Update on new developments on the EU acquis – audit directive and new regulation

Workshop: Transposing the EU acquis communautaire: status and perspectives

Andrei Busuioc, CFRR. Vienna, 28-29 November 2012
Session objectives

» Brief high level overview of the major recent developments in audit regulation

» Provide a brief introduction to the EC proposals for a new Statutory Audit Regulation and updated Statutory Audit Directive
Europe 2020 Strategy - improvement of the business environment, the proposal - enhancing the internal market for statutory audits to allow small and medium-sized firms to grow and encourage the entry of new players.

The proposals regarding the statutory audit of public-interest entities - measures to enhance auditor independence and to make the statutory audit market more dynamic.

The Commission proposes that the amended Statutory Audit Directive coexists with the Regulation on specific requirements on the statutory audit of annual financial statements and consolidated financial statements of public-interest entities.
Liberalization of the ownership rules for auditors

- permitting broader ownership
- facilitate audit firms' access to capital
- may result in increasing the number of providers of audit
- might encourage new entrants into the market, including through expanded capital-raising in public markets
Facilitation of cross border audit firms –
- an audit firm registered in one Member State will be able to conduct audits in another member state - if the lead engagement partner is registered in the other Member State

Cooperation at EU level is also necessary to harmonise the requirements of the aptitude test for statutory auditors to render it more predictable and transparent.
European passport for the audit profession - The Commission proposes the creation of a Single Market for statutory audits
- Audit firms to provide services across the EU
- Convergence of aptitude test and recognition of experience

Adoption of International Standards on Audit (ISAs) for statutory audits
- to enhance the quality of statutory audits
- For medium-sized entities audits – allowing for a proportionate application of the standards in the case of small and medium-sized companies
Competent authorities **must have responsibility** for registration, monitoring and investigation, although can delegate some tasks subject to conditions and responsibility.

**Prohibition of clauses restricting the choice of certain categories or lists of statutory auditors or audit firms** (so called Big audit firms only clauses)
Statutory audit on PIEs – regulation – general information

» PIE audits will no longer be comprised in SAD, but integrated in the Regulation

» Definition of PIEs – as defined by SAD, but new categories – (investment firms, payment institutions, undertakings for collective investment in transferable securities (UCITS), electronic money institutions and alternative investment funds)

» Content of the proposed regulation also includes –
  – Conditions for carrying out statutory audit of public-interest entities
  – The appointment of statutory auditors or audit firms by public-interest entities
  – Surveillance of the activities of auditors and audit firms carrying out statutory audit of public-interest entities
  – Supervisory measures and penalties
  – Reporting and transitional and final provisions
Specific requirements on Statutory audit on PIEs - regulation

- ISQC1 style internal control requirements for audit firms;
- European Securities and Markets Authority (ESMA) – more role in developing guidance and in coordination
  - e.g.(in consultation with European Banking Authority - EBA and European Insurance and Occupational Pensions Authority - EIOPA) to develop requirements for quality assurance (including review of compliance with ICQC1 and ethics and training type issues);
Prohibition on non-audit services — financial audit related services permitted (group level, network of audit firms, within the EU; third countries - safeguards); Risk advice, Due diligence and tax advisory prohibited. Commission to adapt the lists of authorized and prohibited services;

Audit committees or competent authorities to be empowered to assess whether some non-audit services can be provided (by derogation for prohibition above);
Specific requirements on Statutory audit on PIEs – requirements for audit firms

» If very large firm (one third of audit fees from large PIEs and part of a network with revenues in excess of EUR 1500 million) it must be “audit only” (at the level of network and for PIEs);

» Auditors need to conduct work with professional skepticism;

» Specific organization and file and record keeping requirements for auditors including matters of their non compliance;

» Auditors must notify competent authorities (supervisors) of breaches by PIEs;

» Enhanced reporting requirements for auditors in respect of fraud – to the audited entity and to the supervisors;
Expanded audit report including materiality, how audit conducted and key judgments;
  - Audit report to be no longer than 4 pages and include names of all those participating in the audit;

Additional longer audit report to audit committee; and upon request to competent authority;

Report to supervisors if identify material breaches by the client;

ESMA to provide technical standards for financial disclosures by auditors and transparency reporting;

Auditors required to make a Corporate Governance statement (where appropriate);
Specific requirements on Statutory audit on PIEs – audit committees

» Each PIE to have an **audit committee** with non-executive members, one with audit and one with audit or accounting experience;

» Unless a renewal, audit committees **to propose two auditors** (not the incumbent) for appointment to shareholders stating a justified preference;

» **Tenders must include smaller firms** (defined by revenues in the member state);

» Various **new conditions before an auditor can accept appointment** – assess and document - links to competence, resources etc.;

» **Pre clearance** from audit committees of any **audit related services**;
PIE to appoint auditors for a **minimum period of two years**;

PIE to appoint an auditor for a maximum period of up to 6 years or 9 years if joint audit. To be extendable in exceptional circumstances to 8 and 12 respectively;

Auditor cannot accept re-appointment for four years;

Outgoing auditor must supply a handover file;

ESMA to draft the technical standards – content of a handover file;
Specific requirements on Statutory audit on PIEs – competent authority

» Extensive powers and responsibilities for Competent Authorities;

» Replicates previous Commission recommendation on what constitutes an inspection;

» Competent Authorities to have a market monitoring responsibility including assessing concentration risk – for 6 largest audit firms in a member state;

» Competent authorities to ensure contingency plans are prepared – for cases if a large firm may discontinue operations for various reasons;

» Competent Authorities to publish their programs and results of QA work annually;
Extensive powers to ESMA in setting standards and ensuring regulatory cooperation;

ESMA to develop European quality certificates for PIEs auditors to be valid across the Union - the quality standard is voluntary and not a requirement to audit PIEs in another Member State;

Colleges of Competent Authorities may be formed to undertake certain quality assurance tasks;

Colleges will be facilitated by the Home Member State but may be established by ESMA;

Establishes various supervisory measures and sanctions. Guidelines on sanctions to be issued by ESMA.
**EU Parliament** - about 1,000 amendments at the JURI committee, and 600 at the ECON committee

**Watering down the initial EC proposals on**

» **Rotation of auditors** – potentially will remain but for longer period (longer in case of joint audits)

» **Shared (joint) audits requirements**

» **Role of PAOs** – adding back the possibility for delegation

» **ESMA central role in audit regulation in the EU** is challenged – role of a regulator or just a coordination? Also alternative proposal - an enhanced role for the European Group of Auditor Oversight Bodies (EGAOB)
The Committee on Industry, Research and Energy

» Excluding voluntary audits from the application of the audit provisions - higher costs and additional administrative burden especially for small and medium-sized entities

» Keep the requirement of majority voting rights to be held by statutory auditors – mitigating the risk of compromising independence

» Move certain requirements related to audit committees for PIEs to the directive (instead of regulation) - more flexible approach to Member States - to adapt provisions to their national frameworks;

» Aligning general independence requirements in the directive and regulation (even if the requirements for PIE audits are higher)
The Committee on Industry, Research and Energy

» To reconsider or at least adjust the most extensive market interventions in the proposal, i.e. a limitation of related financial audit services and the concept of mandatory external rotation

» Rotation - to extend the maximum duration of audit appointments

» strengthen the position of the audit committee
  – public tender procedure for the auditor selection should be conducted every 7 years, and
  – All audit-related services subject to the prior approval of the audit committee

» to prohibit non-audit services and make audit-related and other assurance services expressly mentioned subject to prior approval of the audit committee (also, both the list of prohibited and the list of permitted services should not be closed)
Committee on Economic and Monetary Affairs

» Rotation – to change with mandatory 7 year tender
» Shared audits – to leave a choice to audit committees
» Non-audit services
  - Consult audit committee on all
  - Tender significant non-audit services

» Proposed role of ESMA – to be changed to European Group of Audit Oversight Bodies (EGAOB) (through advice to the EC)

» PIEs definition – delete the provisions regarding large public interest entities (i.e. Non-differentiation of PIEs); remove UCITS and AIF (undertakings for collective investments in transferable securities and alternative investment fund)

» Dialogue with National Regulators and the ESRB (European Systemic Risk Board)
Next steps

Timetable European Parliament

Exchange of views 25-26 January 2012
Hearing 26-27 March 2012
Presentation of draft report 9-10 July 2012
Deadline for amendments 19 September 2012
Consideration of amendments 10-11 October 2012

Vote JURI draft report 27 November 2012 / delayed to January 2013
Vote plenary January 2013/delayed (June 2013? or never?)
» Link to the proposal

http://ec.europa.eu/internal_market/auditing/reform/index_en.htm#new