

FINANCE COMMITTEE
OF THE ITALIAN CHAMBER OF DEPUTIES

**FINAL DOCUMENT PURSUANT TO ARTICLE 127 OF THE RULES ON:
Green Paper - Audit policy: lessons from the crisis (COM(2010) 561 final)**

Approved on February 9, 2011

The Finance Committee of the Chamber of Deputies,

having examined the Green Paper - Audit Policy: Lessons from the Crisis (COM(2010) 561 final);

Whereas:

audit is a key component of the system of controls over company operations, above all for listed companies, and is an essential tool for ensuring greater stability in the financial markets;

during the last decade, however, deficiencies in the audit function have been found in numerous cases with national and international relevance, and serious shortcomings have emerged in the regulatory and supervisory framework of that sector;

many recent situations have shown that, in some cases, auditors did not adequately analyze the accounts they were charged with reviewing, failing to perform their key function of reporting problems with the accounts to corporate bodies and the market;

in response, national and European legislators have taken steps to prevent the recurrence of such failures and to remove those shortcomings;

the European regulatory framework governing statutory audit is essentially set out in Directive 2006/43/EC, which provides a detailed set of measures regarding auditor independence, audit quality control systems, supervision by public authorities and penalties, establishing a comprehensive regulatory system that, however, has only recently been transposed into the legal systems of the Member States;

in view of the multinational nature of many of the entities subject to audit and the close interdependence that characterizes contemporary financial markets and the overall structure of the global economic system, it is necessary that these initiatives be coordinated or harmonized to an even broader extent in order to

avoid the deleterious effects of regulatory arbitrage and ensure greater transparency and comparability of the accounts of companies and groups;

this need for the greatest possible harmonization at the European level at least, in addition to more general considerations, is of specific interest to Italy, given that the existence in national law of appropriately stringent rules in the audit sector threatens to create a regulatory asymmetry that, paradoxically, could leave the national economy and financial system at a competitive disadvantage, as it might, for example, discourage the entry of foreign investors in the Italian market or offer a pretext for restricting the activity of Italian investors in foreign markets;

in this context, strengthening public standards on audit is certainly advisable, but it is also necessary to ensure that this is not pursued through a generalized increase in the regulatory burden or an indiscriminate expansion of the duties assigned to auditors. This would certainly not achieve the objective of improving the quality of audit and strengthening mechanisms for communication between auditors, companies' internal control bodies, investors and the market in general;

any regulatory action in this area must primarily focus on specifying the responsibilities of auditors, clearly distinguishing them from those pertaining to management, internal control bodies, credit rating agencies, financial analysts and supervisory authorities with a view to avoiding overlapping responsibilities and a confusion of roles that would transmit dangerously distorted signals to the market;

it also appears necessary, for the purpose of revising legislation and consistent with the principle of proportionality, that the solutions developed by the Commission provide for a differentiated and calibrated approach proportionate to the size and characteristics of the audited company, given that what may be necessary for large systemic institutions may not be appropriate for other listed companies, SMEs or small and medium-sized practitioners (SMPs);

whereas:

it is necessary to improve the capacity of the audit report to convey the key information produced by the audit to management of the audited company, investors and the market in general;

it is also necessary to reinforce dialogue between auditors, internal control bodies and supervisors in order to make full use of the findings resulting from analysis of the accounts by the auditors;

the global market for audit services is highly concentrated, as shown by the fact that over 90 percent of listed companies use the audit services of the Big Four global audit groups;

this raises sensitive issues, relating first and foremost to the independence of auditors' assessments, conflicts of interest for audit firms, which often provide the company being audited with other, much more profitable non-audit services as well. Other issues concern the potential problems that could arise in the event of one of these large groups suddenly exiting the 'audit market';

it is necessary for this final document, along with the text of the opinion issued by the Committee for European Union Policies, to be promptly transmitted

to the European Commission within the scope of the political dialogue and to the European Parliament and the Council;

CALLS ON THE GOVERNMENT

to take action in the appropriate decision-making fora of the European Union to:

a) ensure that the scope and purpose of audit are not extended, for example by including the task of assessing the economic and financial health or future prospects of the audited companies, both because this additional activity does not appear to have a basis in the technical standards that should guide audit activities and because an extension of the scope and purpose of audit would risk creating misunderstandings about the actual value of the audit opinion, thereby providing distorted information to the market;

b) welcome proposals to define the roles and responsibilities of auditors even more clearly, for example with regard to the opinion expressed by the auditor concerning the consistency of the management report with the financial statements, also bearing in mind the changes to the contents of the report introduced under European regulations;

c) support initiatives to enhance the clarity and effectiveness of the structure and language of the audit report in order to improve transparency in communications between audit firms, stakeholders and the market in general, ensuring however that a more explanatory approach in the audit reports does not merely result in the multiplication of the information provided to investors and the market in general, without achieving the true aim of improving the readability of these documents;

d) ensure that consideration is given to clarifying the content of audit reports where a qualified opinion is given on the financial statements, for example by providing for such concerns to be spelled out in a clear and concise manner so as to give shareholders a clear picture of the accounting issues found by the auditors;

e) ensure that, again with regard to the content of audit reports, any regulatory action requiring the provision of additional information above and beyond that contained in the financial statements (for example, concerning the market risks of the audited company or developments in the sector in which it operates) does not give rise to a confusion of roles between the auditors and management of the company, as well as between the auditors and other parties called on to express an opinion on the company, including credit rating agencies and financial analysts in particular;

f) ensure that, in order to guarantee the full and effective performance of audit activities, auditors have access to all the information about the company being audited necessary for such purpose, establishing specific obligations for the audited company and eliminating any possible conflict between the auditor's access to such information and the rules on market abuse and access to privileged information set out in European regulations;

g) ensure that quality and independence, which are cornerstones of the audit function, are pursued - consistent with the principle of proportionality – first and foremost through the strict enforcement of existing rules by auditors and careful supervision of implementation by the competent authorities, rather than through the indiscriminate enactment of additional burdensome regulation;

h) ensure that consideration is given to the possibility of establishing simplified forms of audit for unlisted small and medium-sized enterprises in order to promote greater transparency, which would have a positive impact on the ability of these companies to raise funding on the capital markets without, however, burdening those companies with disproportionate requirements and costs;

i) strengthen dialogue between the auditors and audit committees, for example by disseminating the content of certain communications between the auditors and such committees more widely in order to improve the quality of financial reporting and to ensure more effective performance by internal control systems;

l) enact legislation to adopt the International Standards on Auditing (ISA) within the European Union, retaining, however, the option of making any necessary amendments to the standards in order to adapt them to the European context, taking special account of the specific characteristics of small and medium-sized enterprises, which represent a major feature of the European economy as a whole and the Italian economy in particular. At the same time, care must be taken to ensure that any such amendments do not jeopardize the overall consistency of these standards;

m) strengthen measures to combat conflicts of interest for audit firms, in particular by establishing a harmonized framework of more stringent rules and prohibitions governing the provision of non-audit services to audited companies or companies belonging to the same group;

n) support proposals to extend to the European level rules - already present in Italian law - governing restrictions on the provision of non-audit services by auditors, at least for listed companies and public interest entities, pursuing the greatest degree of harmonization in this regard outside the European Union as well;

o) ensure that considerable caution is exercised in assessing the possibility of entrusting a public authority with responsibility for the appointment and remuneration of audit firms in view of the difficulties that such a radical change in the current system could create. Instead, consideration should be given to the possibility of providing for the internal control body of the company to express its opinion on termination of the audit engagement, of introducing a requirement for the audited company to specify the criteria for selecting the auditor in advance so as to ensure greater transparency in the engagement procedure and of allowing companies to appoint a new auditor during the year prior to the termination of the engagement of the previous auditor in order to reduce the adverse effects resulting from the loss of knowledge that comes with the turnover of audit firms;

p) support the proposal to require, within a framework of harmonized rule-making at the European level, the rotation of audit firms after an appropriate

period of years, possibly in addition to the obligation, already provided for in Directive 2006/43/EC, to rotate key audit partners. In this regard, such rotation already provided for in Italian law and, in the opinion of the organization representing the auditing profession, has not had an adverse impact on their activities and may in fact have a positive effect in terms of the independence of audit firms;

q) achieve the greatest degree of harmonization possible regarding the audit of companies belonging to multinational groups, in particular through the definition of a common regulatory framework governing access to information from the group parent or the parent company on the part of audits firms working with subsidiaries or companies under common control;

r) take steps to harmonize European rules on the independence of auditors, financial liability, professional ethics, training and access to the profession, including by way of a single European register of auditors and audit firms, or through the establishment of a European quality certification for such persons, as well as providing for greater involvement of supervisory authorities in the verification of the technical qualifications of auditors;

s) achieve greater integration of supervision of audit firms by national authorities, so as to respond effectively to the increasing international integration of audit firms belonging to the same network and the great importance of multinational groups. In this regard, it would be advisable to seek greater harmonization of the rules that govern the audit function, extend supervisory reporting obligations to the auditors of listed companies, as is already the case in the banking and financial industry;

t) take account of the fact, again as regards the institutional framework for overseeing the audit sector, that the proposal to establish a new European supervisor for the audit industry could raise substantive issues, and should in any case be subordinate to the achievement of effective integration of existing national rules, particularly with regard to auditor independence, auditing standards, procedures to monitor quality, and supervision. It would therefore be preferable to support the proposal to assign responsibilities in this field to the European Securities and Markets Authority (ESMA), especially with regard to the cross-border aspects of supervision of audit firms;

u) undertake a careful evaluation of the issues involved with the high degree of concentration that currently exists in the market for audit services, in which some 90 percent of listed companies have engaged one of the Big Four audit groups, examining in particular whether this situation might represent a threat to the independence of audit firms and conflicts of interest resulting from mixing the provision of both audit and non-audit services;

v) to consider taking steps, including the enactment of legislation, to support the growth of smaller audit firms in order to foster a more competitive market for audit services. For the same purpose, steps should be taken to prohibit the inclusion of clauses in company bylaws restricting the appointment of auditors to the Big Four audit firms, as such clauses are a prejudicial factor devoid of any reasonable justification and jeopardize achievement of a more open market for such services;

z) draw up contingency plans to handle an unexpected contraction in the supply of audit services, particularly in the event of the demise of one of the Big Four audit firms;

aa) strengthen and closely monitor the mechanisms for cooperation with the authorities responsible for supervising auditors in non-EU countries, in view of the sensitive issues raised by the existence of multinational groups listed on multiple markets, for which it is essential to ensure equivalent and comparable audit standards worldwide.

**OPINION OF THE EUROPEAN UNION POLICIES COMMITTEE
OF THE ITALIAN CHAMBER OF DEPUTIES**

The European Union Policies Committee of the Italian Chamber of Deputies, having examined the “Green Paper - Audit Policy: Lessons of the Crisis - COM(2010) 561 final”,

whereas:

the measures taken in response to the crisis at both the EU level and globally to stabilize the financial system primarily focused on the role of banks, hedge funds, credit rating agencies, supervisory authorities and central banks, while insufficient attention has been paid to the audit function;

the European Commission's intention to perform a thorough review of existing legislation at the European and global level, in cooperation with its international partners on the Financial Stability Board and the G20, is to be welcomed;

a single European market for audit services requires maximum harmonization and the creation of a “European passport” for auditors in order to establish a European registration system based on common requirements for professional qualifications, governance, ownership and independence applicable throughout the European Union. Such registration may be subject to oversight by a single regulatory authority, similar to that recently proposed for credit rating agencies;

such a comprehensive system could also encourage competition in the market for auditing large companies, as it would simplify the development of European audit networks and reduce the cost of audit services at the European level;

at the same time, it also appears necessary, for the purpose of revising legislation and consistent with the principle of proportionality, that the solutions developed by the Commission provide for a differentiated and calibrated approach proportionate to the size and characteristics of the audited company, given that what may be necessary for large systemic institutions may not be appropriate for other listed companies, SMEs or small and medium-sized practitioners (SMPs);

to this end, it is especially necessary to avoid the excessive expansion of the tasks assigned to audit firms and the related obligations;

very careful consideration should be given to the possibility of exempting SMEs from the statutory audit requirement, or at least to introduce a new type of statutory audit appropriate to their needs, such as a “limited audit” or “statutory review”. As regards SMPs, the “limited audit” or “statutory review” could be

accompanied by proportionate rules on quality control and oversight by audit regulators;

the structure of the audit market for listed companies, which is characterized by a high degree of concentration, does not offer enough choice to customers and could also entail the accumulation of systemic risk and limit the availability of financial information on large companies subject to audit;

it is necessary to strengthen the supervision of audit firms at the European level and, to this end, it would be preferable to assign jurisdiction in this field to the ESMA;

underscoring the need for this opinion, along with the final document issued by the relevant Committee, to be transmitted to the European Commission within the scope of the political dialogue and to the European Parliament and to the Council, gives its

APPROVAL