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**MINISTER FOR ECONOMIC
AND BUSINESS AFFAIRS**

Green Paper – Audit Policy: Lessons from the Crisis

General comments

The Danish government welcomes the initiative by the European Commission to review how the audit function could be enhanced in order to contribute to increased financial and economic stability.

The Danish government agrees with the importance and societal role of the audit function and considers, not at least in times of financial instability, the audit function crucial. In this regard, the Danish audit legislation specifies that the statutory auditor shall be the representative of the public during the performance of the audit.

The Danish government therefore agrees that the audit function plays an important role to the confidence in financial statements and contributes to financial and economic stability.

The Directive on Statutory Audit has just recently been implemented in Member State legislation and the Directive already deals with many of the issues raised in the Green Paper. The effects of the measures in the Directive on the audit function have therefore not yet been assessed.

The Danish government has focus on better regulation and administrative burdens and is concerned whether full impact of the Directive of Statutory Audit is known.

New administrative burdens on European companies may impede the growth of the companies and new measures as a result of the green paper should be carefully considered.

The Danish government therefore agrees with the European Commission to the need for differentiated and calibrated approach, which is adapted and proportionate to the size and complexity of the audited company as well as to the auditor.

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Specific comments

Role of the Auditor

The Danish government welcomes the initiative of the European Commission to review improvements of the auditors' communication to audit clients and other stakeholders.

Recognizing the "expectation gap" the Danish government finds that extension of the audit report should be considered very carefully. It is important that it cannot be questioned whether an audit report is without qualifications or it is a qualified audit report.

The Danish government stresses the importance of the division of responsibilities. The responsibility of the auditors is to report on historical financial statements, which include going concern considerations in a limited future period. The responsibility of the management is to prepare the financial statement, including information about the anticipated future prospects of the company. An extension of the auditor's mandate should not comprise the division of responsibilities between the auditor and the management of the audited company.

The Danish government supports discussions on how to improve the communication to management of the audited company. The Danish legislation e.g. requires the auditor to report to the management during the audit process (Auditors' records). Amongst other things the auditor must report on significant issues regarding the audit, including, in particular, material uncertainties, errors, misstatements or omissions in the company's bookkeeping, accounting or internal control. The auditors' records shall also be kept for use by the audit committee and for the use by regulatory authorities.

In Denmark generally accepted auditing practices requires the audit to comply with International Standards on Auditing (ISA). The Danish government finds that ISA promote audit quality and is favourable to the implementation of the ISA into Community Law. However, recognizing the dogma that "an audit is an audit" other auditor services to the SME segment should be taken into consideration. Other auditor services that addresses the less complex structures of SMEs and meet the needs of those companies would be in line with the desire to reduce the administrative burdens.

Independence of the auditor is fundamental and the exercise of professional scepticism is essential to the confidence in statutory audit. The Danish government will therefore have an open and positive approach to discussions on initiatives to reinforce the independence of auditors auditing Public Interest Entities.

The Danish government agrees that the proportion of fees an audit firm receives from a single audit client compared to the total audit revenues of the audit firm may compromise the auditors' independence. According to the Danish audit legislation an audit firm must therefore not have a share of more than 20 percent of its turnover with the same customer in each of five consecutive financial years.

The Danish government is positive as to examine a limitation on the proportion of audit fees from a single audit client.

The Danish government is, however, very sceptical to a system where the appointment, remuneration and duration of the engagement are the responsibility of a third party, e.g. a regulator, rather than the company itself. The system violates the shareholders' right to appoint the auditor and conflicts with Article 37 of the Directive on Statutory Audit. Secondly, a system where a regulator appoints the auditor would clearly compromise the independence of that regulator and possibly the independence of the auditor. And thirdly, such a system will contribute to uncertainty about the division of liability in case of errors or other irregularities.

The Danish government welcomes a discussion on the market concentration and the market structure. The Danish government supports that the European Commission initiate a work with Member States, audit firms, stakeholders and international fora to discuss a contingency plan in case of the demise of a so called systemic audit firm. But as stated below the Danish government does not see joint audits to play a role in this plan.

As regard the market structure it should be noted that a major barrier to growth of medium sized audit firms is the missing representation on markets where the audit firm is not represented

The Danish government has concerns in regards to mandatory rotation of audit firms. An Italian study¹ of mandatory rotation of audit firms indicates that mandatory rotation does not have any effect but rather increases the cost of audit and reduces the audit quality. The Danish government therefore finds the current requirement of mandatory auditor rotation adequate.

Until 2005 listed companies in Denmark was required to appoint two different auditors/audit firms. The Danish experience is that the audit work was in fact only carried out by one of the auditors although both auditors

¹ Bocconi University, Italy, 2003 (revised 2005) – “Economic consequences of mandatory auditor rotation – the impact of mandatory rotation on audit quality and on pricing: the case of Italy”. Mandatory rotation of audit firms has also been discussed in “Independence of Australian Company Auditors” by Ian Ramsay, Harold Ford Professor of Commercial Law and Director of the Centre for Corporate Law and Securities Regulation, The University of Melbourne, October 2001.

had the same responsibility for the audit. Neither did the system contribute to audit quality. The system of joint audits was therefore revoked. The Danish government is not in favour of reintroducing joint audits and do not share the Commissions analysis that it has positive effects on the market structure.

The Danish government finds the idea of the creation “of a European passport” interesting and supports a further examination of the subject. An examination should take into account the provision in the Directive on Statutory Audit, which state that auditors should be approved by the Member State requiring the statutory audit to secure the proper knowledge of e.g. tax law, company law, etc., which are not harmonised on EU level. The examination should take into account the Directive on recognition of professional qualifications that already allows that service providers to provide cross-boarder services except statutory audit.

Limitation of the auditor liability has not been specifically addressed in the green paper. The Danish government, however, finds it appropriate to comment on this issue. The Danish government does not support a limitation of the auditor’s liability. The Danish law of compensation and indemnification contains a reduction provision, which can reduce unreasonable damage claims.

The Danish government therefore holds the position that the profession has the possibility to establish arrangements where the audit firms, including firms participating in a network, do not have joint and several responsibility to damage claims.

Supervision and international co-operation

The Danish government is positive to awards developing and creating an efficient and effective structure of the public oversight systems of the Member States. In this regard, the Danish government has noted that developments have already taken place within the EGAOB and the sub-groups of EGAOB and it would be natural to build on these developments. The financing should be taken into account in the European Commission’s considerations.

International co-operation on the audit field, including on audit firm oversight, is important and the Danish government supports developing the international co-operation further. This must ensure an efficient and equal dialogue between competent authorities and should secure the audit firms from unnecessary burdens when subject to inspections from more than one oversight authority.

Small and Medium Sized Enterprises and Practitioners

As stated above, the Danish government is favourable to examine auditor services to SMEs that addresses the less complex structures of SMEs and meet the needs of those companies.

In general, the Danish government overall stresses the importance of fighting “red tape” and its impact on for example SMEs. Before any initiatives are taken based on the ideas of the green paper an impact assessment must be carried out to make sure that new administrative burdens do not impede the growth of the companies. As stated in the general comments any initiative should be proportionate to the size and complexity of the audited company as well as to the size and complexity of the auditor.

Finally, the Danish government would like to stress concerns if initiatives are taken before the full impact of the Directive on statutory Audit is known. New initiatives risk being a burden to the audit firms and the audit clients and without the intended effects on the issues pursued.

Yours sincerely

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