

3rd FEE Annual European SME/SMP Congress 2007

Working in an Audit Firm

Dr. Harald Ring

I. Current Situation from an Ethical Point of View (Independence)

- Basis Statutory Audit Directive

(8th Directive) entered into force on 29 June, 2006 with a transposition period of two years,

- Member States are obliged to adopt and publish the provisions necessary to comply with a directive before 29 June, 2008,



- Article 22, para. 1a

Member States shall ensure that a statutory auditor or an audit firm shall not carry out a statutory audit if there is an direct or indirect financial, business, employment or other relationship between the statutory auditor, audit firm or the network – including the provision of additional non-audit services – and the audited entity from which an objective, reasonable and informed third party would conclude that the statutory auditor's or audit firm's independence is compromised. If the statutory auditor's or audit firm's independence is affected by threats, such as self review, self interest, advocacy, familiarity or trust or intimidation, the statutory auditor or audit firm must apply safeguards in order to mitigate those threats. If the significance of the threats compared to the safeguards applied is such that the independence is compromised, the statutory auditor or audit firm shall not carry out the statutory audit.

- Article 22, para. 1a simply contains a briefing of the independence principles and the threats and safeguard approach.
- The 8th Directive refers to the commission recommendation of 16 May, 2002 on auditor's independence in the EU including detailed regulations.
- Essential improvement:
Conceptual approach, i.e. no rule-based approach

Advantages:

- ⇒ More demanding
 - ⇒ Covers all situations
- Conformance with the IFAC code of ethics as far as possible.

Important, because differences between Article 22, of the 8th Directive/EU recommendations and IFAC code of ethics would cause big problems.

- Important to bear in mind:
 - ⇒ IFAC addresses member bodies.
 - ⇒ 8th Directive addresses member states (legislators and other regulators).
- How to ensure that the regulations of independence will be observed in practice?



Article 22, para. 2

Member States shall ensure that the statutory auditor or audit firm documents in the audit working papers all significant threats to his, her or their independence as well as the safeguards applied to mitigate those threats.

- **Independence Check**

Special problem: Networks

Article 22, para. 1a implements the demands on independence onto the „Audit firm or the Network“.

Article 2, para. 5 of 8th Directive defines what „Network“ means.

Larger structure

- which is aimed at cooperation to which a statutory auditor or an audit firm belongs and
 - which is clearly aimed at profit or cost sharing or shares common ownership, control or management, common quality control policies and procedures, a common business strategy, the use of a common brand-name, or a significant part of professional resources.
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- This provision integrates for the first time cooperation between statutory auditors in a form of a network.

Consequently, if the independence of one network partner deemed to be compromised there will be an impact on all members of the network.

Impact:

Prohibition for carrying out the statutory audit. In case of breach

- ⇒ no valid audit,
- i.e. no right of fee
 - breach of the law (the professional will be sentenced to pay a fine).

- Problems:

Networks of small and medium sized audit firms have very varying structures.

They are very loose or only temporary cooperations.

Due to the variety of undetermined legal terms interpretation in the context of the 8th Directive is requested.

- Unsolved issues:

- Often it is difficult or even impossible, to get the required information of a foreign partner.
- Agreements on cooperation often do not include any legal obligations of the foreign partner to pass on all the information concerning the domestic independence check .

This was not a problem in the past, as long as the members of the foreign network partners

- did not participate in the inland audit,
- were not able to exercise any influence on the inland audit.

⇒ In view of the wide scope of network structures there will be a wide scale of unsolved questions.

- The national legislators implementing the network definition should pay attention to the recital 11 of the 8th Directive:

The criteria for demonstrating that there is a network should be judged and weighted on a basis of all factual circumstances available.

II. Working a multi disciplinary practice

- Not unusual that SMPs provide at the same time
 - audit services,
 - tax services,
 - legal services,
 - consulting services.
 - Currently big national differences exist concerning compatability of providing simultaneously audit and other related services (e.g. France, Italy).
 - The 8th Directive includes no ban (recital 12):
However, this should not lead to a situation where member states have a general duty to prevent statutory auditors or audit firms from providing non audit services to their audit clients.
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- Small and medium sized audit firms as a rule work for small and medium sized enterprises.

According to my experience: Most of the clients prefer to have one or only a few persons to get in touch with and to discuss

- questions of audit and accounting as well as in the range of tax consultancy, legal advice and business consultancy.

- Advantage:

The partner in the audit firm has a wide range of knowledge of the individual legal and economic situation of the client.

This leads to:

- reduced risk in giving advice to the client
 - ⇒ auditor fulfills the best conditions for high quality services,
 - ⇒ reduction of the client's costs.
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- On the other hand there are difficult preconditions:

A wide range of services implies a wide experience/education of the partner.

In times of specialisation these requirements get more and more difficult.

However: For the professional and the audit firm this is reasonable and of advantage, because

- a global consultancy is interesting and challenging,
 - only the consultant who is operating globally is able to get into the position of an accepted partner of the client,
 - ever since audit firms execute the function of training/education as well as a stepping stone for the following career after the audit firm (e.g. in business or in public administration). A widespread multi disciplinary education features best conditions for this purpose,
 - while doing a global consultancy a close and constant relationship to the client will be generated,
 - one can only find substantial qualified staff-members permanently, if they can work challenging, i.e. if they can also give advice extensively.
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- **My personal advice to young professionals:**

Accept the challenge – it pays!

