

## POSITION OF THE POLISH LEWIATAN CONFEDERATION ON THE EU FRAMEWORK FOR CORPORATE REPORTING

### **Part I – EU Framework for Corporate Reporting**

Information contained within corporate reporting is deemed to be highly important to users as it is has been audited. Such information is critical to investors, stakeholders, and vital for well-functioning capital markets and provides relevant and reliable information about an entity. Reliable corporate reporting allows users to make strategic investing and business decisions.

Issues which have been identified with respect to corporate reporting in recent years does not mean that the overall quality and reliability of corporate reporting by listed EU companies is low. However, there is room to continuously improve.

If an entity has weak governance and a poor control environment corporate reporting, issues will arise. But all pillars of the corporate reporting need to be effective to provide accurate, transparent and reliable information to the capital markets. All parties within the pillars have a role to play and actions to be undertaken at the EU level should be assessed also in combination with all of the actions being taken.

It is also vital that the actions are implemented with sufficient time given the complexities of the EU framework, relationship between the EU and member states, and the interdependencies of various actions.

Green and digital transition and better corporate social responsibility needs to be supported as well.

### **Part II – Corporate Governance**

Most corporate failures arise from business model failure, poor governance, and failure of weak internal controls or fraud. Management and supervisory boards have primary responsibility for reliable corporate reporting and this is their role and accountabilities that should be strengthened. Furthermore, current obligations and accountability of the board for the quality of corporate reporting are unclear and are not interpreted consistently across the EU. Minimum corporate governance and reporting standards should be met by companies as a precondition for a listing in a major stock market index.

Management should establish effective systems and controls with a focus on the risk of fraud, going concern. Publicly disclose a statement about the effectiveness of these systems and controls. Audit committees should oversee this. Furthermore, it should be assessed whether the internal audit function and/or independent party should be engaged to attest this statement.

### **Part III - Statutory Audit**



The quality and reliability of financial information is enhanced when it is subject to an external audit. Is Information that lies outside the scope of the audit is less reliable. This definitely positive impact of auditors' work is not always visible to and understood by stakeholders.

In terms of audit quality, it should be noted that there are significant variations in the understanding and measurement of audit quality across the EU. In Poland there is no framework to measure audit quality which is in common use.

Furthermore, reducing inconsistencies in the interpretation of auditing standards and audit regulation could have a positive impact on audit quality.

Regulatory environment is becoming more complex while as a result of recent audit market reform there is a patchwork landscape across the EU, particularly in the area of audit firm rotation and non-audit services restrictions.

Different rotation periods across Member States adds complexity without contributing to audit quality with some tenures lasting more 24 years and others with rotation periods less than 10 years. Germany has recently removed the option to extend past 10 years, while Poland has recently extended the tenure from 5 to 10 years.

When it comes to non-audit services restrictions vast majority of countries have black list approach, with some derogating tax and valuation services, while in Poland and the Netherland – white list of allowed services, very narrow in scope, have been implemented.

Inconsistent audit firm rotation and non-audit services regimes in the EU result in difficulties in appointing PIE auditor in a number of cases where there is multi -PIE group structure.

The above coupled with increasing exposure to liability prevent firms from entering the PIE audit market or reduce their participation in this market. Since 2017 we have observed a declining trend in the number of audit firms in Poland serving PIE audits and in the number of audit firms overall.

Harmonization of the duration of audit rotation and non-audit restrictions is then needed.

When it comes to the audit market choice it should be noted that in Poland number of audit firms auditing PIEs is already high when compared to some other EU countries.

To a great extent PIEs in Poland do not encounter difficulties when appointing the auditor at the appropriate costs, though they may arise due to patchwork regimes in different countries in the EU

We are supportive of strengthening the responsibilities of audit committee on the appointment and oversight of auditors and increased transparency to shareholders on how and why they selected their chosen auditor. Audit committees are best positioned to choose the audit firm which will deliver the highest quality audit and also demonstrate the process and key considerations in making their decision-

Mandatory joint audits for PIE will not contribute to higher quality as this is evidenced by the recent studies. There is however evidence that joint audits are more costly and as a result of mandatory firm rotations may cause audit committees have less choice as a result of independence rules.

The most recent study 'Effects of and experiences with joint audit' by the Erasmus Competition & Regulation institute commissioned by Dutch Finance Ministry - October 2021<sup>1</sup> conclude that:

- according to the researchers, the joint audit model does not appear to result in an improvement of audit quality
- national and international regulators do not appear to be convinced of the benefits of the joint audit model,
- stakeholders do not have a strong desire to adopt the model; and
- the joint audit model may have a price-increasing effect.

The study included a literature study, organized workshops with scientific researches and gathered subjective experiences with interviews and questionnaires. The scope considered both the Dutch market as well as international markets.

It seems to us that each pillar of the corporate reporting ecosystem contributed to the deficiencies identified. Regulatory findings should be considered in the context of all three pillars of corporate reporting and the related responsibilities of the boards auditors and their supervisors.

Under current standards the auditor has a limited public role regarding a company's system of internal control over financial reporting. Reducing inconsistencies in the interpretation of auditing standards and audit regulation could have a positive impact on audit quality.

Inspection findings do not provide a picture of the quality of the firm's overall system of quality mgmt. nor do they indicate whether there was a deficiency of the work supporting the audit opinion issued or whether the underlying FS required restatement.

Current obligations and accountability of the boards for the quality and reliability of corporate reporting are unclear and are not interpreted consistently across the EU. Internal control systems may not be appropriately designed or operated to facilitate the early identification and resolution of fraud and viability risks.

We believe that in order to enhance audit quality the following measures should be taken:

- a) auditors performing assurance procedures on the effectiveness of the internal controls systems in the PIE;
- b) Further harmonization of the rules on mandatory rotation

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<sup>1</sup> E. Dijkgraaf, J. Hoogstins, E. Maasland, *Effects of and experiences with joint audit*, Erasmus Competition & Regulation institute, October 2021

- c) Limiting the number of Member State options in the EU Audit framework to ensure consistency across the EU
- d) Creation of a passporting system for PIE auditors and audit firms, allowing auditors to provide their services across the EU based on their approval in a Member State
- e) Strengthening the informational value of audit reports

#### **Part IV - Supervision of PIE Statutory Auditors & Audit Firms**

Supervision of auditors is mostly done at the national level and not always subject to oversight and coordination at an EU level.

The effective oversight would be when it understands the standards and principles of auditing and how the audit profession/business operates. This coupled with the lawyers and civil servants will bring valuable insights and well balanced approach.

We believe there can be improvements made that will increase the effectiveness and efficiency and quality of supervision for PIE statutory auditors and audit firms. This could be achieved through for example:

- 1) An effective exchange of information between PIE regulators and the statutory auditor about identified material irregularities and going concern related risks should be established, including effective implementation of articles 7 and 12 of the EU Audit Regulation
- 2) Audit oversight bodies should provide relevant information to the public about audit firms' SoQM which can be used in the quality considerations of ACs when selecting the statutory auditor.

We also believe that improvements could be made in the following areas:

- 1) Direct oversight of audit committees /boards on specified matters such as irregularities and fraud should be in place across the EU
- 2) Supervisors reporting on audit quality should include information about the reliability of underlying corporate reporting by the audited entity
- 3) Inspection findings should provide a picture of the quality of the firm's overall system of quality management
- 4) Strengthening the role and powers of the CEAOB and reporting by audit oversight bodies on audit quality across the EU could be more consistent, timely and transparent
- 5) Supervision of auditors done at the national level could be subject to oversight and coordination at an EU level.

There is still a lack of harmonization in the way in which the different national supervisory authorities carry out their duties. Further harmonization is needed at EU level in order to improve the quality of supervision, with a view to achieving better quality reporting by companies and audits as a whole.

The status, organizational structure and funding rules of supervisors vary from one country to another, which affects the different response of the supervisory authority in similar cases of weaknesses or shortcomings in different countries and in the assessment of the cause of the poor quality of the service provided.

Inspection reports should always include information about what needed to be done (in another way) to ensure the educational and corrective aspect of supervision. The primary objective of controls should therefore be to improve quality and not to trigger sanction procedures. The number of proceedings initiated or sanctions imposed cannot be an assessment of the quality of supervision. The supervisory system should not place the sanctions system above or without a system and environment that guarantees the promotion of educational solutions for the development of the audit profession and the quality of the supervised area.

The regulatory burden on investigations and sanctions should be proportionate and should not discourage audit firms but should improve the quality of the services provided. Audits should not be limited to checking compliance, i.e. supervisors should not only check the compliance of auditors' conduct with standards and legal provisions, but should properly assess the use of professional skepticism and judgment in a particular event.

Effective oversight of the audit market should benefit from the relevant legal services, employees - civil servants, as well as people with experience in the profession of statutory auditor. Appropriate distribution of the team and combination of potential guarantees the quality of the inspection assessment and increases the maintenance of the oversight body's findings in the appeal proceedings. Regulators need to understand auditing standards and principles and how the audit profession/firms operate. In addition to lawyers and civil servants, whose work is essential to the effectiveness of the authority and who provide valuable insights, an understanding of the audit profession is needed to ensure a balance in the overall views and prospects of the regulator over auditors.

## **Part V - Supervision and Enforcement of Corporate Reporting**

The following actions would increase the quality and supervision of reporting by listed companies:

- 1) An effective exchange of information between capital markets regulators and the statutory auditor about identified material irregularities and going concern related risks should be established, including effective implementation of articles 7 and 12 of the EU Audit Regulation;
- 2) Regulatory accountability and enforcement mechanisms should be established for non-compliance with mgmt.'s responsibilities to set up effective systems and controls addressing the company's key risks, including viability and fraud risks, and for respective oversight responsibilities by ACs.
- 3) Greater consistency for the oversight of AC's between member states – it would hold ACs accountable for their role in corporate reporting. This should be done by holding all directors to account and should not create an environment which is unattractive, discouraging directors from taking on board roles or hinders investment and listings within the EU capital markets.





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- 4) Harmonise the supervision of financial reporting and company information across the EU as there are benefits to be gained from having a consistent approach across the EU to the proportion of reports to be inspected and to the business sectors to which they relate.
- 5) Enhance cooperation between authorities at the national and European level - it could lead to an increased sharing of information and best practices between regulators.

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