

SUMMARY OF CONFERENCE
“THE GREEN PAPER – THE FUTURE OF THE AUDIT MARKET”
held by:
The Polish Economic Society
in cooperation with
the National Chamber of Statutory Auditors
and the Accountants Association in Poland
on 7 February 2011

A conference entitled “The Green Paper – the Future of the Audit Market” held by the Polish Economic Society (PTE) in cooperation with the National Chamber of Statutory Auditors (NCSA) and the Accountants Association in Poland (AAP) took place on 7 February 2011 at the headquarters of the PTE National Board. Its primary objective was to present and discuss the main issues related to:

- the role of statutory auditors in the modern economy,
- the challenges facing statutory auditors,
- the development of and prospects for the audit market in Poland
- the proposals and suggestions concerning changes in auditing methodology and the operation of audit firms set forth in the European Commission’s Green Paper of 13 October 2010 (“Green Paper. Audit Policy: Lessons from the Crisis”).

Along with members of PTE, NCSA and AAP, the conference was attended by a number of Ministry of Finance officials, including Undersecretary of State Wiesław Szczuka and Director of the Accounting Department Joanna Dadacz, to name just a few, as well as by many statutory auditors and accountants.

Opening remarks were made by:

- Prof. Elżbieta Mączyńska, President of the Polish Economic Society,

- Prof. Zbigniew Messner, President of the Main Board of the Accountants Association in Poland,
- Adam Kęsik, President of the National Council of Statutory Auditors.

The conference moderators were: Prof. Anna Karmańska (Warsaw School of Economics) and Prof. Gertruda Świdorska (The National Chamber of Statutory Auditors).

Conference agenda (speeches in order of presentation):

- “Poland’s Position on the Questions Put Forth in the Green Paper as Presented by the Ministry of Finance” – Wiesław Szczuka, Undersecretary of State, Ministry of Finance,
- “The Professional Role and Tasks of Statutory Auditors in the Light of the Green Paper Recommendations” – Adam Kęsik, President of the National Council of Statutory Auditors,
- “The Accounting Enigma – Global Risk” – Prof. Elżbieta Mączyńska, President of PTE
- “Trends in Accounting and the Responsibilities of Auditors” – Prof. Jerzy Gierusz, Member of the Scientific Council , AAP,
- “Current Threats to Accounting Supervision in Corporate Groups” – Leszek Dubicki, independent audit expert,
- “The Green Paper – Audit Policy on Small and Medium Enterprises (SMEs)” - Krzysztof Burnos, National Council of Statutory Auditors, Member of the Commission for International Cooperation,
- “Ramifications of the Solutions Recommended in the Green Paper for Small Audit Firms” – Agnieszka Tyczyńska, Finans-Servis, Finance and Accounting Consultants.

The document entitled “Green Paper. Audit Policy: Lessons from the Crisis”, published by the European Commission on 13 October 2010 is regarded to be an important step towards a world-wide discussion on the future of the audit market and the role which auditors should play in the global economy.

The publication of the European Commission’s document was motivated by the recent economic crisis and the fact that many financial institutions and companies which were badly affected at the

initial phase of the crisis had been given unqualified audit reports, which means that the auditors reported no imminent threats to their business activity.

Thus, the following questions arise:

- Do the role and the scope of audit of financial statements meet the stakeholders' needs?
- Why do auditing services fail to fit the stakeholders' expectations?
- Can the *status quo* be improved and how?

The conference participants agreed in full with the opinion presented in the "Green Paper" that along with corporate governance, audit of financial statements should be the primary factor contributing to the financial stability of companies.

Actually, the relationship between corporate supervision / governance and the quality of auditing financial statements is very close as in the absence of systematic cooperation between supervisory bodies and statutory auditors, and without a mutual understanding on the objectives and manner of operation of corporate supervision and statutory auditors, it is impossible to rationally evaluate the auditor's work or put it to effective use. Thus, the independence, competence and commitment of the members of companies' supervisory bodies, and especially supervisory boards, seems to be the key to the proper understanding of the role of statutory auditors in the process of supervising the accounts and finances of companies and a critical factor in guaranteeing auditors' independence.

Consequently, should the quality of corporate governance, and in particular that of audit committees within supervisory boards, not improve, the position of auditors is not likely to be strengthened. Insufficient qualifications of the members of corporate governance bodies are manifested in a worrying, persistent tendency to reduce fees for auditing financial statements and to impose tighter deadlines, while expecting better results. Given the above, any consulting services provided by the auditors to the audited entities enhance their economic efficiency, enabling them to employ properly qualified experts in order to meet their auditing obligations. At the same time, a number of conference participants expressed the opinion that such non-audit

services tend to be perceived as undermining the auditors' independence and are gradually eliminated by corporate governance and market actors.

An intensely debated subject was the independence of auditors, which involves two primary questions:

- Given the weaknesses of corporate governance leading to lower fees of auditors and to shorter project time frames, can one rely on a system where the audited entities appoint and pay the auditors, and determine audit dates?
- Do increased restrictions on non-audit services that can be provided by the auditors to the audited entities result in less efficient use of the auditors' work and considerably lower benefits arising from the audit?

These questions were found critical to defining the independence of auditors in relation to the audited entities. While a dramatic change in the manner of appointment and remuneration of auditors seems unlikely at present, alternative solutions in this respect should be considered. It was generally accepted that improved quality of corporate governance should strengthen the auditors' position and independence. Corporate supervisors should carefully consider the possibility that auditors may be best positioned to perform some non-audit consulting services. This would ensure the efficient use of the auditors' work without undermining their independence.

Another topic under discussion was the scope and manner of application of the International Standards on Auditing (ISAs). While the ISAs are widely accepted for auditing large corporations and business groups, their application with respect to small and medium enterprises (SMEs) raises doubts. It is deemed necessary to adjust the ISAs to the scale of SMEs. Furthermore, the risk of disproportionate audit-related administrative burden on small and medium audit firms was identified. Thus it is necessary to maintain proportionality of regulations concerning the oversight over audit companies, the independence of auditors and audit companies, and the application of auditing standards with regard to strategic companies versus SMEs.

Some voices were critical not so much of the way auditors examine financial statements as of the usefulness, clarity and reliability of the financial statements and accounting principles based on the International Financial Reporting Standards (IFRS). Particular areas of concern include:

- increasingly complicated accounting principles,
- valuation of balance sheet items based on difficult to verify estimates which take into account a number of future factors
- valuation based on fair value estimated by external appraisers with reference to market prices or comparative approaches.

This raises worries that

- the choice of the method and manner of valuing balance sheet items is based on increasingly unreliable foundations which may crumble in the wake of market changes such as an economic downturn,
- the information that explanatory notes to financial statements provide is becoming less comprehensible to the stakeholders.

Thus, it may be advisable to recourse to more conservative principles for balance sheet valuation under the IFRSs, while explanatory notes would provide some examples of alternative methods of valuation and the rationale behind them.

Furthermore, the discussants pointed to some worrying changes in the organization of accounting departments in business groups, and particularly in Polish subsidiaries of international holdings. Frequently, centralized accounting and the establishment of Shared Services Centers (SSCs) detracts from the quality of accounting reports of corporate groups due to the elimination of local decision-making and supervisory positions (such as chief financial officers and chief accountants), while supervision provided by SSCs turns out to be inadequate. There is much evidence that while this results in the subsidiaries receiving close supervision from the corporations' headquarters over their finances (costs, margins, financial liquidity), the risk of failing to comply with the local tax regulations has escalated. This situation may additionally impede auditing procedures in corporate groups and their subsidiaries.

Controversy surrounds the “European Passports for Auditors”. While national (local) auditors are believed to face up to this challenge, there are fears that they will no longer be in a position to audit local subsidiaries of foreign corporations. In economies where direct foreign investment plays a crucial role this would change fundamentally the nature of auditing of many companies with significant regional or even national importance.

Another controversial subject is giving support to small and medium audit firms in order to provide companies with a better choice of non-Big Four auditing companies. Obviously, this is a question on which small and medium audit firms and the Big Four firms take different stands, as the latter emphasize that the prevalence of the Big Four in the Polish market is much smaller than in Western European countries. Still, small and medium audit firms are vitally interested in the implementation of some ideas included in the “Green Paper” as they may offer new opportunities for development.

What is noteworthy, all speakers emphasized that corporate supervisory bodies should gain a greater understanding of the role of auditors. At the same time, improved cooperation between supervisory boards (and their audit committees) and auditors is crucial for the future of auditors and auditing firms. Auditors expect that closer cooperation would strengthen their role and independence, and reverse the downward trend in remuneration which may harm the quality of audit services.

Prepared by: Leszek Dubicki, independent audit expert,

Consultancy: Maryla Jankowska, conference participant, PhD student at the Warsaw School of Economics

The Authors can be reached at:

The Polish Economic Society: rzecznik@pte.pl, zk@pte.pl