

Policy Position

The EU must not procrastinate on urgent audit market reforms

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#Auditing

#Competition

#Reform

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After the Wirecard accounting scandal, the EU Commission promised to reform the rules for auditors. Now it must finally present them: The problems are clear and there are plenty of proposed solutions, writes Sebastian Mack.

For years, the auditing firm EY certified Wirecard clean balance sheets, but in the end, 1.9 billion euros were missing. In response to the collapse of the payment processor, the EU announced [far-reaching reforms](#). By the end of 2022, the responsible Commissioner Mairead McGuinness wanted to present a legislative proposal.

But now the EU Commission seems to be in no hurry. At the beginning of December, McGuinness [stated](#) that the Commission would have to further deepen its assessment of the problems. She did not name a date for concrete reform proposals.

This is unjustified. The problems of the audit market dominated by the "Big Four" Deloitte, EY, KPMG and PwC are well known and there are enough proposed solutions. The Commission itself conducted a [public consultation](#) and commissioned a study on the rules introduced after the financial crisis. The [results](#) were published beginning of December and underline the acute need for action:

Market concentration remains high

Since 2016, there has been a Europe-wide obligation to rotate auditors. Large, listed companies must change their auditor every ten years at the latest and put out a call for tender. This is intended to strengthen competition and counteract excessive proximity between the auditor and the audited company.

However, more than half of the companies invite only the Big Four to tender. As the costs of participation are high, smaller audit firms often do not participate in tenders, even if they are invited. This has consequences:

In Italy and Ireland, the Big Four share about 90% of the total audit fees among themselves, in Germany they dominate the market with 95%.

More independence, less competition

In order to reduce conflicts of interest, the EU established a blacklist of prohibited consultancy services that auditors are not allowed to offer to their audit clients. In addition, the fee from permitted consultancy services may not exceed 70% of the audit fee.

While the 70% cap is too high to effectively strengthen independence, the blacklist harms competition. For large, complex companies, only a handful of audit firms qualify anyway. If one or two are then excluded from the audit because of consultancy services, companies have little choice.

Hardly any sanctions

To enforce the European rules, all EU member states must put auditors under supervision and sanction violations. However, the maximum penalties vary widely, ranging from 14,300 euros in Latvia to 5,000,000 euros in Portugal.

Regardless of the theoretical possibilities, in practice supervisors are reluctant to sanction non-compliance. Cyprus, for example, did not impose any sanctions at all between 2017 and 2020. In the same period, fines of more than one million euros were imposed only four times in the entire EU. Large audit firms pay such penalties out of petty cash.

Non-transparent supervision

National supervisors are also reluctant to publish their activities. In the case of sanctions, many supervisors only disclose aggregated figures or anonymise the rule-breakers. They also often do not communicate the results of their own investigations of auditors.

With this lack of transparency, the supervisors are doing a disservice to the companies. They want to know whether their auditor has done something wrong and how the supervisor assesses the quality. This mystery-mongering only protects the bad auditors.

No sign of a single market

The European audit market consists of a patchwork of national rules. Member states can deviate from the EU requirement of ten years for the rotation obligation: in Bulgaria it is seven years, in other countries up to 24.

The national definitions of audit and advisory services and the cap on permitted advisory services are also inconsistent. Even the auditors plead for changes: Nine out of ten are in favour of harmonisation to simplify the application of the rules and reduce costs.

Putting the audit market on its feet

The available results leave no doubt that the reforms of auditing rules adopted after the financial crisis have not eliminated the problems. Potential [solutions](#) have been proposed. To finally increase competition, smaller audit firms also need to be able to audit large and complex companies. The best way they can build up the necessary experience and capacity is to make shared or joint audits mandatory, with the mandatory participation of a non-Big Four audit firm.

Similarly, supervisors need to become more transparent to help companies in their search for an auditor and warn of black sheep. To effectively prevent conflicts of interest, consulting services for audit clients should be prohibited without exception. And finally, there needs to be more European coordination and harmonisation in rules as well as in their enforcement.

Reforms must not be postponed any longer

In order for the reform to go through before the European elections in 2024, the EU Commission must now present its legislative proposal quickly. The last reform negotiations lasted more than two years and went down in history as the mother of all lobby battles.

The resistance of the established players will also be significant this time. But that should not scare policy makers. If they want to prevent scandals like Wirecard in the future, they must initiate fundamental reforms.

In its [coalition agreement](#), the German government promised to strengthen the independence of auditing and to counteract the high market concentration. If it is really serious, it must now press for reforms in Brussels.

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