European Consultation

Strengthening the quality of corporate reporting and its enforcement

December 2021

mazars

Introduction

Key features of the EU Consultation on corporate reporting

- **Context:** to draw lessons from the Wirecard case and assess the efficiency of the EU Audit and Corporate Reporting framework since the 2014 audit reform, the European Commission published a Call for evidence and launched a consultation on **Strengthening the quality of corporate reporting and its enforcement** in the EU (November 12, 2021).
- **Goal:** to evaluate the EU Public Interest Entities' (PIEs) audit framework and corporate governance framework for listed companies.
- **Key issues:** high quality and reliable corporate reporting; audit quality; supervision of audit firms and corporate reporting; sustainability reporting; attractiveness of the Capital Markets Union.

3 pillars of corporate reporting:

General assessment

Part I

1. Companies (boards and audit committees)
2. Statutory auditors
3. Supervisors

Specific assessment

Part II

Part III

Part IV & V

Part I. EU framework for high quality and reliable corporate Reporting

Assessment of the overall EU framework on the three pillars of high quality and reliable corporate reporting and their interaction.

Part II. Corporate governance

Evaluation of the functioning of company boards and audit committees.

Part III. Statutory audit

Measurement of the efficiency of the changes brought by the 2014 audit reform and ways to improve the functioning of statutory audit.

Part IV. Supervision of PIE statutory auditors and audit firms

Assessment of the role, means and powers of national audit supervisors and of EU supervisory convergence.

Part V. Supervision and enforcement of corporate reporting

Evaluation of the efficiency of supervisors of listed companies' compliance with disclosure obligations, relevance of their powers, and of EU supervisory convergence.

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Policy context

Why is this European audit reform happening now?

The audit market faces increasing demands on scope (ESG) and quality but suffers from a diminishing number of auditors in the PIE market.

The 2014 audit reform has not delivered as much as expected. The Commission highlights:

1. **Audit quality concerns**

   Recent audit cases (Wirecard, Carillion) question the efficiency of the financial information production chain, the independence of auditors and the efficiency of internal and external controls.

2. **Persistent high concentration in the EU PIE audit market**

   Dominant audit firms hold *"an average EU market share of 70% of all PIE statutory audits and over 90% of total revenues"**. PIEs are increasingly faced with a lack of choice for their auditor(s).

CSRD implementation by 2023 will not answer the current audit market structure shortcomings.

With the expected adoption of the Corporate Sustainability Reporting Directive (CSRD) by 2022, corporate reporting will be extended to sustainability reporting, which will be based on specific standards under preparation and subject to a limited or reasonable assurance. The European Commission objective is to avoid "green washing".

As experience shows in France, Spain and Italy, in most cases (up to 80-90%), PIE's will ask their auditors to extend their assignments and perform sustainability assurance on top of the financial reporting statutory audit.

Despite the European Commission stating that sustainability reporting goes hand in hand with addressing audit market structure shortcomings, the short CSRD implementation timeline will only replicate the financial audit market quality and choice issues.

*Commission Market Monitoring Report (Jan. 21)

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Key policy options and likely measures for PIEs and their auditors

What are the policy options contemplated by the European Commission?

At this initial stage, the European Commission is considering the following improvements:

1. Fully integrate **sustainability reporting** in the tasks of PIEs, auditors and supervisors.
2. Enhance the role of management, **audit committees and boards** on corporate reporting.
3. Identify ways to strengthen auditors' independence and professional skepticism to enhance audit quality, including reviews on:
   - Mandatory **rotation** of audit firms;
   - Prohibited **non-audit services**.
4. Reinforce **supervisory efficiency of** audit and corporate reporting, and further favour EU-wide supervisory convergence.

Likely measures that will impact statutory audits of PIEs:

- **Mandatory audit committees** covering both financial and sustainability reporting.
- More rigorous **fraud prevention and detection internal controls** and processes, implemented by the management along with their efficiency oversight (audit committee and board).
- More rigorous **internal quality controls within audit firms.**
- Wider use of **joint audits.**
- Harmonised and **shorter mandatory audit firm rotation** periods.
- **Harmonisation of the non-audit services list,** rather than mandating operational separation of audit and non-audit services within multidisciplinary firms.
- **Reinforced supervisory and enforcement powers** and means for national audit supervisors, and increased EU-wide supervisory convergence through the **Committee of European Audit Oversight Body (CEAOB).**
- Reconsidered national **liability caps** for audit firms.

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Optimising audit practices and market structure in the EU

Mazars' key messages (1/2)

The European Commission's initiative to improve the EU Corporate and Sustainability Reporting framework is more than welcome.

High quality audited financial and sustainable information is critical to trustful investment decisions and capital flows within a more integrated Capital Markets Union able to building up a more resilient economy.

To do so, the European Commission should improve all three corporate reporting pillars.

1. Auditor's quality enhancement

Auditors' independence and properly oriented incentives are the components of high-quality audits. They can be reinforced by:

- Endorsing and implementing the ISQM 1 & 2 in the EU to update internal quality control requirements for audit firms.
- Introducing step-by-step mandatory joint audit for large listed companies, banks and insurance companies, to insert the "four-eyes" principle and cross-reviews within the audit process, leading to a joint opinion.
- Fully harmonising and extending the minimum engagement length for auditors (several years) / fully harmonising the mandatory audit firm rotation period (Making the rotation period a multiple of engagement periods).
- Fully harmonising the current list of prohibited non-audit services ('blacklist').

A progressive introduction of mandatory joint audit will open and diversify the audit market and offer PIEs further choice for their auditors.

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Optimising audit practices and market structure in the EU

Mazars' key messages (2/2)

2. Companies' corporate governance
The EU corporate governance framework is properly designed but needs to be consistently implemented across the EU and could be better articulated by:

- Making audit committees mandatory for large listed PIEs.
- Reinforcing the oversight role of the audit committee on fraud, efficiency of internal controls, and going concern information.
- Repositioning the role and presence of the statutory auditors within the governance bodies (audit committees and parts

3. Supervisor's efficiency

The EU corporate reporting and audit supervisory framework could better mirror the increasing integration of PIE business and investment flows by:

- Entrusting the CEAOB with formal powers and increased resources to propose common EU rules and favour convergence of national supervisory practices.
- Adopting EU-specific standards and/or guidelines for harmonised implementation of prohibited non-audit services and functioning of joint audit provisions. The latter should cover proportionality of sanctions in the context of joint audit.
- Making the powers and skills of national audit supervisors, CEAOB and ESMA consistent with the introduction of sustainability reporting under the forthcoming CSRD.

Taking part in the debate

Contributing to the EU Consultation

The EU consultation is open to any stakeholder and takes the form of an on-line questionnaire that can accessed through the following link: [Corporate reporting – improving its quality and enforcement (europa.eu)]

Timeline	Ordinary legislative procedure
12 Nov 21- 4 Feb 2022 **Q4 2022**	**1. Process towards a legislative proposal by the European Commission** • Call for evidence and Consultation by the European Commission' services (12 weeks) • Publication of feedback from stakeholders' responses • Formal legislative proposal by the European Commission
2023/2024 **Co-decision legislative process** **(European Parliament & Council of Ministers)**	**2. Negotiation and vote in the European Parliament (EP)** • Amendments, negotiations and votes within the EP Committee in charge (ECON and/or JURI) and committees for opinion • Amendments, negotiations and votes in the EP plenary session to vote on a final text **2. Negotiation and vote of the Council of Ministers** (Ministers from 27 EU Member States – ECOFIN or COMPET) • Consultation of national stakeholders • Amendments, negotiations and votes to agree on a final text (> 55% of governments representing > 65% of the Union's citizens) Trilogue between EP, Council and European Commission to agree on the same text before final vote in EP and Council
	3. Implementation in Member States EU Regulation provisions that are directly applicable and EU Directive provisions that require a national transposition become applicable at a date specified in the legal text

How does a joint audit work?

What are the main features of a joint audit?

An audit of an entity by two (or more) auditors to produce a single audit report.

Audit planning is performed jointly and fieldwork is allocated between auditors to avoid duplication. (balanced work allocation)

The work performed by each auditor is subject to a cross-review by the other auditor.

The auditors jointly review the critical issues affecting the entity.

The auditors jointly report to the entity's management, its Audit Committee and its shareholders.

Much like a solo audit, the joint audit of a group's consolidated financial statements is divided into 5 key phases:

1. Defining the audit approach or audit strategy;
2. Auditing the financial statements of subsidiaries;
3. Auditing the holding company or parent company's individual financial statements (Phase 2 & Phase 3 could take place simultaneously);
4. Auditing the consolidated financial statements;
5. Establishing a joint audit opinion.

Contact

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