

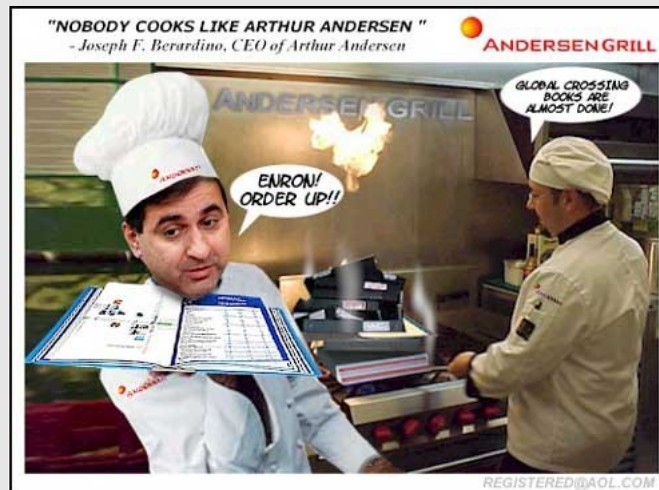
Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States

Markus Grund, CFA

Agenda

- 1. Introduction**
- 2. Legal Background**
- 3. Applications**
- 4. Next Steps – The way forward**

„ 1. Introduction - Joke: The Arthur Andersen Case“



Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 3

1. Introduction - Recent Accounting Scandals

2001	Enron (estimated 45 billion dollar damage)
2002	Adelphia Communications, ImClone Systems, AOL Time Warner, Merck & Co., Bristol-Myers Squibb, Merrill Lynch, CMS Energy, Mirant, Computer Associates, Nicor Energy, Duke Energy, Peregrine Systems, Dynegy, Qwest Communications Int'l., El Paso Corporation, Reliant Energy, Global Crossing, Tyco, Halliburton, WorldCom, Homestore.com
2003	Parmalat
2004	Fannie Mae (over 9 billion dollar earnings restatement, loss in market capitalization)
2005	AIG
2008	Bernie Madoff (estimated 65 Billion dollar damage)

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 4

1. Introduction - Recent Accounting Scandals

Lessons learnt:

- Not enough Independence from Client
- Profit maximation
- Poor Corporate governance
- Poor Ethical behaviour
- Stretching accounting standards over the border

Question:

=> Improving Quality, but how?

1. Introduction - Audit Quality

What is audit quality?

Audit quality deals with building an appropriate professional opinion on the financial statements of a company. It includes:

- Leadership, including tone at the top and audit firm strategy;
- People of competence, quality, objectivity and integrity;
- Working practices and quality control procedures;
- Internal monitoring by audit firms of leadership, people, client relationships and working practices; and
- External monitoring under public oversight to encourage and assist audit firms to improve audit quality.

1. Introduction - Drivers for audit quality

„The culture within an audit firm.“ (FRC Nov. 2006, „Promoting Audit Quality“)

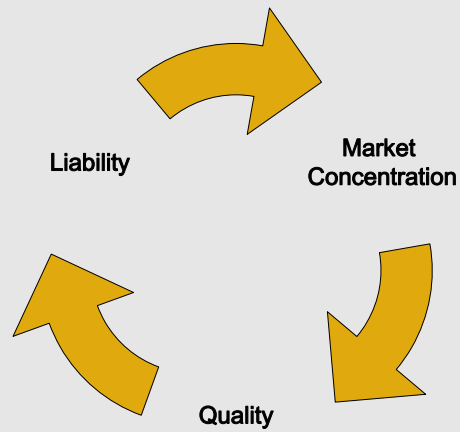
- Whether the firm’s leadership effectively promotes the importance of auditors’ discharging their professional responsibilities;
- Whether there is compliance with standards of ethics and professional conduct;
- Whether the firm’s human resources initiatives promote personal characteristics such as integrity, objectivity, skepticism, and robustness; and
- Whether the firm avoids short-term decisions that have a negative effect on quality.

1. Introduction - Audit quality and Fees

“If auditors receive more than the normal level of fees from their clients, auditors’ economic bonding to the clients is non-trivial, creating incentives for auditors to compromise their audit quality. However, if auditors receive less than a normal level of fees, auditors have no (or relatively weak) incentives to compromise audit quality.”

(“The Association between Audit Quality and Abnormal Audit Fees” Jong-Hag Choi, Jeong-Bon Kim, and Yoonseok Zang, November 2005)

1. Introduction



Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 9

1. Introduction – Market concentration

- **Worldwide:** more than \$100billion revenue within 10 largest audit firm networks;
- +/-40% are generated in Europe;
- Roughly 40% of the revenues come from statutory audit services.

Source: European Commission

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 10

1. Introduction – Liability limitation

Commission Recommendation on limitation of auditors' liability (MEMO/08/366 6. Juni 2008)

Liability limitation and impact on on audit quality:

- Limitation applies not in case of intentional breach of duties (collusive behaviour with management in committing fraud).
- Regular inspections provide better guarantees for the quality compared to unlimited civil liability rules which constrain access to highly concentrated audit market. Audit quality should be driven more by sound regular inspections whilst liability should complement such efforts but not make the audit business unattractive.

1. Introduction - Drivers for audit quality

What can Quality Assurance achieve?

- Same quality level for all audits (streamlining of process) within audit firm (not other tasks like consulting)
- Benchmarking of quality between different auditors (best practice)
- Improving the overall Quality-level

Limitations:

- If the quality of the underlying accounting standards is insufficient or not clear enough, no quality assurance system in the world could mitigate such deficiencies

2. Legal Background

November 2000:

Release of Recommendation on Quality Assurance for the Statutory Audit in the European Union: Minimum Requirements (the EC Recommendation on Quality Assurance)

June 2006:

„Statutory Audit of Annual Accounts and Consolidated Accounts“ (the Statutory Audit Directive or Directive) was published by the EU, Article 29 (QA) and Article 43 (PIEs: frequency of QA)

May 2008 :

Recommendation on external quality assurance for statutory auditors and audit firms auditing public interest entities (PIEs)

2. Legal Background

Introduction of the „8th directive“:

- Harmonization (but not to the maximum)
- Improving Quality by introduction of ISAs
- Improving System through Public Oversight bodies
- Improving Quality by introducing Quality Assurance (QA)-System:

„... The public oversight system of Member States should be encouraged to find a coordinated approach to the carrying out of quality assurance reviews with a view of avoiding the imposition of unnecessary burdens on the parties concerned.“

2. Legal Background

	Recommen- dation 2000	„8th directive“ 2006	Recommen- dation 2009
Methodology	Peer Review or Monitoring (Recommendation 2), differentiation between PIE and Non PIE	Monitoring independent of audit profession and subject to public oversight (Art 29 1a), no differentiation between PIEs and non PIEs	Monitoring with inspections; independent POB has ultimate responsibility for the external QA-system for statutory auditors and audit firms of PIEs

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 15

2. Legal Background

Monitoring	Monitored peer review	Monitored peer review with inspections
quality assurance reviews are undertaken by staff employed by a review organisation	the review organisation organises and supervises the reviews to be undertaken by experienced and authorised practitioners of audit firms or statutory auditors	Independent POB has ultimate responsibility for the external QA-system
	reviewers may be accompanied by members of the review organisation	POB able to participate and has rights according to files, working papers etc.

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 16

Monitoring	Monitored peer review	Monitored peer review with inspections
the review organisation is inherently independent of the reviewed audit firms	the review organisation is also inherently independent of the audit firms and it also ensures that those who undertake reviews are independent and free of conflicts from the audit firms they review	Statutory auditors and audit firms auditing public interest entities should be subject to inspections that are executed by a public oversight authority, either exclusively, or together with another appropriate body in accordance with: <ul style="list-style-type: none"> - Approval of methodologies - Approval of reports - Approval of Inspectors - Instructions to delegated body

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 17

2. Legal Background

Definition of PIEs within the recommendation from November 2000:

The term 'public interest entity' includes amongst others: listed companies, credit institutions, insurance companies, investment firms, UCITS (undertakings for collective investments in transferable securities) and pension funds.

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 18

2. Legal Background

Definition within „8th directive“:

‘public-interest entities’ means entities governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC, credit institutions as defined in point 1 of Article 1 of Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions⁽¹⁾ and insurance undertakings within the meaning of Article 2(1) of Directive 91/674/EEC. Member States may also designate other entities as public-interest entities, for instance entities that are of significant public relevance because of the nature of their business, their size or the number of their employees;

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States; Markus Grund, CFA | 08.03.2010 | Seite 19

2. Legal Background

	Recom- men- dation 2000	„8th directive “ 2006	Recommendation 2009
Funding	no pro- vision, but over- sight system should be inde- pendent	Free and secure from undue influence of audit profession (Art 29 1b)	Funding arrangements for QA-system: - level of funding and financial control, should not be subject to approval or veto by persons or organisations that are representatives of or otherwise affiliated with the accounting profession, the audit profession or an audit firm. - Sufficient overall level of funding.

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States; Markus Grund, CFA | 08.03.2010 | Seite 20

2. Legal Background

	Recommendation 2000	„8th directive“ 2006	Recommendation 2009
Funding			If funds for the quality assurance system are provided by statutory auditors or audit firms subject to inspections, any fee or other contribution payable by them should be mandatory and required to be paid in full on a timely basis.

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 21

Legal Background

	Recommendation 2000	„8th directive“ 2006	Recommendation 2009
Resources	Adequate	Adequate (Art. 29 1c)	Availability of inspectors insufficient: Use of experts under certain conditions allowed

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 22

2. Legal Background

	Recommendation 2000	„8th directive“ 2006	Recommendation 2009
Personal background	Professional education and relevant experience; special training on quality assurance reviews	Professional education and relevant experience; special training on quality assurance reviews (Art 29 1 d)	

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 23

2. Legal Background

	Recommendation 2000	„8th directive“ 2006	Recommendation 2009
Selection of Reviewers	independent and objective in fact and appearance	No conflict of interest (Art. 29 1e)	Independence: - Inspector and inspector mgt. System - inspector can not be: 1. practising 2. employed 3. associated with a statutory auditor

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 24

2. Legal Background

	Recom- men- dation 2000	„8th directive“ 2006	Recommendation 2009
Selection of Reviewers			<ul style="list-style-type: none"> - Two years „cooling off“ period - declaration of „no conflict of interest“ (false declaration sanctioned) - remuneration by POB; in no case from inspected auditor - Experts could assist under certain conditions inspector

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States; Markus Grund, CFA | 08.03.2010 | Seite 25

2. Legal Background

	Recommendation 2000	„8th directive“ 2006	Recommendation 2009
Scope	Assessment: <ul style="list-style-type: none"> - quality of the audit work (working papers) - compliance with auditing standards, - compliance with ethical principles and rules, including independence rules, - - Internal control system of audit firm 	<ul style="list-style-type: none"> - Compliance with applicable auditing standards and Independence requirements - Assessment of Internal control system of audit firm 	<ul style="list-style-type: none"> - Assessment of the design of the internal quality control system of the audit firm - Effectiveness Test of IKS of PIEs - Assessment of Transparency Report findings

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States; Markus Grund, CFA | 08.03.2010 | Seite 26

2. Legal Background

	Recommendation 2000	„8th directive“ 2006	Recommendation 2009
Scope	<ul style="list-style-type: none"> - audit reports: 1. appropriate format and type of opinion; 2. compliance of financial statements with the financial reporting framework as referred to in the audit report; 	Assessment of: <ul style="list-style-type: none"> - Quantity and quality of resources spent - Audit fees charged (Art. 29 1f) 	Assessment of: <ul style="list-style-type: none"> - Compliance with applicable auditing, quality control, ethical standards and Independence requirements - Quantity and quality of resources spent - Audit fees charged (Art. 25 8th directive)

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 27

2. Legal Background

	Recommendation 2000	„8th directive“ 2006	Recommendation 2009
Scope	3. failure to mention non-compliance of financial statements with other legal requirements as referred to in the audit report.		

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 28

2. Legal Background

	Recommendation 2000	„8th directive“ 2006	Recommendation 2009
Report	Evaluation of results	Main conclusions of the QA-review (Art. 29 1g)	
Timing	Maximum of six years	At least every six years (Art. 29 1h), every three years for PIEs (Art. 43 1)	

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 29

2. Legal Background

	Recommendation 2000	„8th directive“ 2006	Recommendation 2009
Publication	Possible publication of results	Annual report on QA-system (Art. 29 1i)	Annual Report on results of the QA-system with: <ul style="list-style-type: none"> - information on recom. issued - follow up on the recom. - disciplinary actions and penalties - quantitative and other key performance information on financial resources and staffing, and the efficiency and effectiveness of the QA-system.

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 30

2. Legal Background

	Recommendation 2000	„8th directive“ 2006	Recommendation 2009
Recommendations	reporting should also include recommendations for professional and/or regulatory actions, follow-up to recommendations and sanctions	Within a reasonable period the recommendations should be followed by the auditor (Art. 29 1j)	<ul style="list-style-type: none"> - Communication on findings and conclusions to auditor before report is finalized - Max. 12 months period from the issuance of the inspection report to reduce deficiencies in IKS; afterwards disclosure of deficiencies through POB

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States; Markus Grund, CFA | 08.03.2010 | Seite 31

2. Legal Background

	Recommendation 2000	„8th directive“ 2006	Recommendation 2009
Sanctions	Removal of the statutory auditor from the audit register	Disciplinary actions or penalties according to Art. 30	POB should have the right to take disciplinary actions or impose penalties in respect of statutory auditors and audit firms

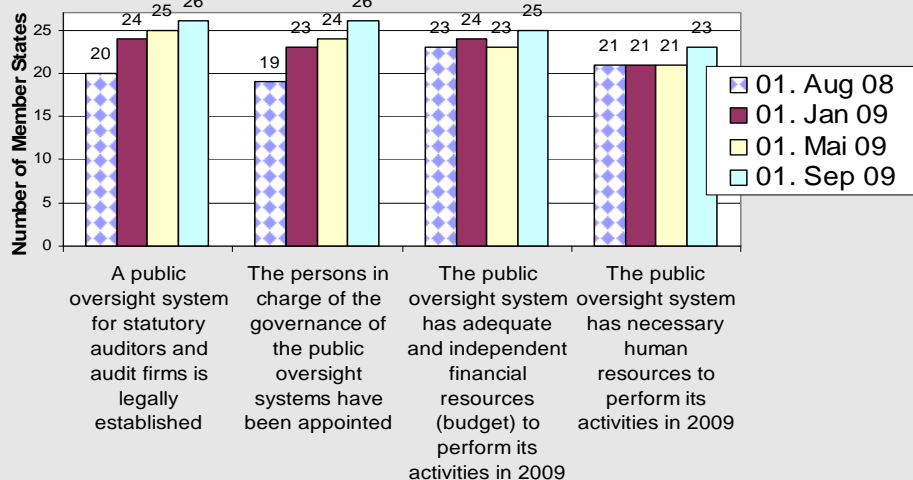
Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States; Markus Grund, CFA | 08.03.2010 | Seite 32

2. Legal Background

	Recomm endation 2000	„8th directive“ 2006	Recommendation 2009
Sanctions			-POB should inform public in timely manner about final sanctions and actions (contains identification of auditor and deficiencies which led to sanction) - Amendment of misleading transparency reports

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States; Markus Grund, CFA | 08.03.2010 | Seite 33

3. Applications (Source: European Commission September 2009)



Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States; Markus Grund, CFA | 08.03.2010 | Seite 34

3. Applications (indicative Information July 2008)

Oversight Body performs direct inspections of audit firms	Oversight Body performs indirect inspections ¹ of audit firms	Oversight Body has no role in inspections of audit firms ²	Countries in which no inspections of audit firms are performed	Insufficient information currently available
Australia Canada Italy (listed) Japan Luxembourg Malta Netherlands (listed) Norway Singapore South Africa Switzerland United Kingdom (listed) Denmark Spain Bulgaria France (listed companies) Sweden United States	Austria Belgium France Germany Lithuania	Ireland Latvia Hungary	Bahamas Bermuda British Virgin Islands Cayman Islands	Estonia Finland Greece Romania Poland Slovenia Portugal Slovakia Czech Republic Cyprus

^[1] i.e., the conduct of certain aspects of inspections is delegated to other bodies by the Oversight Body (typically, to professional bodies or peers, i.e. other audit firms), with the Oversight Body retaining certain functions and powers *vis a vis* inspections.
^[2] These countries have not yet finished the transposition of the Directive on Statutory Audit

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 35

4. Next steps with regard to QA

European Union Member States are requested to inform the European Commission about actions taken in light of this most recent Recommendation by 6 May 2009.

In the light of new international developments, in particular the involvement of appropriate bodies and experts in the execution of inspections, the European Commission intends to evaluate the situation in 2011.

FEE will support the European Commission's review of the implementation of the Recommendation.

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 36

Annex: Links

Transposition measures of Member States:

http://ec.europa.eu/internal_market/auditing/directives/transpo_en.htm

Transposition Scoreboard:

http://ec.europa.eu/internal_market/auditing/directives/index_en.htm

Benchmark on QA-Commission Recommendation:

http://ec.europa.eu/internal_market/auditing/quality/index_en.htm

National websites:

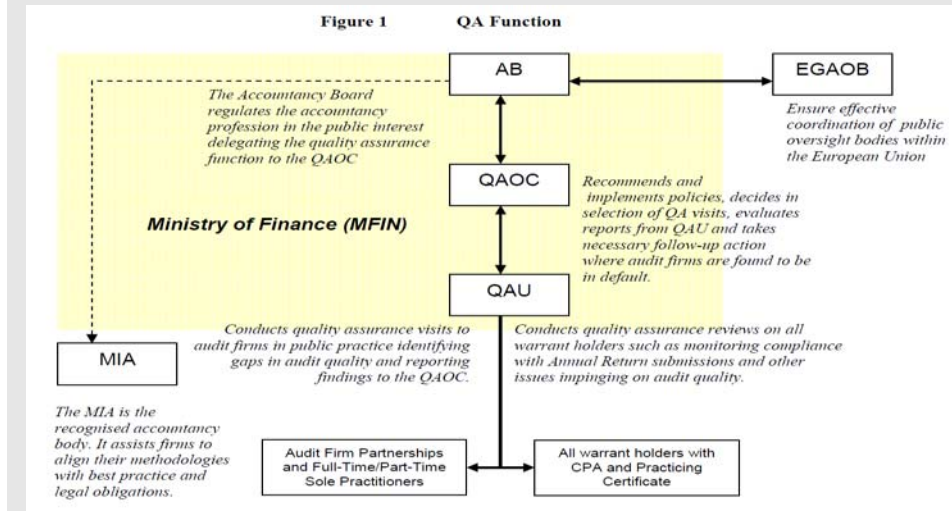
http://ec.europa.eu/internal_market/auditing/links_en.htm#bodies

Annex: Practical Case: QA-system in Malta

The Maltesian Experience (Small Member State Application)

Source: Quality Assurance Handbook, Maltesian Ministry of Finance, December 2006

Annex: Practical Case: QA-system in Malta



Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 39

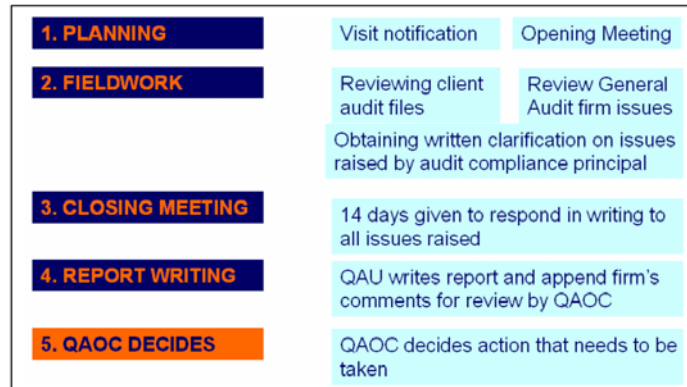
Annex: Practical Case: QA-system in Malta

	According to Quality Assurance Handbook (December 2006)
Methodology	Monitoring through QAU
Funding	Quality Assurance regulatory fee is charged
Resources	QAU-Agents

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 40

Annex: Practical Case: QA-system in Malta

The Quality Assurance Review process can be illustrated in the following diagram.



Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 41

Annex: Practical Case: QA-system in Malta

Fee schedule:

The Quality Assurance Regulatory Fee to be charged to firms and sole practitioners in public practice on an annual basis irrespective of whether a quality assurance visit has been made is as follows:

- | | |
|-------------------------------|----------------------|
| • 5 or more partner firm | Lm2,400 (€ 5,590.50) |
| • Three to four partner firm | Lm 700 (€ 1,630.56) |
| • Two to three partner firm | Lm 250 (€ 582.34) |
| • Full time sole practitioner | Lm 100 (€232.94) |
| • Part time sole practitioner | Lm 50 (€116.47) |

Fees for follow up visits are based on time costs which have been set at Lm15 (€34.94) per man hour.

These fees fall due on a calendar year basis and will be payable within 30 days from billing.

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 42

Annex: Practical Case: QA-system in Malta

	According to Quality Assurance Handbook (December 2006)
Personal background	No information contained
Selection of Reviewers	No information contained

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 43

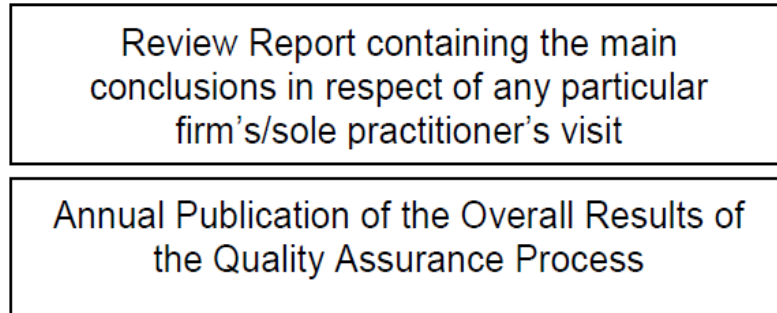
Annex: Practical Case: QA-system in Malta

	According to Quality Assurance Handbook (December 2006)
Scope	<ul style="list-style-type: none"> • Credibility Reviews • Independence Reviews • Statutory Compliance • Audit Report Reviews • Internal Quality Control Procedure Review
Report	<ul style="list-style-type: none"> - Closing meeting to discuss findings and recom. - Report writing and publication - QAOC forms decision based upon report and communicates to the auditor

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 44

Annex: Practical Case: QA-system in Malta

Figure 2 Levels of Reporting



Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 45

Annex: Practical Case: QA-system in Malta

	According to Quality Assurance Handbook (December 2006)
Timing	<p><i>Visit cycle</i> a visit cycle of three years on audit firms performing assurance services on public interest entities and four years for all others.</p> <p><i>Following a complaint</i> a complaint may be received by the Accountancy Board, wherein the latter may decide to refer the matter to the QAOC to schedule a visit.</p> <p><i>From annual return</i> the ongoing desk-top monitoring of the annual returns submitted by those in practice may instigate a review.</p> <p><i>Random Visit</i> the QAOC reserves the right to carry out visits at random.</p>

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 46

Annex: Practical Case: QA-system in Malta

	According to Quality Assurance Handbook (December 2006)
Recommendations	<ul style="list-style-type: none"> - Improvement of system - Follow up on recommendations by QAU

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 47

Annex: Practical Case: QA-system in Malta

	According to Quality Assurance Handbook (December 2006)
Sanctions	<ul style="list-style-type: none"> • Re-scheduling of visit at short notice, with no justifiable reason – flat fee of Lm250 (€582.34); • Per diem charge, if response to closing minute notes is not received within 14 days of presentation by QAU reviewers – Lm50 (€ 116.47) per day; • Per diem charge, for delays in submission of fees due – Lm50 (€ 116.47) per day; • Failure to submit documentation requested by the QAU within the specified time – Lm50 (€ 116.47) per day; and • Failure to respond to the QAOC on requested remedial action - Lm50 (€ 116.47) per day.

Within the light of the 8th Council Directive, applications of Quality Control Systems of Member States: Markus Grund, CFA | 08.03.2010 | Seite 48