

Reform of the Audit Market

Position of the European Federation of Financial Services Users (EuroFinuse)

3 August 2012

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EuroFinuse has experts participating in the Securities & Markets, the Banking and the Pensions Stakeholder Groups of the European Supervisory Authorities, and the EC Financial Services User Group. Its national members also participate in the national financial regulators and supervisors bodies when allowed. For further details please see our website: www.eurofinuse.org.

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EuroFinuse, the European Federation of Financial Services Users, is concerned about the reform of the European auditing market regulation that is currently debated at the European Parliament with respect to both European financial services' users and shareholders of the European audited issuers.

Outlined below are the main points of our position on the Audit reform proposal by European Commissioner Michel Barnier, and related discussions at EU institutional level.

We believe that the current economic damages endured by shareholders of European listed banks with good audit reports¹ challenges the proper functioning of the audit markets in Europe. This in turn would have profound implications for both the European financial industry and audited companies of any kind in Europe

Therefore, we generally support the initial Proposal for Regulation from the European Commission.

However, our position differs with regards to market concentration, one of the key issues in the Proposal for Regulation from the European Commission (despite the lack of consensus of reports on audit market concentration). When addressing the issue of market concentration itself, we argue that having few big players in the market is not necessarily a bad thing, as it may be the result of factors like economies of scale (due to the conditions of the market, the way to offer cost competitive audit services is through few big sized companies). We believe that in order to protect long-term shareholder value the best approach should be to ensure that the market of audit services works properly.

EuroFinuse shares the concerns of some Members of the European Parliament on overregulation as this would increase costs for companies without significant benefits for shareholders, and consequently reduce shareholder value. However, we are expecting a badly needed change in the status quo of audit markets which currently are extremely damaging for shareholder value of Banks and all European firms.

¹ Banks such as Northern Rock, Landsbanki, Glitnir and AIG; and companies like Enron are only some of the cases where despite of good audit reports the financial and patrimonial situation of the audited firms was very weak

In our view, the intervention should be aimed at the underlying existing conflicts of interests of or between audited firms' executive boards and auditors. To this extent, we believe that the most efficient approach is to empower shareholders to efficiently control the auditing of the firm in order to confront potential conflicts of interests directly. In this way, the performance of audit firms would either be rewarded or punished through market mechanisms.

Shareholders could indeed gain a significant control over auditing matters if the designation of the firms' Audit Committee members had to require shareholders' approval in General Assemblies first. This would ensure control of shareholders on auditing matters, at least for listed companies, and partly avoid any existing conflicts of interest of board members when tendering for auditing services to the firm.

Another positive step would be to require Audit Committee members (or at least a majority of members including the chair) to be truly independent from the company's management. EuroFinuse already stressed the importance of the role of such Board members on its [position on the Green Paper on the EU Corporate Governance Framework](#). However, we do not think that this "comply or explain" principle which we generally support for corporate governance is appropriate for establishing the right requirements for Audit Committee members. As previously said, the badly needed changes are not likely to happen if they are not absolutely and directly enforceable.

Another key strategic point deals with transparency and the sufficient supply of information on auditors' selection. We believe that adequate and sufficient information regarding the auditing of firms should be presented to shareholders at General Assemblies, and publicly disclosed if possible. Currently, shareholders have very little information on the criteria used when choosing the auditor and the offers received when tendering for auditing services.

We also believe in the necessity of establishing mandatory tendering and rotation procedures for auditors to increase transparency. Considering however, the appropriate time frame for the proposed rotation scheme one should take the factors in favor and against the long-term relationships between auditor and audited firm into account. EuroFinuse believes that the European Commission is on the right track by establishing a

mandatory auditor rotation after a maximum of six years. However, we consider it could be beneficial to set up an even lower threshold such as a maximum of five years for statutory auditing, because having a “fresh pair of eyes” can help avoid many of the aforementioned problems of firms’ auditing.

We also consider adequate the Commissions’ proposal to separate auditing and advisory mandates to achieve the badly needed transparency on the relations between firms’ management boards and auditing firms.

Finally, another vital strategy to eliminate current conflicts of interests is to make auditors liable to shareholders by implementing a European-wide collective redress scheme. This would allow shareholders to claim for damages in case of e.g. wrong “diagnosis”, similarly to medical services. Auditors should have a professional insurance against these kinds of damages, like doctors have for possible damages caused to patients. To this end, it is crucial to ensure that the European Securities and Markets Authority (ESMA) and the European Commission effectively examine Member States’ civil liability systems, according to Articles 46.4 and 46.5 of the Proposal for Regulation². This would advance future harmonization procedures in this area and help set up a consistent basis for the collective redress scheme for shareholders of audited firms throughout Europe.

² Proposal of Regulation on Specific Requirements Regarding Statutory Audit of Public-Interest Entities
http://ec.europa.eu/internal_market/auditing/docs/reform/regulation_en.pdf