

Our Ref NJJ/AM/0307  
Your Ref THIRD COUNTRIES

European Commission  
DG Internal Market and Services  
Unit F4 - Auditing/Liability  
SPA 2 (JII), 02/085  
B-1049 Brussels, Belgium

2 March 2007

Dear Sirs

**CONSULTATION ON IMPLEMENTATION OF ARTICLES 45 - 47 OF  
THE DIRECTIVE ON STATUTORY AUDIT (2006/43/EC)**

**COOPERATION WITH NON-EU JURISDICTIONS ON AUDITOR  
OVERSIGHT**

Grant Thornton International welcomes the opportunity to respond on behalf of its member firms on the above named consultation paper published by the European Commission (EC). We support the approach taken by the EC in seeking views from stakeholders, and we hope that the results of this consultation paper will come to be seen as an important step in achieving consistency and reciprocity among audit regulators around the world.

Grant Thornton International (Grant Thornton) is one of the world's leading international organisations of independently owned and managed accounting and consulting firms. Firms operate in 113 countries and employ over 25,000 people worldwide. Grant Thornton has member firms in 21 European Union (EU) countries and a further two member firms in European Economic Area countries.

**General comments - implementation of Articles 45-47**

The key phrases in the consultation paper are "reciprocity" and "co-operation". If global markets are to function efficiently, not only must there be globally accepted financial reporting, auditing and ethical standards, but enforcement of those standards by the regulators in each jurisdiction must be consistent and based on globally accepted principles. At present it is evident that regulators have much to do in order to improve co-operation, cross-border consultation and reciprocity. We applaud the EU regulators' efforts to continue progress together with third country regulators in all aspects of audit regulation. In this regard, the early signs from the International Federation of International Audit Regulators (IFIAR) are encouraging.

We strongly support the prompt adoption of International Standards on Auditing (ISAs) for use in the EU under Article 26 of the Directive on Statutory Audit 2006/43/EC (the Directive). There should be no carve-outs, and add-ons should be restricted to only what is necessary to comply with domestic legal requirements. In this way the EC will optimise its achievement of consistency of rules (in this case for audit) within the EU and set the example for authorities in other jurisdictions to follow.

The possible impact of the failure to adopt common standards across the EU was recently illustrated when IAS 39 *Financial Instruments: Recognition and Measurement* was not adopted in full by the EC. This caused confusion in the minds of users of financial reports and hindered consistent global adoption of International Financial Reporting Standards. Article 26 does not set a deadline for adoption, but non-adoption of ISAs will soon cause problems for Member State authorities and audit firms.

On ethics, we observe disturbing signs that ethical standards, more so than auditing or financial reporting standards, are being implemented by local jurisdictions around the world without apparent reference to an internationally accepted code of ethics. Ethical standards are an important driver of audit quality and one globally accepted set of ethical standards would be hugely beneficial investors, regulators and auditors.

Consequently we strongly support the adoption across the EU of the International Federation of Accountants (IFAC) Code of Ethics, with no carve-outs or add-ons. In the same way as for EC adoption of ISAs, by adopting the IFAC Code of Ethics the EC would set an example for authorities in other jurisdictions to follow.

Although Articles 22, 24 and 25 of the Directive give wide national discretion on independence rules, nonetheless we believe that a solution at EU level is vital. An EU level solution is necessary to avoid different rules or inconsistent application of rules across Member States. Widely accepted independence rules will also help to avoid "competition" among jurisdictions seeking to claim that they have the "most independent" auditing environment.

We observe that there is increasing consensus among share owners in the EU that convergence to a single set of high quality reporting, audit and ethical standards will increase market confidence.

#### **General comments - co-operation with non-EU jurisdictions on auditor oversight**

We also support consistency and reciprocity in the field of auditor oversight systems. In the ideal situation, this should be based on an assessment of a third country's oversight systems by the Commission. EC assessment will make the assessment process more reliable, more consistent and more cost effective than assessment by Member States of individual members of audit networks operating or located in a third country. EC assessment will also ensure that all firms in a third country are similarly treated and that there is no scope for different Member States to apply different considerations to auditors from the same third country.

It is unclear how the EC will proceed in the event that a third country meets the equivalence criteria, but there is little or no reciprocity with that third country. Without reciprocity it is unlikely that statements or proclamations by the EC or Member State regulators will be enforceable on third countries. For this reason we believe equivalence and reciprocity must be linked, and not considered as separate issues.

We believe it will be possible to avoid multiple registrations by an individual audit firm in multiple EU jurisdictions. We would encourage the EC to urge Member States to cooperate to allow one EU registration that would be acceptable across all Member States. If a single EU registration is not immediately practical, an interim process should seek to achieve uniformity in registration requirements across Member States. On a related matter we would encourage the EC to work with Member States to establish a central website where stakeholders can go to obtain information about registered auditors.

If you have any questions on this response, please contact April Mackenzie (phone: +1 212 542 9789; email [April.Mackenzie@gt.com](mailto:April.Mackenzie@gt.com)) or Nick Jeffrey (phone: +44 870 991 2787; email [Nick.Jeffrey@gtuk.com](mailto:Nick.Jeffrey@gtuk.com)).

Yours faithfully

A handwritten signature in black ink that reads "April Mackenzie". The signature is written in a cursive style with a long horizontal flourish extending to the right.

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## **APPENDIX - GRANT THORNTON INTERNATIONAL'S RESPONSE TO SPECIFIC QUESTIONS RAISED IN THE CONSULTATION PAPER**

### **Assessment and decision on equivalence of third countries**

*Question 1: Do you have further comments or concerns to share, on the equivalence?*

**Grant Thornton view:** We agree that the assessment of third country equivalence should be linked to reciprocal arrangements with the audit regulation authority of that third country.

Reciprocal arrangements, or at least criteria needed to satisfy the reciprocity test, have not been addressed in this paper. Without criteria for the reciprocity test, the assessment process risks being inconsistent and misunderstood. Therefore we recommend that criteria for reciprocity be considered by the EC.

The decision on third country equivalence should be taken at the EC level. Where the EC is in the process of assessing equivalence, or where the third country has not yet met the equivalence tests, that fact should be made public. Publication might be by the Directorate General for Internal Market and Services issuing a press release to alert investors and Member States. The press release might announce an amendment to a publicly available database by third country of the status of the EC assessment process and EC assessment decisions.

Assessment of a third country's oversight systems by the EC will be more reliable, more consistent and more cost effective than assessment of individual members of audit networks operating or located in that third country or the assessment of the oversight systems by individual Member States.

We note that neither the EC rules and EC adopted standards nor third country rules and standards will be static, so equivalence will need to be reviewed periodically.

### **Transitional solutions under Article 46**

*Question 2: Do you have comments on the need for transitional measures?*

**Grant Thornton view:** We do not support the "first avenue" which would require third country audit firms to register in Member States now, and postpone assessment by the EC of audit regulation to a later stage. This risks similarly onerous and inefficient obligations being imposed by third country authorities when the goal the EC should be aiming for is reasonable equivalence assessment criteria and reciprocal arrangements with the audit regulation authorities in third countries.

We support the "second avenue" which is a practical cost saving solution because of the large numbers of audit firms and third countries requiring assessment. Where there is equivalence then additional EC oversight should not be required.

## **Priorities for the assessment of third countries**

*Question 3: Do you have any comments or observations on the above list of third countries? Do you have any specific information on those third countries which you would like to share with the European Commission services, and if so, which?*

**Grant Thornton view:** We agree with the assessment in the paper.

We have no information to share on third countries. However, the International Federation of Accountants Compliance Programme includes information we believe the EC may find useful ([www.ifac.org](http://www.ifac.org)).

## **Possible (additional) workstream on the basis of Article 45**

*Question 4: Do you have any comments or observations that you wish to bring to the European Commission's attention as regards the explanation in section 3.2?*

**Grant Thornton view:** Case 1 (third country does not qualify for equivalence decisions so third country audit firm must register in respective Member State) appears to be the most likely scenario. We would expect proportionality to be applied here, together with a public statement, as outlined in our response to question 1.

Case 2 (third country obtains equivalence yet Member State uses option granted in Article 46(1) to modify registration requirements) must be exceptional, if not actively discouraged by the EC.

We agree that it might create difficulties, and be potentially damaging to EU capital markets, if Member States were to develop fundamentally different registration requirements. We would encourage the EC to be alert for the emergence of different registration requirements to ensure that flexibility is not abused. The EC will also need to consider different registration requirements to ensure consistency with principles underlying the European Union such as level playing field for all and facilitation of the free flow of capital.

It is unclear how the EC will proceed in the event that a third country meets equivalence criteria, but there is little or no reciprocity with that third country. It is unlikely that statements or proclamations by the EC or EU regulators will be enforceable on third countries without reciprocity. For this reason we believe equivalence and reciprocity must be linked, not considered as separate issues.

However, lack of reciprocity should not be allowed to stand in the way of the EC granting equivalence. Reciprocity may be harder, and so take longer, to achieve than assessment of equivalence. For example, acceptance of ISAs in the US may prove difficult for the EC and others to achieve, but this should not prevent the EC granting equivalence to US GAAS and US oversight (if the equivalence criteria are met) while continuing to seek reciprocity.

## **Possible role of the European Group of Auditors Oversight Bodies**

*Question 5: Do you have any comments on a concept for co-operation in registration procedures that would aim at reducing administrative burdens and cost?*

**Grant Thornton view:** There must be a system of co-operation in registration procedures between the authorities of Member States. We agree that the European Group of Auditors Oversight Bodies (EGAOB) is an appropriate forum for discussing and facilitating that co-operation.

## **Auditing standards**

*Question 6: Do you have any comments on the use of International Standards on auditing and US auditing standards (US GAAS) by third country audit firms for registration purposes for a limited transitional period?*

**Grant Thornton view:** We strongly support the prompt adoption of ISAs for use in the EU, with no add-ons or carve-outs. Article 26 does not set a deadline for adoption, but non-adoption will soon cause problems for Member State authorities and audit firms for example on the grounds of consistency of standards where some Member States have already adopted ISAs, but others have not.

In the meantime we support in principle the use of ISAs or US GAAS as a transitional measure. If US GAAS is to be accepted for use in the EU then under the principles of reciprocity we would expect that ISAs would be accepted for use in the USA (but see comments at the end of our response to question 4).

## **Independence rules**

*Question 7: Do you have any comments on independence issues under Article 45?*

**Grant Thornton view:** Articles 22, 24 and 25 give wide national discretion on independence rules and a solution at EU level is vital. An EU wide solution is vital to facilitate an accepted set of rules with consistent application across Member States. Widely accepted independence rules will also help to avoid "competition" among jurisdictions seeking to claim that they have the "most independent" auditing environment.

We observe disturbing signs that ethics, more so than auditing or financial reporting standards, are being instigated by local jurisdictions (for example in France) with no apparent reference to an internationally accepted code of ethics. Ethical standards are an important driver of audit quality and one globally accepted set of ethical standards would be hugely beneficial to investors, regulators and auditors.

Option 1 (individual assessments of third countries independence rules) would be undesirable on the grounds of cost, inefficiency and possibly inconsistent application.

Option 2 (allow use of the IFAC Code of Ethics) is a sensible solution. If a third country's framework of independence rules were at least equivalent to the IFAC Code then that should also be acceptable.

The EC appears to be deferring possible benchmarking of the IFAC Code against the Directive on the grounds that the IFAC Code is being reviewed. We note that the IFAC proposals are unlikely to become effective until 2008 at the earliest, and urge the EC to allow use of the current IFAC Code of Ethics.

The concepts of equivalence and proportionality should be observed here. For example the principle that an audit partner rotates within a reasonable time frame might be considered an acceptable requirement for equivalence. Therefore if one jurisdiction requires rotation every eight years, but the EU says every seven years, then the extra year alone should not be a reason to deny equivalence.

### **Co-operation regarding Article 47**

*Question 8: Do you have any concerns which you would like to make European Commission services aware of?*

**Grant Thornton view:** In our view data protection is an issue that is distinct and must be considered separately from client confidentiality. Data protection should not form part of the assessment process for equivalence on the grounds that the Directive does not identify data protection.

Data protection and client confidentiality are issues that will require co-operation between EU and non-EU oversight bodies.

### **Possible scope for co-operation**

*Question 9: Do you have any comments on the conditions set up in the adequacy test?*

**Grant Thornton view:** There might be scope for local authorities to be asked to investigate on the third country authority's behalf, perhaps under instruction, giving the third country authority assurance on specific issues.

Some of the proposals appear difficult to apply in practice, both within the EU and also with a view to obtaining reciprocal arrangements. For example, it is unlikely that UK audit working papers that contain personal information could be transferred outside the EU. In paragraph (b) documents deemed not necessary for investigation or inspection is an important safeguard to ensure that third country oversight regimes do not ask for documents merely because those documents might unveil something of interest.

Paragraph (d) says "it should in principle not be possible to use [transmitted documents] for different purposes or by different authorities". It is vital that the conditions for reciprocity provide reasonable protection against papers provided to the third country oversight regime being passed onwards to other investigatory authorities in the third country.

The scope for co-operation will need to be agreed with third country oversight bodies. It is unlikely that any statements or proclamations by the EC or EU regulators will be enforceable on third countries without reciprocity.

### **Direct Transfer from audit firms**

*Question 10: Which circumstances could, in your view, be considered as exceptional?*

**Grant Thornton view:** The strict criteria in Article 47(5) are such that any circumstance meeting all these criteria will by definition be "exceptional". Exceptional circumstances might be where a formal investigation has been instigated, as opposed to a routine investigation which would not be deemed exceptional.