



Oifig an Stiúrthóra um
Fhorfheidhmiú Corparáideach

Office of the Director
of Corporate Enforcement

**ODCE Response to DETE's Consultation Paper on the
EU Commission Recommendation 2008/362/EC on External Quality Assurance
for Statutory Audit Firms auditing Public Interest Entities**

Introduction

The Office of the Director of Corporate Enforcement (ODCE) is pleased to respond to this Consultation Paper from the Department (DETE).

In approaching this Consultation Paper, significant regard must be had, in the ODCE's view, to the upheaval in international financial markets in the recent past and in particular to the poor international reputation from which Ireland now suffers as a consequence of the impact of recent international volatility and more particularly our economy's excessive exposure to the property market.

Against this background, Ireland is very much in the international spotlight at present, and all national decisions which impinge on our standing in the financial markets are subject to scrutiny. It seems to the ODCE that we must follow international best practice as far as possible and not leave ourselves open to further international criticism now or in the future for any perceived inadequate response to market developments. A strong regulatory framework is particularly important. Ideally, we should depart from the international norm only where there are very good reasons for doing so and where we are likely to convince other administrations and the financial markets that such a departure is fully justified in an Irish context.

These considerations are important in the context of Ireland's implementation of the above Recommendation. Questions have been and are being raised about the recent performance of both company directors and auditors in Irish banks and building societies in particular. For instance, the performance of certain former directors and the auditors of Anglo Irish Bank Corporation Ltd is at present the subject of investigation by a Special Investigator. The fact that the professional body in question felt the need to appoint a respected former Comptroller and Auditor General to lead this investigation rather than appoint a member of its own profession is in itself a reflection of the importance for credibility reasons of having these matters dealt with on an independent basis in the public interest. This decision has relevance to the choice of quality assurance model which is to be selected arising from this consultation process.

In implementing this Recommendation therefore, Ireland should, in the ODCE's view, develop an independent and credible system of quality assurance for auditors engaged in the audit of public interest entities (PIEs). In this context, we particularly concur

with the following comment attributed to Commissioner McCreevy in the Consultation Paper:

“A cornerstone of the Directive is the establishment of an external quality assurance carried out by an independent public oversight body. According to the Directive the external quality assurance system should be objective and independent from the auditing profession.”

The particular questions posed in DETE’s Consultation Paper are addressed below.

Question 1: Which of the options do you consider is the most appropriate for Ireland to adopt?

Option II.

Question 2: In commenting on one or more of these Options, please indicate:

- (a) what benefits you would see accruing from the Option’s implementation;**
- (b) what disadvantages, if any, would you see resulting from the Option’s implementation.**

Discussion of Option I

Option I, if adopted, would confer statutory responsibility on the recognised accountancy bodies (RABs) for quality assurance of the auditors of both PIEs and non-PIEs. We note that the Consultation Paper does not record any jurisdiction as opting for Option I. As suggested in the Paper, this Option would not support the necessary independence and credibility of the quality assurance function. In particular, it could damage Ireland’s reputation as a place for inward investment and would certainly give rise to the necessity for third country quality assurance inspections of certain Irish audit firms.

In the ODCE’s view, the arguments against this Option overwhelm those in favour of it at the present time, and accordingly, we believe that Option I would not result in a first class quality assurance system that would meet either national or international demands for proper independent oversight. On that basis, we favour its rejection.

Discussion of Option II

Option II proposes to assign total responsibility for quality assurance to the Irish Auditing and Accounting Supervisory Authority (IAASA). As a general comment, the ODCE is somewhat disappointed at the relative brevity of the discussion in the Consultation Paper in favour of (or indeed against) Option II.

In the ODCE’s view, this Option must be considered very seriously having regard to the developments outlined earlier in the Introduction. The comment attributed to Commissioner McCreevy strongly suggests that this is the Commission’s preferred option for adoption by the Member States. Based on the review contained in the Department’s Consultation Paper, this Option also appears to represent the emerging best practice model internationally with many progressive administrations, including

notably the UK, the US and Japan, having already taken this approach. In the view of the ODCE, these additional factors support the case for adopting Option II.

On the other side of the equation, we believe that the arguments set out in the Consultation Paper against this Option are overstated in the present climate even though we acknowledge that the potential challenges as outlined in the Paper are present to some extent.

While IAASA truly faced a “greenfield” scenario when it was established, this characterisation is not, we believe, appropriate to the extension of its remit envisaged in this Option. In taking on additional responsibility for reviewing issuers’ compliance with the requirements of the EU Transparency Directive in recent years, IAASA has already shown itself, with proper resources, to be very capable of implementing and fulfilling an expanded remit. On that basis, we do not consider that there is a particularly sound basis for the reluctance expressed in the Consultation Paper associated with conferring on IAASA the additional responsibility envisaged in Option II.

Likewise, we do not share the reservation that IAASA would find it difficult to recruit appropriately qualified personnel. While that has been its experience in the past, the employment market for professional staff has fundamentally changed in recent months, and there is every prospect at this stage that one or more new permanent posts in IAASA would prove highly attractive for suitably qualified people.

We also do not believe that it is correct to assume that the body of existing expertise in the RABs would be lost to IAASA if it were conferred with additional responsibilities under this Option. A partial transfer of function from one or more RABs to IAASA could well be accompanied by a transfer of some appropriate staffing and expertise particularly in the present weak employment market for professional staff. Even if this situation were not to transpire, the expertise issue could be addressed to some extent by IAASA seeking access to the RABs’ current review working papers and by drawing on the practices of comparator public oversight bodies abroad in order to establish their own best practice for carrying out inspections. This would allow them to blend best practice experiences in creating their own methodology.

The Consultation Paper does not discuss in any detail the cost implications of Option II and the possible options for meeting that cost. The ODCE understands that the Option essentially envisages a partial transfer of function from the RABs to IAASA. As such, we see no reason why part of the associated finance supporting that function in the RABs should not travel with the function to IAASA even if some modality issues would arise. Therefore there seems to be no necessary reason why the implementation of Option II should necessarily involve an additional overall cost burden on the Exchequer, PIEs or their auditors. It should, in the ODCE’s view, be possible to implement it in a ‘cost-neutral’ manner.

Discussion of Option III

Option III, the delegation model, allows RABs to continue to carry out the review work but subjects them to oversight by IAASA. According to the Consultation Paper, a minority of other jurisdictions are adopting this Option.

In the view of the ODCE, this represents a ‘second best’ option which would miss an important opportunity for Ireland to place itself in the leading group of States which would have an unquestioned and credible regime of quality assurance in the present volatile international economic environment. Certain third country audit regulators may well be unconvinced by a regime which involves splitting responsibility between the RABs and IAASA. This would mean that audit firms could well be subjected to both national and international inspection and review. This offers the unpalatable prospect of those firms facing additional disruption and bearing additional cost arising from multiple inspections.

Conclusion

Overall therefore, this Office favours Option II, the direct inspections regime, because it represents the most credible and highest quality assurance in the difficult circumstances currently prevailing in the national and international environment.

Question 3: If you consider that implementation of the “delegation model”, i.e. Option III, is the most appropriate course of action, do you have any observations on paragraph 22, Part II, entitled “How an Option III model might operate”?

As we have not supported Option III, no response to this question is needed.

Question 4: Were Option I to be implemented, the current situation, i.e., where IAASA has no direct role in, and no responsibility for, quality assurance of auditors of PIEs would continue. If your preferred option is to see Option I implemented:

- (a) do you foresee any difficulties under those circumstances in Ireland being able to successfully advance the argument that its audit regulatory system should be relied upon by third country audit regulators?**
- (b) if you do envisage such difficulties, how would you suggest such difficulties being addressed?**

As outlined above, this Office does not support the adoption of Option I. We do not believe in particular that it is realistic to expect that the identified difficulties are capable of being overcome. If the Commission does not support this Option, we cannot see how Ireland could in reality persuade other administrations and international investors of its merits.

Question 5: Do you have any views on the proposed definition of PIEs with respect to the Options set out above, and in particular, as regard the Option which you consider it most appropriate to adopt?

This Office has general concerns with the somewhat limited definition of PIEs as outlined in the Consultation Paper. Ireland has a distinctive corporate structure in that many of its larger economic entities are not listed on the Irish Stock Exchange. This is driven by two factors, firstly the large amount of foreign direct investment that this country has been successful in attracting, much of it from outside the EU. Also we

have a number of large indigenous Irish companies that are privately owned or are unquoted plcs and are therefore not listed. At the same time, such companies play a very important part in the fabric of the Irish economy.

In the circumstances, the ODCE favours an expanded definition of PIE which would include all companies with a turnover in excess of €50 million and a balance sheet total in excess of €25 million. This is consistent with Section 42 (Audit Committees) of the Companies (Auditing and Accounting) Act 2003 and with the recommendations of this Office on the implementation of that provision.

Confidentiality

In response to the request in the Consultation Paper, this Office wishes to confirm that it has no difficulty with the Department publishing this submission in its entirety.

Office of the Director of Corporate Enforcement
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