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## **Address to the Global Public Policy Symposium**

*Check Against Delivery  
Seul le texte prononcé fait foi  
Es gilt das gesprochene Wort*

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## Introduction

It is a pleasure for me to be here with you today. From the European Commission's point of view, the timing of this Conference could not be better. We have just put the finishing touches to the new 8<sup>th</sup> company law directive on statutory audit. It is the ideal moment to discuss how we can ensure that the application of this new framework can contribute to audit quality. And beyond this, how the EU can best contribute to global efforts on audit, both through International Standards on Audit and by promoting wider convergence and co-operation between regulators and oversight bodies.

### 1. The European dimension: the new legislative framework – the 8<sup>th</sup> Directive

Let me start with the 8<sup>th</sup> Directive. You know the history and background. The end result is, I think, a balanced framework which, if applied well should give us a sound framework for European audit. The directive is principles-based and it allows for some flexibility at the level of Member States. But certain key principles, which should help bolster audit quality, are now dealt with at EU level. Now the ink is drying on the political agreement, the formal adoption is foreseen for Spring 2006 and consequently the transposition into national law should be completed at the latest by Spring 2008.

What are the key principles in the Directive? I think they can be summarised in the following five points:

*Firstly, independent public oversight for auditors in Europe.* In most Member States, the profession has been accustomed to being self-regulated. I have first hand experience of this. But I think we have to recognise that times have changed. Auditors operate in the public interest and they have to be seen to be regulated independently. The Directive establishes the principle of robust and independent public oversight and sets criteria for judging this, but respects the different cultural traditions in the Member States of the European Union.

Public oversight can alleviate some problems but it is not a panacea. The profession's role is as important as ever. There needs to be strong direction setting the "tone at the top", but the newcomers must be convinced they have a role in setting the "tone at the bottom". I was interested to read in the FT last week that more graduates seem to want to try their hand at doing this, after the publicity of recent scandals. As the saying goes, there is no such thing as bad publicity...

But you know as well as I do that the real issue is how keep good graduates as they learn the trade and mature. Top class education and training of employees is a start. Yet maintaining motivation over a career requires more than this. Regulators can do their bit to try and restore the overall credibility of the profession but the profession crafts its own image ... I'm sure that Mike [Rake] will have something to say on this.

*The second key issue of the 8<sup>th</sup> directive concerns auditor independence.* The issue of non-audit services was hotly debated, particularly in the Council. The final text is not prescriptive: it builds on the existing Commission recommendation. It applies sound principles which will need to be applied wisely by regulators and by the profession.

*Thirdly*, the proposed Directive requires the *mandatory rotation* of the key audit partner of public interest entities every seven years at the latest. Member States may still opt for “external rotation”. But in my view the clear presumption is that rotation of auditors, rather than firms, is the best regulatory practice.

*The fourth key point* is the requirement for listed companies to set up an *audit committee* or a body performing functions equivalent to an audit committee. Much energy was devoted to debating this issue. In the end, I’m pleased to say that good sense prevailed ...

*Lastly*, I should like to say a few words on the question of limiting auditor liability. Audit firms would like to have a limitation of their liability, at least to acts for which they can be held directly responsible. There is a particular fear that the next corporate scandal would reduce the Big Four to the Big Three. Events have shown that auditors do not have such deep pockets as some like to think they do. Some EU Member States already have limitations or are moving in that direction. I can see there are good arguments in favour of EU action. The Directive invites the Commission to issue a report before the end of 2006, and to follow up this report with recommendations to Member States.

As a first step, we will carry out a study on the economic impact of the alternative liability regimes, the competition in the market and the availability of the insurance. The results will be available in the autumn of next year. Dialogue between investors and auditors is also essential. Therefore, we are going to create a forum, which will work in parallel, to obtain opinion of market experts, including investors, on the overall regulatory issue of limiting financial burdens for auditors. By this time next year, I intend to be in position to assess the options and decide what can be done.

## **2. The global dimension**

Let me now turn to address briefly the global dimension. The EU has clearly pinned its flag to the mast in favour of international standards. This is an endeavour I wholeheartedly support. In fact, returning to the accounting and auditing world after some 30 years away I have to admit I was rather surprised that work had not advanced more quickly. My first year in office has given me ample reason to understand why progress has been slow, given the complexity of the structures and variety of competing interests in this area.

### **a) Challenge of IFRS**

As companies grapple with the cost and administrative burden of migrating to IFRS this year, we need to remember the very considerable benefits that IFRS will bring. I know the one-off costs can be substantial, but they should give way to a significant stream of benefits in future years.

Furthermore, we have an agreement with the SEC with the objective of removing the burdensome US GAAP reconciliation requirement for EU issuers in the US, as early as 2007, but no later than 2009. The convergence this will entail must be a two way street and it must not destabilise the IFRS platform in Europe. I would like to stress that convergence is not an invitation to standard-setters to try and advance the theoretical frontiers of accounting. I will not take on board any revolutionary new standards. This should be a practical exercise, firmly anchored in business reality, to be undertaken in the interests of users and investors. The main objective is to try and narrow the differences between the existing standards, not to make accounts even more indigestible with a whole set of new standards!

We will not be adding new carriages to the IFRS train, just as it has left the station. We need, first and foremost, to be sure that existing IFRS beds down and that we reap the benefits at home. The different traditions and accounting approaches in EU Member States means that achieving consistent application of IFRS will be a major challenge. The Commission therefore welcomes the various steps already taken by CESR (Committee of European Securities Regulators) to ensure consistent enforcement. Auditors and preparers can do much themselves to improve consistent application. The big accounting firms are uniquely placed. We are looking at whether it would be useful to create any structures to assist. However, we do not want any EU body, formal or informal, providing EU interpretations and guidance. This runs counter to the whole principles-based philosophy of IFRS.

#### **b) International Standards of Auditing**

The 8<sup>th</sup> Directive foresees the use of international standards on auditing for statutory audits conducted in the EU. But adoption of these standards will be subject to strict conditions.

The EU will have to determine whether the current governance structure of the International Auditing and Assurance Standards Board (IAASB) is adequate, both in terms of standard setting and public oversight. As a first step, the Public Interest Oversight Board (PIOB) has now been set up. The Commission has nominated two observers to the PIOB. We expect further improvements of the governance of the IAASB, including with respect to the funding of the standard-setting activities. On the substance of the standards, the Clarity project of the IAASB is crucial. We hope that as a result of the project, high quality principles-based standards will emerge which are clearer and more readily enforceable.

#### **c) Cooperation between audit regulators**

The 8<sup>th</sup> directive gives us a basis for effective and balanced co-operation between regulators in the EU on one hand, and with regulators in third countries, such as the US Public Company Accounting Oversight Board (PCAOB), on the other hand. We will need to put some flesh on the bones of the directive as the PCAOB puts in place its programme for inspections in Member States. Within the EU we will be working to build up co-operation between oversight bodies. We will have to do this by way of a step by step approach as not all Member States yet have independent oversight bodies.

### **3. Concluding remarks**

Ladies and Gentlemen, I sincerely hope that we can work together constructively over the next few years. It is going to take a concerted effort from regulators, standard setters and the profession if we are to deliver on the illusive concept of "better financial reporting quality", on a global basis. Nonetheless, I am convinced it is a concept worth striving for and which it is worth trying to define more sharply. Capital markets, enterprises and those who invest in them deserve no less. I think we should give it our best shot.

Thank you.