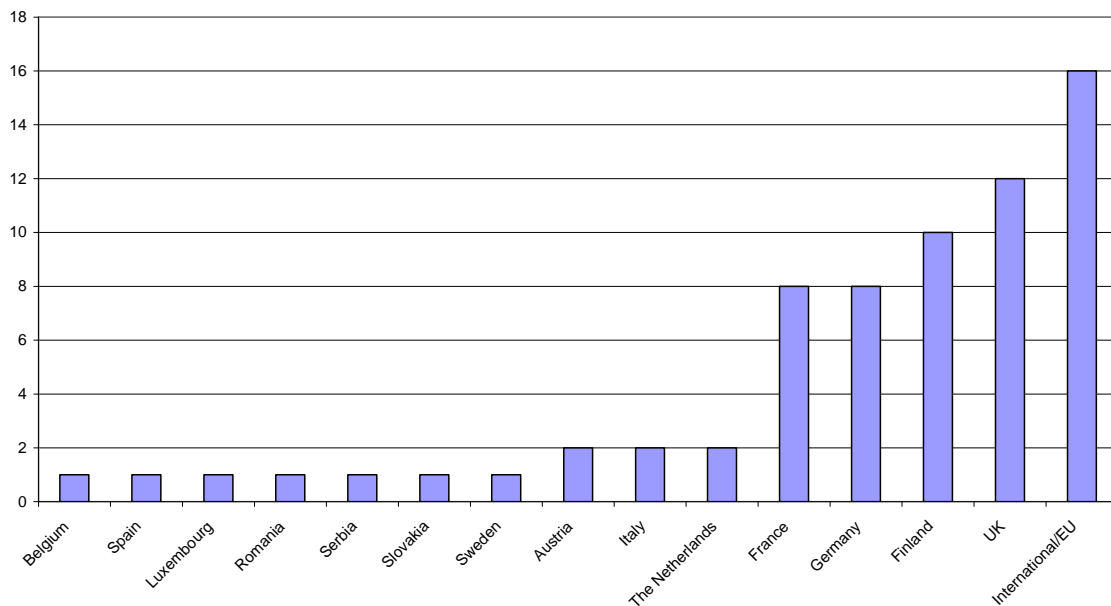


Figure 2: Respondents - according to origin (NB: the category of 'international/EU' comprises respondents who replied, according to their statements, on behalf of entities with global or European reach.)

The statistics presented in the following sections reflect our understanding of the replies.

## 2. RESPONSES TO QUESTIONS 1 AND 2

### 2.1. The market for the audit of international companies

Overall, respondents acknowledge a need to open up the market for the audit of international companies to more suppliers or at least to ensure that the current market structure does not deteriorate further. Many respondents believe that the existing **oligarchic** situation where only four large networks (Big 4)<sup>1</sup> constantly hold a high market share for audits of international companies is not sustainable. Respondents approach the issue from different angles:

#### 2.1.1. Lack of choice?

For some respondents the problem can be described as **lack of choice**: audit committees and shareholders would benefit from a less concentrated market as they would be able to choose from a wider range of audit firms than is currently the case. The lack of choice concerns the audit market for large international companies (some respondents refer to large listed companies) rather than the whole market for international companies. Small international companies do not seem to be concerned by this issue. More choice is vital for specific parts of the market, for example audits of the financial institutions, given the rules on independence and the necessity to have specific expertise, choice is often even more limited (less than the Big 4) in this market.

Respondents who highlighted the lack of choice consider, in general, that this problem does not imply a **lack of competition**. Nevertheless, a small number of respondents underline that in the current situation, there are insufficient incentives for the audit firms to deliver high quality audit services and that there is a lack of competition in the market for the audit of large international companies.

#### 2.1.2. Lack of recognition of capacities of other firms?

Some respondents consider that the market share of the four largest networks in the audit market for international companies cannot be justified solely by the fact that these networks are the only ones able to undertake audits for companies with subsidiaries abroad. For the audits of the majority of international companies, the real choice is larger than the Big 4 and includes some mid tier audit firms, but these firms are at a disadvantage due to the **lack of recognition** of their capacities. Many mid tier audit firms already have the capacity to work in the international audit market (except perhaps for the top end of this market) but they are currently unable to 'break into' the market. Therefore, for some respondents, mainly from the mid tier audit firms category, there is a sufficient number of networks but the quality of audits performed by the mid tier audit firms as well as their network capabilities do not have a sufficiently wide recognition. These respondents consider that the problem of lack of choice is effectively limited to the Big 4 only in the top end of audit the market for large international companies.

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<sup>1</sup> Deloitte&Touche, Ernst & Young, PricewaterhouseCoopers and KPMG.

### 2.1.3. Systemic risk?

Other respondents consider that the availability of audit services is currently satisfactory and that there is a robust competition in this market segment, but they recognise nevertheless that this situation implies a **systemic risk** for the capital markets that can be expected if a large audit firm leaves the market suddenly. This systemic risk is also perceived as a threat by respondents highlighting the current lack of choice. Given the lack of players perceived as having the capacity to audit financial institutions, the collapse of one of the Big 4 would be even more serious for this category of client. Such a loss would also have a serious impact on public confidence for audit services. Given the key role of auditors in the relationship between companies and investors, it could also result in a crisis of confidence in financial markets. The current concentration in the market for large public company audit services therefore poses a threat to financial market stability.

In general, the majority of respondents are not convinced that market forces themselves will provide a solution to the problems they have identified. Therefore, a large majority of respondents would welcome initiatives to encourage new entrants to the audit market for international companies whilst ensuring that a high audit quality is maintained. This is especially important in the context of the current financial crisis.

## 2.2. Need for a European audit market ?

Firstly, respondents consider that the EU has yet to benefit fully from the steps taken by the new Statutory Audits Directive<sup>2</sup> (hereinafter the 'Directive'). In this context, a consistent implementation of the Directive (no "gold plating" by different Member States) is essential for creating an environment conducive to the development of more audit providers operating with a greater cross border capacity.

In addition, stakeholders noted that, to-date, there has only been modest trans-national co-ordination of regulatory policies at European level to allow for a simplified framework for audit firms. They underline the need to encourage the creation of a single European-wide audit market. The legal framework and supervisory structures in EU are currently not sufficiently integrated to facilitate the integration of the audit market.

Nevertheless, the issues are not only of a European but also of a global nature. Some respondents underline that even if a new audit firm owned by external investors would gain a significant market share in the EU, it could only co-operate in a network structure with US auditors. The worldwide growth of such firms would therefore be constrained by the application of US rules. Accordingly, in order to be effective, actions increasing choice have to be co-ordinated at an international rather than European level. Greater integration at European level would be necessary but not sufficient.

Finally, some respondents also underline that in many developing markets outside the EU, such as China, there is an audit capacity issue as companies face problems in finding qualified auditors. It is also mentioned that some firms from these developing markets could emerge and gain dominance in the global market.

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<sup>2</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, published in the Official Journal L 157, 09/06/2006 P. 0087-0107.

### 2.3. Need for more integrated audit firms and networks?

On one hand, according to many auditors the current situation is satisfactory. Auditors can choose between several legal possibilities (partnership, limited liability partnership or limited liability company...), and networks can adopt a wide range of different structures from loose associations of separate firms to full integration. Some auditors consider that policy makers should preserve the existence of non-integrated networks as these structures respond to the needs of certain clients.

On the other hand, some investors or companies believe that current structures limit the efficiency of the services performed and cannot ensure quality throughout the network. They consider that the current structures with financing partners are outdated: that the lack of investments negatively impact on innovation capabilities. Existing partners would remain dedicated to just defending their current positions and focusing on existing markets and on the development of value-added services for existing clients rather than gaining new clients or markets.

Therefore, according to some respondents, more integrated audit firm structures and networks should be encouraged, for example through a modification of the rules on control of audit firms. Other respondents indicate that some networks are currently becoming increasingly integrated within the existing partnership model.

## 3. RESPONSES TO QUESTION 3

The first option presented in the consultation paper concerns the modification of the rules on the control of audit firms to allow for capital investments from external investors, beyond what is currently permitted by Article 3 of the Statutory Audit Directive. Several possibilities are conceivable in this respect. It could be an outside investor model where the majority of the voting rights are no longer held by auditors. It could imply a ban on imposing restrictions on the ownership of audit firms or only a relaxation of the rules (allowing external investors to take majority shareholdings and voting rights in a firm). It could also be a multidisciplinary practice model where auditors and members of other regulated professions such as tax advisers or lawyers provide the capital (but the majority of the capital would not be reserved for qualified auditors).

### 3.1. Is access to financial capital a key factor to accelerate further the integration of audit firms and the emergence of new players?

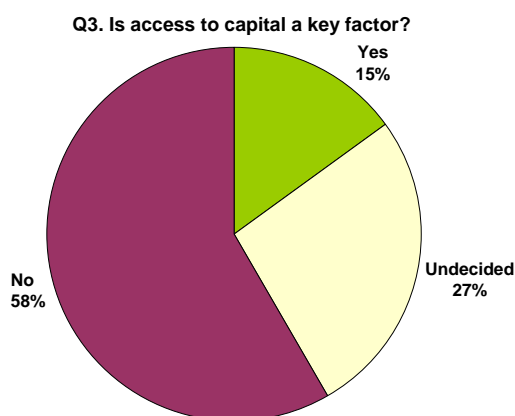


Figure 3: Percentage of replies from all the categories of respondents.

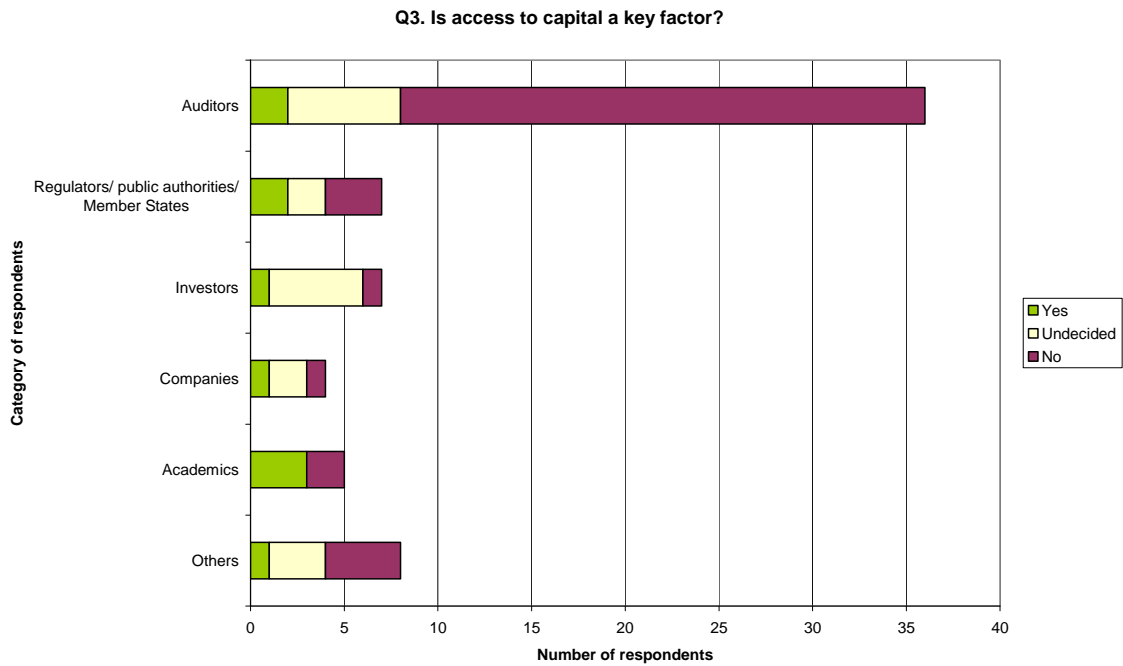


Figure 4: Number of respondents in each category.

Most of the respondents (58%) consider that the lack of access to financial capital is not the most important factor preventing the emergence of new players, even though they frequently acknowledge that financial resources have a role to play. It is suggested that the Commission should also consider other potential barriers to entry (see further below - section 5).

### 3.2. Is there a need to change the current rules on ownership?

**Q3. Should competing models of ownership be allowed?**

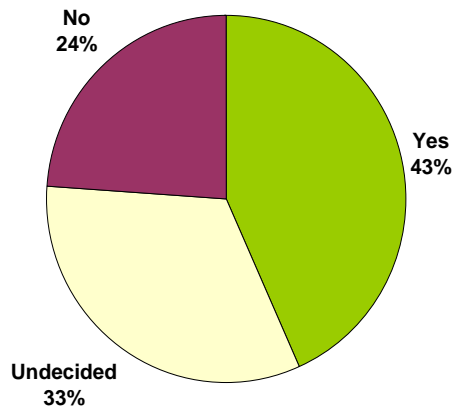


Figure 5: Percentage of replies from all the categories of respondents

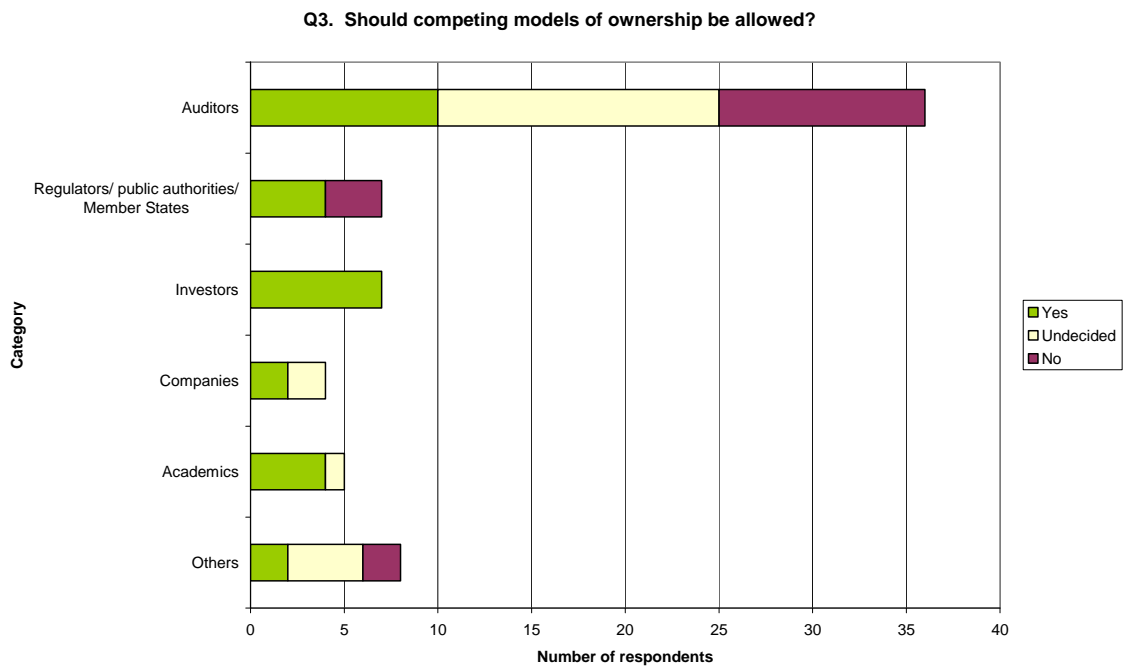


Figure 6: Number of respondents in each category (NB - the answers in favour of allowing competing models refer to any change to the current ownership rules, covering various options (ban on imposing restrictions on ownership, multidisciplinary models, partial relaxation of the capital ownership, other models).

For most of the respondents, changing the rules on ownership structure should not be seen as a 'silver bullet': a wider number of catalysts have to be analysed. Nevertheless, 43% of respondents would support a modification of the current rules on control of audit firms whereas 33% of the respondents are undecided and only 24% are opposed to any change. This modification could imply the possibility for external investors to invest in the audit firms or to expand the rules to include other professionals who work full time in audit firms and are subject to the same ethical rules.

All investors who responded are in favour of changing the current rules on control of audit firms. Even if there is no clear evidence that a lack of access to financial capital is the most important factor, allowing access to external financial capital may contribute, together with other actions, to the emergence of new players in the long term. Even if it does not lead to more choice, it could at least contribute to ensuring sustainability of the current market. Most of the academics also support changing the current rules.

There is no clear opposition from companies to changing the rules on control of audit firms (some are in favor of the reform whereas others are undecided).

The views among auditors are split. Some associations of auditors and mid tier audit firms believe that external capital is one of several factors that could influence the decision to pursue expansion. For others, the availability of talented people and the need to develop relevant expertise is more important than access to financial capital. Some also doubt that such a reform would lead to the emergence of new players and they underline the risks linked to a model where the capital is provided by outside investors (see section 4). Some auditors would instead favor a solution that allows greater possibilities for establishing multidisciplinary practices (see section 4.3).

The views among respondents from the category of regulators, Member States and public authorities are also very much split.

### **3.3. How should the rules be modified?**

Many respondents, across the categories, feel that a total lifting of all ownership rules would not be a good idea. Therefore, many respondents, even those in favour of a reform of the current rules, feel that some restrictions on the control of audit firms should be maintained, such as restricting the maximum number of voting rights per investor to, for example, 10%.

Some auditors would be opposed to external investors but they consider that ownership could be widened to include other professionals who work full time in audit firms and who are subject to the same independence and ethical standards. Nevertheless, investors, for example, underline that the provision of non-audit services by audit firms could have a negative impact on a company's choice when selecting an auditor because of the independence rules in place. Therefore, it would not be appropriate to encourage the creation of multidisciplinary practices where auditors are associated with lawyers, tax and accountancy firms.

Further models are conceivable, such as state-owned bodies which would operate under the same regime as commercial audit firms. Nevertheless, if an audit firm were state-owned it would be unlikely to attract the best people because the level of remuneration might not match that of the private sector. Moreover, a state-owned audit firm might also raise political concerns due to the liability exposure of public funds. There is also the possibility of a hybrid model: combining a partnership with external investors and/or funding from the taxpayer. Finally, majority ownership could be extended to include auditors and audit firms from third countries that are subject to equivalent oversight and professional regulation to those applicable in the EU. In this way, new possibilities could be created to invest in securing global audit quality.

Any rules on ownership should be defined at EU level and not at national level. It is underlined that restrictions as to who can own or control audit firms differ from Member State to Member State and limit the possibility for external ownership models, thus constituting a barrier for the establishment of cross border audit firms. Harmonisation of the rules on control structures would help increase the cohesiveness of the audit firm networks and possibly encourage competition for large audits. It would be therefore welcomed, as a first step, that all Member States implement the current provisions of the Directive consistently and avoid any 'gold plating'.

### **3.4. Main arguments in favour of a majority of external investors:**

A change in the ownership rules would enable non-Big 4 audit firms to access enough capital to compete in the market. The lack of capital is perceived as an inhibitor to the emergence of new significant players. A network or a firm attempting to compete with the largest firms will need to make important investments (to attract, train and retain staff, adapt the internal structure...). More relaxed ownership rules would allow enhanced cross border integration of audit firms.

The dynamics in terms of return on and return of investment within the partnership make it difficult for partners to enter into capital investment projects. It could be therefore beneficial to attract financial capital with longer investment horizons (this point of view is supported by some investors, regulators and auditors).

The present ownership models also have, on average, a higher cost of capital. In addition, the ability to access capital rapidly might be of assistance in relation to liability risks and might allow a firm to be recapitalised.

Finally, there may be other benefits of reviewing ownership rules so that non-executives can be appointed to a firm's governing body to facilitate its operation and effectiveness. There would also be more competitive differentiation between firms as different models of ownership could be used.

### **3.5. Main arguments against a majority of external investors:**

The activity of audit firms does not require a lot of capital. Audit firms have so far been able to finance investments in infrastructure through self-financing and relatively limited debt financing. External ownership could even increase the costs of capital: equity investors would require higher returns for accepting higher risks.

Moreover, in practice there are no significant cases of external ownership in audit firms even where it is currently permitted for minority stakes. It is also noted that the unlimited liability regime could discourage outside investments.

Some respondents consider that investors might choose to invest in the existing largest networks rather than in the mid tier networks thus exacerbating the concentration issue even further.

If the EU allowed audit firms to raise external equity capital, it is not clear how this would necessarily advance the development of additional networks as significant investments decisions tend to be worldwide and the governance of firms may fall outside the remit of the EU.

The introduction of outside investors might actually reduce choice and constrict competition as their other investments and business relationships could create conflicts of interests and breach independence rules.

The arguments linked to the issue of risks for independence are analysed in the section 4 below.

## **4. RESPONSES TO QUESTION 4**

### **4.1. Would a modification of the current rules negatively affect auditors' independence?**

A large majority of respondents (67%) expressed concerns that changes in ownership structures and external capital could have a negative impact on audit independence and the quality of the audits. They also indicated that there will be a clear negative impact on the public perception of the independence of the profession.

**Q4. Would other models than partnership ownership negatively affect auditors' independence?**

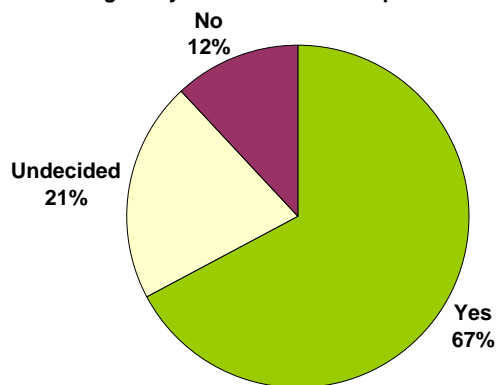


Figure 7: Percentage of replies from all the categories of respondents

**Q4. Would other models than partnership ownership threaten auditors' independence and audit quality?**

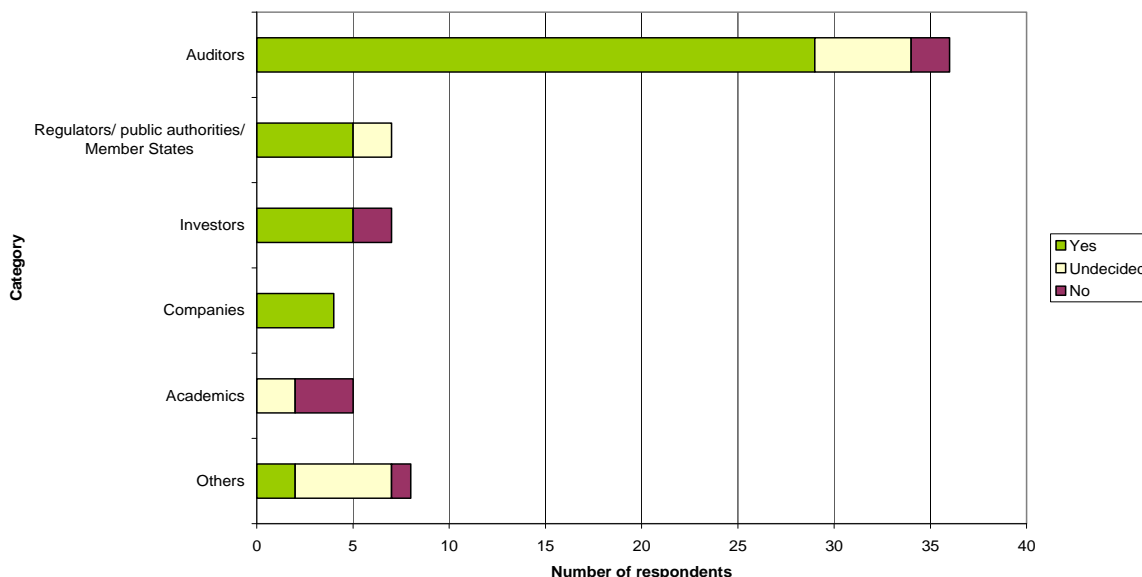


Figure 8: Number of respondents in each category.

Many respondents consider that an expectation of high yielding investments introduces the risk of managing a firm on the basis of profit margins rather than on audit quality. There is a risk that external shareholders will focus on short term profit and could seek to cut costs within an audit firm (such as limiting the budgets for technical training or for internal quality review of the audits) and might, therefore, compromise audit quality. They could also consider that audit services are less profitable than advisory services.

It is underlined that there would be a clear risk for independence if the audit firms would audit clients that have links to their investors. Some respondents express concerns about audit firms being part of a much larger business, if owned by a business in a completely different sector. If an audit firm were owned by a bank or similar business, potential conflicts of interests could ensue.

A small number of respondents from the investor and audit profession categories (some of the mid tier audit firms and some associations of auditors), as well as a majority of academics, do not appear to have concerns regarding the above risks. It would, in any

event, be in the interest of service providers to manage the market perception of their independence. Moreover, they also underline that trans-national practices under the partnership model already show a high degree of commercial focus. Finally, external capital might help to enhance the quality of audits by providing the funding necessary to ensure appropriate training and to monitor quality throughout the network.

#### 4.2. Is there a need for additional safeguards if the ownership rules are modified?

**Q4. Is there a need for additional safeguards to protect independence?**

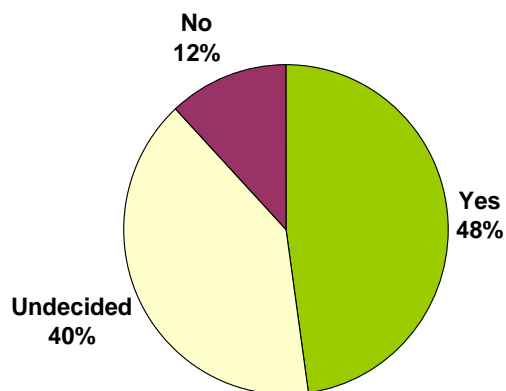


Figure 9: Percentage of replies from all the categories of respondents

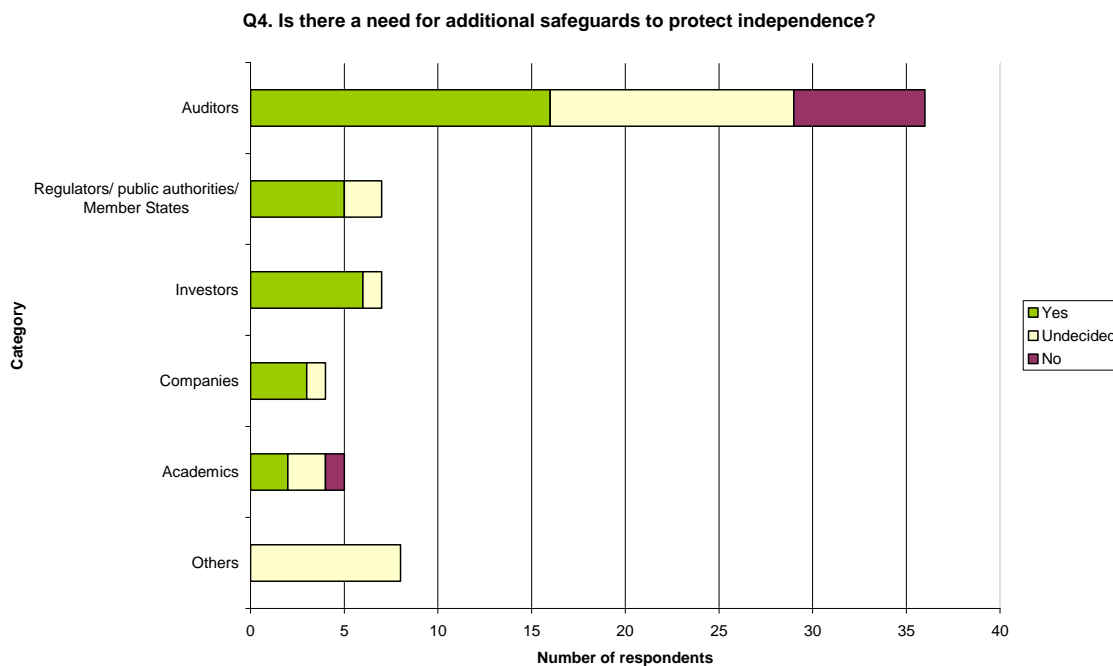


Figure 10: Number of respondents in each category.

Almost half of the respondents consider that additional safeguards would be necessary in the case of a change of ownership rules (whereas 12% are undecided). Such safeguards should be adopted at European level and not at national levels.

Some respondents (some academics, associations of auditors or mid tier audit firms) consider that the existing independence safeguards, including the recently revised IFAC code of ethics, ensure sufficient protection of independence in the case of a change of ownership rules. Public oversight and external inspections are also noted as existing safeguards that could mitigate any risks.

#### *4.2.1. Ability of the safeguards to address the risks*

Respondents consider that a careful analysis should be carried out in order to determine whether additional safeguards would address the risks linked to the presence of outside investors. On one hand, some respondents (mainly auditors and tax advisers) doubt that any safeguards would be sufficient. On the other hand, some associations of auditors, investors and companies consider that, in relation to the external investor model, it would certainly be possible to introduce provisions protecting the independence of auditors vis-à-vis non-auditor shareholders. Most large audit firms already have professional management structures in place, which would not necessarily change if external investors were permitted to own such firms.

There is also concern that the procedures needed, the expenses involved in securing the independence of those who perform the audit, and the governance structures that need to be designed to safeguard independence could have disproportionate costs compared to the benefits that could be achieved. Therefore, additional safeguards could ultimately be an additional barrier to enter the market. If further safeguards have to be introduced, these should therefore only apply to audit firms that choose an external investor model.

### **4.3. What kind of safeguards could be envisaged?**

Respondents proposed examples of additional safeguards that could be adopted in the case of a change of ownership rules. The general view, across the categories, is that in accordance with the provisions of Article 24 of the Directive on Statutory Audit, safeguards are needed to ensure that investors do not have the possibility to influence the daily policy and procedures of the firm or the individual audit results. Safeguards achieving other objectives such as safeguards regarding the capital of audit firms are also mentioned by the respondents. The main safeguards proposed can be grouped as follows:

#### *4.3.1. Safeguards relating to the governance of an audit firm*

Examples of safeguards proposed by the respondents in this context:

- Ethical guidance, which applies to auditors, should also be extended to owners who are not auditors (they could be bound by a contract). "Professional Ethics Committees", with specific powers or requirements to be met by controlling owners or directors of audit firms, could also be established (proposed by regulators and auditors).
- Governance rules for audit firms could be modified: a governance code for audit firms could be adopted to include, for example, non executive directors responsible for ensuring that the firm's independence is not compromised (proposed by investors and regulators).

- Rules could be introduced limiting the extent to which non-audit partners may have management responsibilities or a role in maintaining audit quality. In addition, external investors should not have access to audit and client data (proposed by auditors and investors).

#### 4.3.2. *Safeguards based on capital and voting rights*

Examples of safeguards mentioned by the respondents in this context:

- It should be prohibited to provide capital for non auditors where this would involve risks for auditors' ethics and independence. An illustrative list of possible categories of providers of capital for the audit firms could be established (proposed by investors, regulators and Member States).
- The maximum number of voting rights per investor could be restricted to, for example, 10% (proposed by investors).
- Capital should be injected in a stable and committed form (proposed by investors and auditors).
- Sufficient minimum capital and/or insurance requirements should be imposed to ensure that audit firms have adequate resources to deal with any potential claims or legal actions arising out of the risks taken (proposed by regulators).

#### 4.3.3. *Safeguards based on actions by the regulator*

Examples of safeguards mentioned by the respondents in this context:

- Professionals should be able to raise concerns about independence with audit oversight bodies (proposed by investors and regulators).
- Auditors should be required to maintain specific documentation regarding decisions they have made about managing conflicts of interest and audit oversight bodies should take greater responsibility for reviewing and assessing situations of conflict of interest (proposed by regulators).
- Introducing a "controllers regime" which would require all those wishing to hold more than a '*de minimis*' percentage of shares to seek prior approval from an appropriate regulatory authority (proposed by regulators).

The above-mentioned list of safeguards is not exhaustive and further solutions are developed in some responses.

## 5. RESPONSES TO QUESTION 5

The second option proposed by the consultation paper focuses on further possible catalysts to encourage more players to access the international audit market. Almost all the respondents (90%) believe that a comprehensive analysis should be undertaken: this analysis should address all the issues and not only one aspect of the problem. In addition, the majority of respondents who are opposed to any change in the ownership rules see, nevertheless, other possibilities for action.

**Q5. Is there a need to consider further catalysts to accelerate access to the international audit market?**

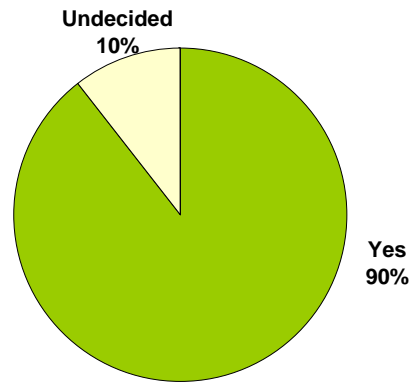


Figure 11: Percentage of replies from all the categories of respondents

**Q5. Is there a need to consider further catalysts to accelerate access to the international audit market?**

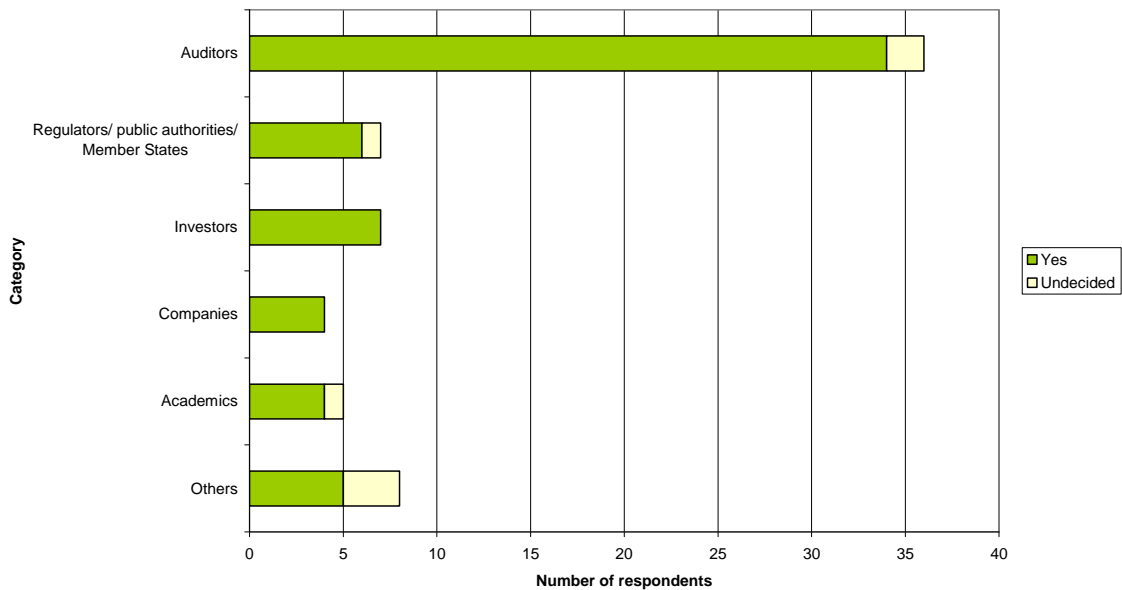


Figure 12: Number of respondents in each category.

## 5.1. Catalysts on the supply side (=auditors)

### 5.1.1. More harmonisation

27 respondents from different categories (including 18 auditors), mention a lack of harmonisation in the regulatory requirements on independence as a possible obstacle for the growth of audit networks in Europe. To address this issue, respondents would favour a **harmonisation of the independence rules** and other ethical requirements for auditors. Some respondents go further and propose not only to harmonise the rules on independence but also to apply, at the EU level, more restrictive rules on the provision of non-audit services. It could allow smaller firms to be more competitive as the Big 4, who provide extensive non-audit services, may be prohibited from tendering in some

instances. In addition, current rules could be a barrier for smaller firms as they may not have the capacity to provide a wide range of non audit services and therefore they could also be less competitive in the audit market. On the contrary, other respondents propose the removal of prohibitions on the provision of non-audit services: more choice would be then available for companies as the rules on conflict of interest would not apply. Moreover, consistent implementation of the Directive, avoiding 'gold plating', (in particular concerning the network definition) would also be conducive to achieving better harmonisation.

18 respondents (including 11 auditors) mention the lack of **harmonisation of educational requirements** among the Member States as a barrier. 15 respondents (including 11 auditors) note that it is currently not possible for a statutory auditor to directly provide services to clients across the EU without registering and passing an aptitude test in the host Member State. Some respondents suggest allowing auditors registered in one Member State to sign audit opinions in other Member States or allowing the establishment of EU networks and firms which are able to provide services across the EU.

28 respondents (including 22 auditors) referred to the debate on **limitation of auditors' liability**: they consider that the harmonisation of the rules linked to the limitation of auditors' liability would be an incentive for audit firms to access the international market.

13 respondents (including 12 auditors) also feel that the lack of **co-ordination of the public oversight bodies** across the EU could be a supplementary barrier to the creation of stronger international networks by the audit firms. As mentioned above, certain Big 4 have begun reorganising their international structures to create more integrated, trans-national structures (e.g. KPMG Europe). In this respect, the respondents underline the need for better co-operation between public oversight systems concerning, for example, inspections.

A further step could be, for the firms who wish to do so, the possibility to register on a European-wide basis. These firms could be subject to a single set of independence requirements as well as to a single regulator.

Finally, in order to bring greater harmonisation in the EU audit market, the adoption of international auditing standards would also be welcomed by some respondents.

#### *5.1.2. Better governance*

Some respondents encourage the Commission to explore the potential benefits of codes of governance for audit firms with public interest entity clients. Such codes could help non Big 4 audit firms to convince audit committees and investors that they have the necessary capabilities to undertake the audit of their company. Better governance would also lead to better audit quality and better assessment of risks. Such codes could for example require audit firms to nominate independent directors or establish principles on allocation of fees and resources across the network.

These proposals are encouraged by some respondents independently of a change of ownership rules and are frequently mentioned by others as possible safeguards in the case of a change of ownership rules.

## **5.2. Catalysts on the demand side (=companies)**

Many respondents, mainly from the category of investors and mid tier audit firms, believe that the principal constraints on the emergence of more players with a significant market share in the audit of listed companies in the European Union are also demand led. Companies do not like changing auditors and some keep the same auditor for decades. There are no clear criteria according to which the decisions on the choice of an auditor are made.

In some Member States, "Big 4 only" contractual clauses could be imposed on companies, for example, by financial institutions. Such practices prevent other audit firms from obtaining audit mandates in the entities concerned.

To address these issues, the respondents proposed the following:

- more frequent tendering procedures for the selection of audit firms and involving shareholders and audit committees in the tendering procedures;
- stimulating audit committees to evaluate auditors based on qualitative factors;
- publishing the results of inspections;
- increase the level of transparency regarding resources, internal quality controls and ethical standards applied by the audit firms;
- preparing a study on the capacity of other networks (non-Big 4) to perform audits of large clients and on investors' appetite for appointment of a wider range of audit firms;
- prohibiting contractual clauses in favour of the Big 4 or requiring companies to disclose any provisions in the agreements that limit their choice of the auditor.

## **5.3. Other actions proposed**

Others actions aimed at reducing concentration in the international audit market are proposed by various respondents:

- introduce joint audits (two firms appointed for one audit engagement): this is favoured in particular by the French audit profession as this practice is mandatory in France for the audit of consolidated accounts: it would give smaller audit firms access to the market of larger audits;
- encourage audits of subsidiaries to be performed by other auditors, not by one single firm for all statutory audits in a group;
- establish minimum capital requirements for audit firms in order to promote investment in human capital;
- require a minimum percentage of the capital to be maintained by each audit partner.

## 6. RESPONSES TO QUESTIONS 6 AND 7

### 6.1. Are current partnership forms of ownership indispensable in order to retain human capital?

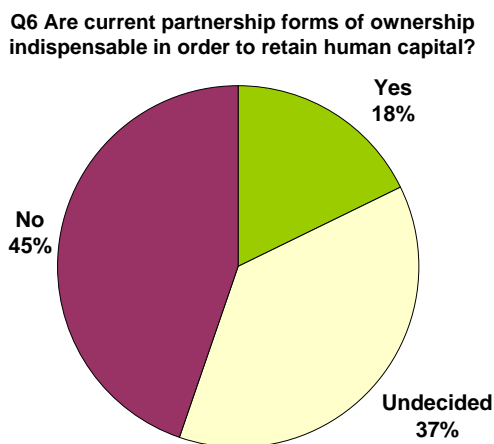


Figure 13: Percentage of replies from all the categories of respondents

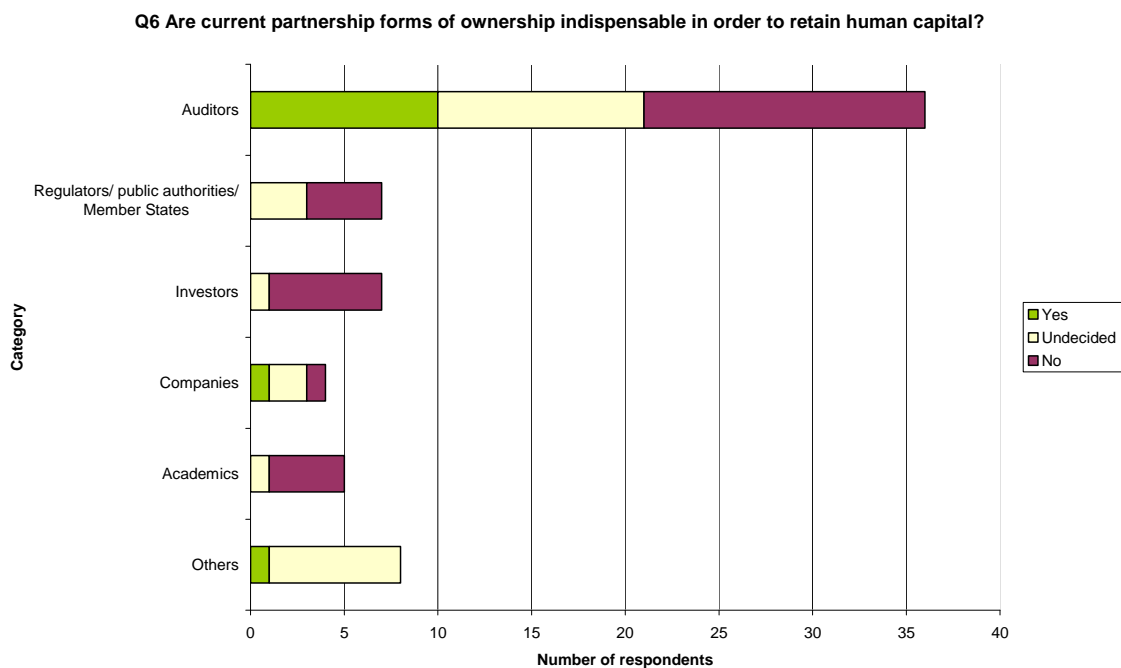


Figure 14: Number of respondents in each category.

45% of the respondents do not consider the partnership type model (whether organised via a partnership or via a limited company) to be indispensable in order to retain human capital. Less than 20% of respondents tend to consider that these structures are necessary in this respect (the remaining respondents are undecided). Even if they do recognise that the current firms have clearly been very successful in recruiting, retaining and developing human capital, many respondents outside the audit profession consider that the recruitment of high quality staff is not correlated with the partnership model. There

are examples from other professions to demonstrate that training and motivation do not depend upon the partnership model. Some investors consider that the removal of ownership restrictions could encourage high quality professionals to join non-Big 4 firms both for financial and professional development reasons. Moreover, as mentioned in section 4 above, external capital might help to enhance the quality of audits by providing the funding necessary to ensure appropriate training and to monitor the quality throughout the network.

On the contrary, for many respondents from the audit profession, being an owner or a potential owner of a firm can be a significant driver to achieve quality and to have a long-term career perspective within the firm. It is argued that the rules on professional ethics are more respected in the partnership structure. Some respondents from the audit profession therefore consider that there is a risk that externally owned firms would not attract high quality individuals who wish to work in such a strictly regulated environment. Finally, as mentioned in section 4 above, there is a risk that external shareholders will tend to cut costs and therefore limiting the budgets for training.

## 6.2. Is human capital more important than financial capital to expand internationally?

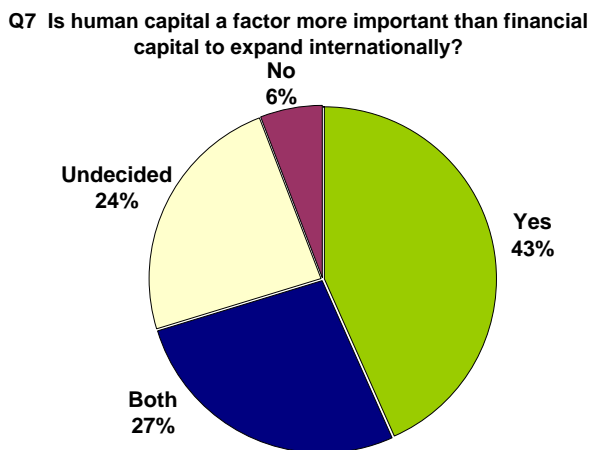


Figure 15: Percentage of replies from all the categories of respondents

**Q7 Is human capital a factor more important than financial capital to expand internationally?**

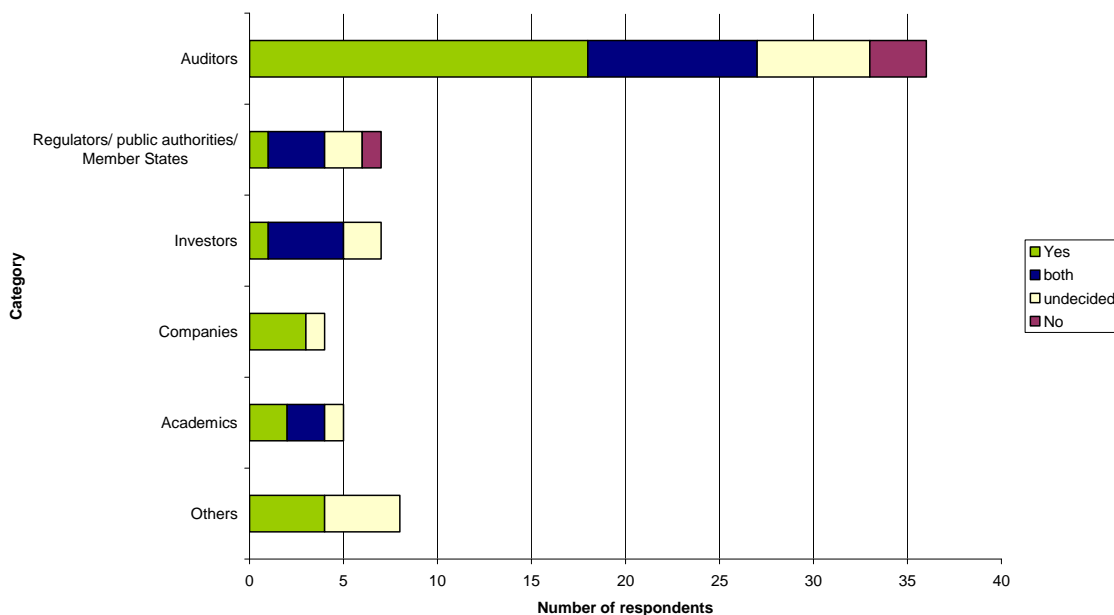


Figure 16: Number of respondents in each category.

27% of all the respondents recognise that both human capital and financial capital are equally important, as both are necessary for developing international capability. Nevertheless, 43% of respondents consider that human capital is more important. Half of respondents from the audit profession and the majority of the respondents from the companies tend to consider that the most important factor is the quality of the staff.

According to the large majority of respondents from the audit profession, the biggest challenge facing audit firms today is the global shortage of educated and trained human resources. Some commentators state that the necessity to comply with heavy regulatory and implementation requirements, as well as unlimited liability regimes, decrease the willingness to establish and to develop audit practices. In addition, many respondents also consider that different qualification systems in the Member States, the necessity to pass an aptitude test before providing auditing services in another Member State, and the prohibitions on the provision of non-audit services are important barriers preventing further integration of audit firms.

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## LIST OF RESPONDENTS

67 organisations and other stakeholders submitted contributions to the Public Consultation published on 18 November 2008 on control structures in audit firms and their consequences on the audit market. The following is the list of the 66 contributions authorised for publication.

	<b>Organisation</b>	<b>Category of stakeholders</b>	<b>Country</b>
1	Professor Hannu Shadewitz	Academic	Finland
2	Leicester Business School/Social Responsibility Research Network	Academic	UK
3	GVGM	Auditor	France
4	Hanken School of Economics	Academic	Finland
5	Cabinet Ribollet, Compagnie Régionale de Lyon	Auditor	France
6	Kingston Smith LLP	Auditor	UK
7	Simon Osborne	Other (Consultant)	UK
8	Auditing Board of the Central Chamber of Commerce	Regulators/PA/MS <sup>3</sup>	Finland
9	Arcanes SARL	Auditor	France
10	PricewaterhouseCoopers	Auditor	International/EU
11	Wirtschaftsprüferkammer	Auditor	Germany
12	KPMG	Auditor	International/EU
13	Experts-comptables et commissaires aux comptes de France (ECF)	Auditor	France
14	Eumedion Corporate Governance Forum	Investor	Netherlands
15	Institute of Chartered Accountants of Scotland (ICAS)	Auditor	UK
16	CFA Institute Centre for Financial Market Integrity	Investor	International/EU
17	Instituto de Censores Jurados de Cuentas de Espana (ICJCE)	Auditor	Spain
18	National Audit Office (NAO)	Regulators/PA/MS	Finland
19	Deloitte	Auditor	International/EU

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<sup>3</sup> Regulators/public authorities/Member States.

20	Deutscher Steuerberaterverband (DSTV)	Other (Tax advisor)	Germany
21	Central Chamber of Commerce	Companies	Finland
22	Finnish Institute of Authorised Public Accountants (KHT)	Auditor	Finland
23	Baker Tilly	Auditor	UK
24	Grant Thornton International Ltd	Auditor	International/EU
25	Ministry of Finance	Regulators/PA/MS	Finland
26	Mouvement des Entreprises de France (MEDEF)	Companies	France
27	Koninklijk Nederlands Instituut van Registeraccountants (NIVRA)	Auditor	Netherlands
28	Treuhand Niederrhein	Auditor	Germany
29	Association of HTM-Auditors in Finland	Auditor	Finland
30	Consiglio Nazionale dei Dottori Commercialisti e degli esperti Contabili (CNDCEC)	Auditor	Italy
31	Investment Management Association (IMA)	Investor	UK
32	Associazione Italiana Revisori Contabili (ASSIREVI)	Auditor	Italy
33	Audit & Compliance s.à.r.l.	Auditor	Luxembourg
34	Association of British Insurers (ABI)	Investor	UK
35	Compagnie Nationale des Commissaires aux Comptes (CNCC)	Auditor	France
36	Professor Dragutin D. Dragojevic	Academic	Serbia
37	Chamber of Financial Auditors of Romania	Auditor	Romania
38	Gerd E. Messner	Other	Austria
39	European Group of International Accounting Networks and Associations (EGIAN)	Auditor	International/EU
40	Nexia Finland	Auditor	Finland
41	Kurt Ramin	Other	Germany
42	Cabinet Gauthier Perthame	Auditor	France
43	Institut des Réviseurs d'Entreprises (IRE)	Auditor	Belgium
44	Ernst & Young	Auditor	International/EU

45	Bundessteuerberaterkammer (BStBK)	Other (Tax advisor)	Germany
46	University of Hertfordshire	Academic	UK
47	BUSINESSEUROPE (The Confederation of European Business)	Companies	International/EU
48	Association of Chartered Certified Accountants (ACCA)	Auditor	International/EU
49	BDO International	Auditor	International/EU
50	EuropeanIssuers	Companies	International/EU
51	Karl Berg GmbH	Auditor	Germany
52	Financial Reporting Council (FRC)	Regulators/PA/MS	UK
53	Institut des Wirtschaftsprüfer in Deutschland (IDW)	Auditor	Germany
54	Kuntaliitto Kommunförbundet	Other	Finland
55	Standard Life Investments	Investor	International/EU
56	CEA Insurers of Europe	Other (Insurer)	International/EU
57	Federation of European Accountants (FEE)	Auditor	International/EU
58	The Institute for Accountancy Profession in Sweden (FAR SRS)	Auditor	Sweden
59	The Institute of Chartered Accountants in England and Wales (ICAEW)	Auditor	UK
60	Auditing Oversight Authority	Regulators/PA/MS	Slovakia
61	International Corporate Governance Network (ICGN)	Investor	International/EU
62	European Confederation of Institutes of Internal Auditors (ECIIA)	Other (Internal Auditors)	International/EU
63	Governance for Owners	Investor	UK
64	Institut Österreichischer Wirtschaftsprüfer	Auditor	Austria
65	France Ministry of Justice	Regulators/PA/MS	France
66	Committee of European Securities Regulators (CESR)	Regulators/PA/MS	International/EU