



*Public Documents  
of the XXVI<sup>th</sup> Annual Conference of  
the International Organization of  
Securities Commissions  
(IOSCO)*

*23-29 June, 2001, Stockholm, Sweden*

**Plenary 4**

**Auditor Independence**

*15. The European Perspective – The EU Draft Recommendation,  
Speech by Mr. Björn Markland*

*Secretary General FAR – the Swedish Institute for the Accountancy Profession*

*28 June 2001*

*Panel Four*  
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IOSCO Conference 28 June 2001, Panel 4

## The European perspective – The EU draft recommendation

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Qualification as *auktoriserad revisor* (authorised public accountant) 1972

President of FAR (the institute for the Swedish accountancy profession) 1982—84

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Technical advisor on the IFAC Ethics Committee and Council 1985—92

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Member of FEE Ethics Working Party

Member of IAPC Review Task Force

Member of the Swedish delegation on the EU Committee on Auditing

## The European perspective – The EU draft recommendation (09.25—09.35)

### **General background:**

- Early efforts to harmonise financial reporting and auditing requirements were reasonably successful (Fourth and Seventh Directives).
- Also, efforts to harmonise qualification requirements for statutory auditors were successful (Eighth Directive).
- An effort to harmonise corporate governance, including auditor independence, failed (draft Fifth Directive).

### **Background to current development:**

- Facing the possibility to resume work on the auditor parts of the draft Fifth Directive, FEE launched a major project on independence. The starting point was a conceptual approach developed by the UK profession.
- The FEE project was reported in a position paper called *Audit Independence and Objectivity* (1995).
- In 1996 the European Commission published a Green Paper called *The Role, the Position and the Liability of the Statutory Auditor within the European Union*. The Green Paper was followed up by a communication on statutory auditing called *The way forward*.
- The Commission called for action in four areas: auditing standard-setting, quality control of statutory audit, free movement of audit services across European borders, and – auditor independence. FEE was asked to cooperate in all these areas.
- In 1998 FEE published a *Core of Common Principles* (CCP) for statutory audit independence and objectivity. The CCP were submitted to the Commission as the profession's proposed way to the harmonisation of independence principles. The CCP were essentially based on the 1995 report.
- In its new Committee on Auditing the Commission started developing an EU recommendation, based on the FEE proposal. It is expected that a final recommendation will be issued after a Committee meeting in Oslo taking place simultaneously with the IOSCO Conference.
- The IFAC Ethics Committee is reviewing Chapter 8 (independence) of the IFAC Code of Ethics for Professional Accountants with the intention to convert it to a conceptual approach. The Independence Standards Board of the United States has developed a conceptual framework for auditor independence. In both projects, FEE has been invited to participate actively in the work, and in both cases existing drafts are compatible with the European thoughts.

### General ideas of the conceptual approach:

- There are fundamental principles, which must always be observed by a professional accountant. In the case of audit, the relevant fundamental principle is objectivity, which necessarily requires the auditor to be independent.
- Before taking on a piece of work, an accountant must consider whether it involves threats which would (in fact or in appearance) impede the observance of fundamental principles.
- Where such threats exist, he or she must put in place safeguards that eliminate them or reduce them to clearly insignificant levels.
- If he or she is unable to implement adequate safeguards, the work cannot be carried out.

### What are the threats to objectivity?

- The *self-interest* threat: The auditor has a financial or other personal interest in the outcome of the audit.
- The *self-review* threat: The auditor has to express an opinion on a judgment he or she has made earlier – e.g. during last year's audit or in a non-audit assignment.
- The *advocacy* threat: The auditor is perceived as an advocate for or against the client e.g. after playing a role in a litigation case, and can therefore be regarded as biased towards or against the client also in the audit assignment.
- The *familiarity* or *trust* threat: Over the time the auditor may become over-influenced by the client's personality or over-confident in the reliability of the client's accounts.
- The *intimidation* threat: The possibility that an auditor may become intimidated by a threat, a dominating personality, or other pressures, actual or feared.

### What are some possible safeguards?

- Work environment
  - Educational requirements
  - Corporate governance system
  - Transparency
  - Disciplinary penalties
- Risk of detection
  - Promote sound attitude to voluntary compliance
  - Complaints system
  - Monitoring by professional bodies
  - External supervision
- Specific safeguards
  - Internal firm control measures
  - Provision for staff to communicate ethical concerns with separate principal
  - Second-partner reviews
  - Compartmentalisation
  - Public explanation of steps taken
  - Additional safeguards applicable to particular cases

## **About the draft EU recommendation**

The draft recommendation contains:

- A preamble, giving the legislative background
- A chapter, *A. Framework*, explaining the conceptual approach
- A chapter, *B. Specific circumstances*, applying the core principles to common situations
- A glossary

## **More information**

**More information about the conceptual approach can be downloaded from the FEE website, [www.fe.be](http://www.fe.be) (see Publications – Ethics – The conceptual approach to protecting auditors’ independence).**