Overview of the amended statutory audit directive requirements

STAREP: Improving Audit Quality by transposing relevant EU requirements:
Accounting and auditing community of practice workshop
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Objectives of the session

» Discuss in detail the requirements of the recently amended Statutory Audit Directive

» The main objectives main objectives of the directive, its recent changes and impact on audit regulation in the EU

» The perspectives of EU member states on the Directive, and potential implications for neighborhood countries and countries that signed association agreements

» Implications for small and medium size audit practices.

» and a Q&A session
Key messages from recent changes

» Restoring the confidence of investors in financial information

» The revised Directive includes measures to
  - strengthen the independence of statutory auditors
  - make the audit report more informative, and
  - strengthen audit supervision throughout the EU

» The Regulation - stricter requirements on the statutory audits of public-interest entities, strengthen independence and professional skepticism, and limit conflicts of interest

» 2 years to implement the revised Directive. The Regulation will also become directly applicable in mid-2016

» The EC will work with the Member States, the national supervisory bodies, and the stakeholders to facilitate a consistent and effective implementation of the new rules across the EU
How is the Statutory Audit Directive structured?

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CHAPTER I:

SUBJECT MATTER AND DEFINITIONS
Subject matter - rules concerning the statutory audit of annual and consolidated accounts

Statutory audit - an audit of annual financial statements or consolidated financial statements: required by EU law; required by national law – for small undertakings; voluntary audits if the legislation defines these audits as statutory audits;

Statutory auditor - a natural person who is approved by the competent authorities of a Member State to carry out statutory audits;

Audit firm - a legal person approved a Member State to carry out statutory audits;
Third-country audit entity - carries out audits of a company incorporated in a third country and not registered in any Member state;

Third-country auditor - a natural person who carries out audits of a company incorporated in a third country and not registered as a statutory auditor in any Member State;

Group auditor - the statutory auditor(s) or audit firm(s) carrying out the statutory audit of consolidated accounts;

Network - the larger structure to which a statutory auditor or an audit firm belongs, has profit- or cost-sharing or shares in common ownership, control or management, common quality-control policies and procedures, a common business strategy, the use of a common brand-name or a significant part of professional resources;

Affiliate of an audit firm - any undertaking connected to an audit firm - common ownership, control or management;
Key definitions (continued)

» **Competent authorities** - the authorities designated by law that are in charge of the regulation and/or oversight of statutory auditors and audit firms;

» **Public-interest entities (PIEs)** - PIEs are defined as listed companies, credit institutions and insurance undertakings. In addition, Member States can designate as PIEs other undertakings that are of significant public relevance, because of the nature of their business, their size or the number of their employees; *(Note – the definition is the same as in the new accounting directive)*

» **Cooperative** – a European Cooperative Society as defined by Council Regulation (EC) No 1435/2003 on the Statute for a European Cooperative Society (SCE), or any other cooperative for which a statutory audit is required under Community law, such as credit institutions and insurance undertakings
Non-practitioner – not involved in audit practices during involvement in governance of POS and three years before (no audits, no voting rights in an audit firm, not member of management of an audit firm, not employed or associated with an audit firm)

Key audit partner(s):
- the statutory auditor(s) designated by an audit firm for a particular audit engagement as being primarily responsible for carrying out the statutory audit on behalf of the audit firm; OR
- in the case of a group audit, at least the statutory auditor(s) designated by an audit firm as being primarily responsible for carrying out the statutory audit at the level of the group and the statutory auditor(s) designated as being primarily responsible at the level of material subsidiaries; OR
- (c) the statutory auditor(s) who sign(s) the audit report;
- **Home Member State** - in which a statutory auditor or audit firm is approved;

- **Host Member State** - in which a statutory auditor approved by his or her home Member State seeks to be also approved, or a Member State in which an audit firm approved by its home Member State seeks to be registered or is registered.
CHAPTER II.

APPROVAL, CONTINUING EDUCATION AND MUTUAL RECOGNITION
» Only statutory auditors and audit firms approved by a MS competent authority can undertake audits (*competent authority should be designated by MS for approval of auditors*)

» Only statutory auditors satisfying qualification requirements can be approved by competent authority

» The competent authorities of a MS may grant approval only to natural persons or firms of **good repute**
Conditions for approval

» natural persons performing audits on behalf of the audit firm – comply with education/qualification requirements and are approved as statutory auditors in a given MS;

» majority of the voting rights in an entity - by audit firms approved in any MS, or by natural persons who satisfy education/qualification requirements (MS can also require natural persons to be approved in another MS);

» majority — up to max. 75 % — of the members of the administrative or management body - audit firms approved in any Member State or by natural persons who satisfy education/qualification requirements (MS can also require natural persons to be approved in another MS); (if 2 people management board - at least one person should satisfy criteria)

» The firm should have a good repute

» Additional conditions can be only related to admin./management body – only if strictly necessary and have specific objectives
Recognition of audit firms

» Audit firm approved in one MS - entitled to audit in another MS – but only if key audit partner is qualified and approved in “host MS”

» Such an audit firm should get registered in host MS (be included in public register)

» Host MS competent authority shall register audit firm if it is satisfied with its Home MS registration (may require a fresh certificate of up to 3 months old) and shall inform home MS competent authority of such a registration
Withdrawal of approval

- Good repute is compromised - valid for auditors and audit firms (time may be given to comply with good repute requirement);
- If voting rights requirements are not respected – valid for audit firms (time may be given for compliance);
- If approval in home MS is withdrawn – this should be communicated to host MS where the same audit firm is registered.
A natural person can be approved if:
- attained university entrance or equivalent level,
- then completed a course of theoretical instruction,
- undergone practical training, and
- passed an examination of professional competence of university final or equivalent examination level, organised or recognised by the Member State concerned;

Competent authorities - shall cooperate to achieve convergence of the requirements, taking into consideration convergence achieved by the profession.
The examination of professional competence – to guarantee the necessary level of theoretical knowledge of subjects relevant to statutory audit and the ability to apply such knowledge in practice; at least part of it – written;

Test of theoretical knowledge

- (a) general accounting theory and principles;
- (b) legal requirements and standards relating to the preparation of annual and consolidated accounts;
- (c) international accounting standards;
- (d) financial analysis;
- (e) cost and management accounting;
- (f) risk management and internal control;
- (g) auditing and professional skills;
- (h) legal requirements and professional standards relating to statutory audit and statutory auditors;
- (i) international auditing standards;
- (j) professional ethics and independence.
Test of theoretical knowledge - Additionally subjects that are relevant to auditing:

- (a) company law and corporate governance;
- (b) the law of insolvency and similar procedures;
- (c) tax law;
- (d) civil and commercial law;
- (e) social security law and employment law;
- (f) information technology and computer systems;
- (g) business, general and financial economics;
- (h) mathematics and statistics;
- (i) basic principles of the financial management of undertakings
Exemptions from examination of professional competence and test of theoretical knowledge

If university degree or exams taken at the university – some exemptions may be granted from test of knowledge or test of practical application of that knowledge:

- If subjects were covered by university curricula – **possibility to recognize and exempt** - MS may exempt from test of theoretical knowledge in one or more subjects - if a person who has passed a university or equivalent examination or holds a university degree or equivalent qualification and the relevant subjects were covered by that examination or degree;

- If practical training was covered in the university – **possibility to recognise and exempt from professional competence related tests** - Member State may provide that a holder of a university degree or equivalent qualification in one or more of the subjects may be exempted from the test of the ability to apply in practice his or her theoretical knowledge of such subjects if he or she has received practical training in those subjects attested by an examination or diploma recognised by the State.
Minimum of 3 years' practical training, including in the auditing of annual financial statements, consolidated financial statements or similar financial statements;

At least 2/3 of it - with a statutory auditor or an audit firm approved in any Member State;

Persons providing practical training should have adequate capacity - MS shall ensure that all training is carried out with persons providing adequate guarantees regarding their ability to provide practical training.
Qualification through long-term practical experience

A Member State may approve a person who does not satisfy education conditions if:

- 15 years experience - enabled to acquire sufficient experience in finance, law and accountancy + examination of professional competence,

OR

- 7 years in professional activities (same fields) + practical training (3 years with an auditor or audit firm) and examination of professional competence (ability to apply theoretical knowledge in practice);

- Additional possibilities to recognize number of years (art 12)
MS to require auditors - appropriate programmes of continuing education:

- maintain theoretical knowledge, professional skills and values at a high level

and

- failure to respect the continuing education requirements is subject to appropriate sanctions (including withdrawal).
Approval of statutory auditors from another Member State

» MS have to establish procedures for such approvals
» Adaptation requirements should not go beyond DIRECTIVE 2005/36/EC on the recognition of professional qualifications
» Aptitude test should be passed – to cover areas not covered by the diploma or other evidence provided by the candidate
» MS has to decide whether adaptation period or aptitude test is needed
» Adaptation period - not exceed 3 years and finalised by an assessment
» Aptitude test - in a language of host MS & covering only the statutory auditor's adequate knowledge of the laws and regulations of that host Member State that is relevant to statutory audits
CHAPTER III: REGISTRATION
» Need to have a public register for statutory auditors and audit firms
» In exceptional circumstances – possible to derogate and disclose less information – if significant threat to the personal security of any person
» Each statutory auditor and audit firm - individual number
» Registration - electronically accessible to the public

» Include in the register - the name and address of the competent authorities responsible for approval, for quality assurance, for investigations and penalties on statutory auditors and audit firms, and for public oversight –
Registration of statutory auditors

» name, address and registration number;

» if applicable – information on the audit firm(s) by which the statutory auditor is employed, or associated as a partner or otherwise

» all other registration(s) in other MS or third countries, including information on registration authority(ies), and, if applicable, the registration number(s)

» Third-country auditors registered - indicated in the register as such and not as statutory auditors
name, address and registration number
legal form
contact information, contact person and website address;
address of each office in the MS
name and registration number of all statutory auditors employed by or associated as partners or otherwise with the audit firm
names and business addresses of all owners and shareholders
names and business addresses of all members of the administrative or management body
membership of a network, list of the names and addresses of member firms and affiliates or an indication of where such information is publicly available
Registration of audit firms (2)

» all other registrations as audit firm in other MS, including the names of the registration authorities, and registration numbers

» where applicable - if the audit firm is registered as a firm from another MS

» third-country audit entities - clearly indicated in the register as such and not as audit firms
For both auditor and audit firms – MS should ensure auditors send updated information to the registry

Auditors and audit firms - responsible for the information submitted to competent authority

Language of the register – of a MS, but may be translated into other languages (officially or unofficially)
CHAPTER IV: PROFESSIONAL ETHICS, INDEPENDENCE, OBJECTIVITY, CONFIDENTIALITY AND PROFESSIONAL SECRECY
Professional ethics

- covering at least public-interest function, integrity and objectivity and professional competence and due care

Professional skepticism

- **an attitude** - questioning mind, alert to possible misstatement due to error or fraud, and a critical assessment of audit evidence, and past experience of the honesty and integrity of the audited entity's management and of the persons charged with its governance

- **special attention** - reviewing management estimates relating to fair values, impairment of assets, provisions, and future cash flow relevant to going concern
Independence and objectivity (1)

» Statutory auditor / audit firm *(including any natural person in a position to directly or indirectly influence the outcome of the statutory audit)*, is independent of the audited entity and is not involved in the decision-taking of the audited entity

» Independence - during the period of financial statements & during the audit

» Auditors and audit firms – to ensure that independence is not compromised

» No audit if - any threat of self-review, self-interest, advocacy, familiarity or intimidation created by financial, personal, business, employment or other relationships
Anyone who can influence result of an audit – no personal or financial interests in audited entity, except owned indirectly (e.g. collective investment schemes or life insurance)

Threats to independence - documented in working papers and mitigation measures

No gifts or favors – unless trivial or inconsequential (as judged by any third party)

If during an audit the entity is merged or purchased – evaluation of threats to independence (e.g. non-audit services)

Terminate any relationships as soon as possible - but not later of within 3 months

Employment - statutory auditor or a key audit partner – no key management or governance positions within 1 year (2 years for PIEs) after ceased to be auditor or key partner (other employees or partners – 1 year after being directly and indirectly involved)
Assessment and documenting threats to independence

» Threats to independence - assessed before accepting or continuing the engagement
  - Whether there are any interests in audited entity
  - If there are some threats – what are the measures to mitigate them
  - Competent employees, time and resources to conduct an audit properly
  - Key audit partner is approved in respective MS

» Simplified requirements on documenting can be applied for small entities audits and voluntary audits
Confidentiality and professional secrecy

» Information to which an auditor has access – confidentiality protection BUT - should not impede enforcement

» Change of auditors – previous auditor – full access to new auditor to all materials related to audited entity and latest audit

» After ceasing to be auditor – confidentiality and secrecy rules continue to apply

» Group audits – confidentiality should not prevent access, transfer of information and documentation to the group auditor

» If audited entity issued securities in a third country – an auditor may only transfer working papers to competent authority of the third country (under conditions of personal data protection)
Owners and governance bodies of audit firms - no influence over audits (not to jeopardize independence and objectivity of the statutory auditor who acts on behalf of the audit firm);

Internal organization of statutory auditors and audit firms
- Governance bodies should not be able to influence the audit
- Sound internal procedures at the firm, including risk assessment and control
- Ensures knowledge and experience of staff and others involved in specific audits
- Ensures that outsourcing does not impair the quality of audits
- Systems to prevent, identify, eliminate or manage and disclose any threats to their independence
- Procedures for conducting audits and structuring audit files, staff supervision and coaching - Establish internal quality control system
- System of recording incidents that may impact audits
- Adequate remuneration and profit-sharing policies with appropriate incentives; non-audit services to audited entities should not be part of performance evaluation;
- Regular monitoring and evaluation of internal control systems
Organization of audits

- Key audit partner in charge with a specific audit – criteria: audit quality, independence and competence
- Key partner should be involved in the audit
- Sufficient time should be devoted to audits
- Statutory auditors/firms should maintain records of breaches of the directive or regulation, measures to address, and report internally on annual basis
- Client account record:
  - Name and address of business
  - Key audit partners
  - Fees charged, including fees for non-audit services
- Audit file for each audit – closed within 60 days after signing audit report
- Records about complaints in writing about performance of the audit

Note. Simplified requirements may be for audits of small entities and voluntary audits
Audit fees & scope not covered by audits

**Audit fees**

- not influenced or determined by additional services to the audited entity
- cannot be based on any form of contingency

**Scope of the statutory audit**

- shall not include
  - assurance on the future viability of the audited entity, or
  - on the efficiency or effectiveness of how management conducted the business
CHAPTER V

AUDITING STANDARDS AND AUDIT REPORTING
International auditing standards - as adopted by the EC

National standards permitted if ISA for the same subject matter not yet adopted by the EC

International auditing standards – ISAs, ISQC1, and other IAASB issued standards relevant to statutory audits

EC empowered to adopt standards if:
- developed with due process, public oversight and transparency and accepted internationally
- contribute a high level of credibility and quality to the annual or consolidated financial statements
- conducive to the Union public good
- do not amend any of the requirements of this Directive or supplement any of its requirements apart from those of independence, professional secrecy and objectivity, group audits and audit reporting.
Additional standards

» Additional audit procedures possible only if – related to legal requirements of a MS, or to add credibility to financial statements

» Additional standards – communicated to the EC - 3 months before entering in force

» Optional - proportionate application of standards for audits of small undertakings - proportionate to the scale and complexity of the activities of such undertakings

» MS may take measures - to ensure proportionate application

Note. Proportionate application is debated due to potentially problematic practical application
the group auditor bears the full responsibility for the audit report
the group auditor evaluates the audit work performed by subsidiary auditors (also in third countries), reviews it and documents it
documents the nature, timing and extent of the work performed by subsidiary auditors – documentation should enable competent authority to review work of group auditors
If access to documentation is limited – alternative measures and informing competent authority (alternative measures include additional audit work)
Competent authority – full access to working papers and documentation related to subsidiary; may be through third country competent authority (if established working relationships)
Audit reporting (1)

- Audit report – as required by audit standards
- Entity, period of FSs, individual and group FSs, financial reporting framework
- Scope of audit, including relevant auditing standards
- Audit opinion - unqualified, qualified or adverse (disclaimer if unable to express an opinion):
  - whether the annual financial statements give a true and fair view in accordance with the relevant financial reporting framework; and,
  - where appropriate, whether FS comply with statutory requirements
- Other matters – emphasis without qualification
- Opinion and statement – management report related
- Statement - material uncertainty – if significant doubt about the entity's ability to continue as a going concern
- Place of audit firms’ establishment
- MS – may have additional audit report requirements
Audit reporting (2)

» If joint audit – joint opinion; in case of disagreements – separate paragraphs and reasons of disagreements

» Signing audit report
  - Signed and dated by the statutory auditor
  - If audit firm - the signature of at least the statutory auditor(s) carrying out the statutory audit on behalf of the audit firm
  - Signature by statutory auditors - by all statutory auditors of at least statutory auditors who conducted the audit; in joint audits – statutory auditors of every firm (name may not be disclosed only in exceptional circumstances - threat to the personal security, but the competent authority needs to know the people involved in any case)
CHAPTER VI:

QUALITY ASSURANCE
Organization of QA and criteria

» Each MS should organize it and meet the criteria:
  ▪ Independent from the reviewed auditors/audit firms & subject to public oversight
  ▪ Funding – secure and free from undue influence by auditors/audit firms
  ▪ Adequate resources for QA system
  ▪ QA reviews staff –
    ▪ appropriate professional education,
    ▪ relevant experience in statutory audit and financial reporting, and specific training on quality assurance reviews
    ▪ 3 years cool-off period for the reviewed audit firm
    ▪ declaration of no conflict of interest for each review
  ▪ Selection of reviewers for specific assignments – free of conflicts of interest
Scope of QA reviews

- testing of selected audit files,
- compliance with auditing standards and independence requirements,
- quantity and quality of resources spent, audit fees charged and internal quality control system of the audit firm

QA review – a report with the main conclusions

QA reviews based on risk analysis – at least every six years for auditors carrying out statutory audits

Overall result of QA system – publishing annually

Recommendations – follow-up by auditors/firms within reasonable period (sanctions if no follow-up)

Reviews - appropriate and proportionate depending on scale and complexity of the auditor/firm (in line with proportionate application of auditing standards)
CHAPTER VII:

INVESTIGATIONS AND SANCTIONS
Effective systems of investigations and sanctions - to detect, correct and prevent inadequate execution of audits

Effective, proportionate and dissuasive sanctions

Administrative sanctions may be already part of criminal law – in that case – notify the EC

Sanctions – to be appropriately disclosed to the public, including withdrawal of approval (note – personal data directive)
Competent authorities – power to impose:
- A notice to cease the breached conduct and abstain from repeating the case
- A public statement (competent authority website) indicating the name of the person responsible for specific breach;
- Temporary prohibition (up to 3 years) to conduct audits (auditor, key partner, or audit firm);
- A declaration that the audit report does not meet the requirements;
- Temporary prohibition (up to 3 years) – for auditors and management of PIEs to exercise functions in audit firms or management bodies of PIEs;
- Administrative monetary sanctions on natural and legal persons
Sanctions can be imposed by competent authorities:
- Directly
- In collaboration with other authorities
- Through judicial system

MS can offer more sanctioning powers to competent authorities

MS have an option to give powers on sanctions to authorities supervising PIEs
Application of sanctions

» Relevant circumstances taken into account:
  - Gravity and duration of the breach
  - Degree of responsibility of the person
  - Financial strengths of the person (annual income, or turnover for firms)
  - Profits or losses avoided (if can be determined)
  - The level of cooperation with the competent authority;
  - Previous breaches by the same legal or natural person
  - Additional factors – per MS law

Any decision by competent authority - right of appeal
Publication of sanctions

» At least administrative sanctions (after the right to appeal expired and the person is informed on the sanction) – type, nature, identity of the person

» If publication is done before appeal term expired – information on the appeal and its outcome should also be published

» Anonymous publication if –
  - Publication of personal data disproportionate (obligatory prior assessment of the proportionality)
  - Publication can jeopardize stability of financial markets or ongoing criminal investigation
  - If publication can disproportionally damage the institutions or individuals involved

» Publication is kept on the website minimum 5 years
» MS should ensure effective mechanisms to encourage reporting of breaches
  - Receipts of such reports and follow-up
  - Protection of personal data (those who appeal and those who is suspected of breach)
  - Right to defense for accused person
  - Audit firms – procedures for employees to report breaches

» Exchange of information
  - Competent authorities – annually aggregated information on all administrative measures to CEAOB; CEAOB – to publish in its annual report
  - Temporary prohibitions – also inform CEAOB
CHAPTER VIII

PUBLIC OVERSIGHT AND REGULATORY ARRANGEMENTS BETWEEN MEMBER STATES
Principles of public oversight

» Each MS – effective PO system & competent authority

» All statutory auditors and audit firms – subject to PO

» Competent authority
  - governed by knowledgeable non-practitioners, which are
  - selected by independent and transparent procedure
  - practitioners and experts can be involved for specific tasks – but no involvement in decision making
The competent authority shall have the ultimate responsibility for the oversight of:

» (a) the approval and registration of statutory auditors and audit firms;

» (b) the adoption of standards on professional ethics, internal quality control of audit firms and auditing, except where those standards are adopted or approved by other Member State authorities;

» (c) continuing education;

» (d) quality assurance systems;

» (e) investigative and administrative disciplinary systems.
Competent authority vs Competent authorities

» One or more authorities can be authorized with different tasks provided in the directive

» But – only one authority can have ultimate responsibility for the tasks listed above (except statutory audit of cooperatives and savings banks which have the auditing performed by an existing supervisory body)

» The authorities should be organized to avoid conflicts of interests

» Delegating tasks
  - MS may delegate (or allow the competent authority to delegate) any of its tasks to authorized institutions *(Note. Restrictions related to PIE audits and auditors - regulation)*
  - The delegation - tasks and the conditions on how they should be carried out; avoid conflicts of interests
  - competent authority should be able to reclaim the delegated competences on a case- by-case basis.
Delegation in summary

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<th>OVERSIGHT OF</th>
<th>non PIEs</th>
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<td>Approval and registration of statutory auditors and audit firms</td>
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<td>Adoption of relevant standards</td>
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<td>Continuing education</td>
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<td>Quality assurance system</td>
<td>may be delegated</td>
<td>may NOT be delegated</td>
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<tr>
<td>Investigative and administrative disciplinary system</td>
<td>may be delegated</td>
<td>may NOT be delegated*</td>
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* Member States are provided with an option to delegate the tasks related to sanctions and measures, but only to a body independent from the profession.

Source: European federation of Accountants (FEE)
Additional tasks for competent authority

» Right to initiate and conduct investigations & take actions

» Transparency – publication of annual work programs and activity reports

» Funding
  - The POS - adequately funded & adequate resources to initiate and conduct investigations
  - Secure and free from any undue influence by statutory auditors or audit firms
Cooperation and mutual recognition of POS

» MS should ensure effective cooperation at the EU level and assign one entity responsible for such a cooperation

» Home-country regulation

» If audit firm performs audit services in another MS (with key audit partner registered in host member state) - QA in home country, while PO – in host country for audits carried out there

» Group auditor – MS requiring group audit cannot impose additional requirements on auditors of subsidiaries from another MS (registration, qualification, etc.)

» If company is listed in another MS – that MS (where securities are traded) cannot impose additional requirements on auditors

» If auditor and firm is registered as a result of approval (including third country auditors) – these become subject to POS/QAS and investigations and sanctions
At the EU level - competent authorities should cooperate

Professional secrecy of staff – except by virtue of MS law

Competent authorities can exchange confidential information

Request and receive information from each other (with some exceptions when security of the state is involved)

Confidential information can also be shared with banking regulators

Possible to request investigation in another MS (also with participation of own staff)
CHAPTER IX:

APPOINTMENT AND DISMISSAL
Requirements for auditors appointment and dismissal

» Appointment of statutory auditors or audit firms
  - By general meeting of shareholders or members
  - Alternative systems for appointments – but independent from management
  - Prohibited - contractual clause restricting to certain categories or lists of statutory auditors or audit firms (*so called “big-4 clauses” included for example in credit contracts*)

» Dismissal and resignation of statutory auditors or audit firms
  - Only where there are proper grounds; Divergence of opinions on accounting treatments or audit procedures – are not considered proper grounds
  - Audited entity should inform PO authority(ies) on dismissal or resignation during the audit & explain the reasons
  - For PIE audits – 5% of shareholders, other bodies of audited entities defined by national law, or competent authorities – can claim in court a dismissal (*proper grounds*)
CHAPTER X: AUDIT COMMITTEE
Requirements and membership

» Required for all PIEs
» Stand alone, or committee of the administrative or supervisory body
» Non-executive members of the administrative or supervisory body, and/or members appointed by general meeting, or equivalent body (for entities with no shareholders)
» At least one member – with accounting or auditing expertise
» Members – competent in the relevant industry
» Majority members – independent of the audited entity (MS can exempt from independence – if all members are also members of administrative or supervisory body)
» Chairman – appointed by AC members, or by supervisory body of an entity, and shall be independent of the audited entity (MS can also require AC chairman to be elected by general meeting)
» For smaller PIEs (SMEs and listed entities with reduced capitalization) – AC function can be performed by administrative or supervisory body (if chairman is part of executive – cannot be chairman of AC function)
Some PIEs may be exempted from the requirement to have an AC:

- Subsidiary – if the AC exists at the group level;
- UCITS (Undertakings for Collective Investment in Transferable Securities) or AIF (Alternative investment fund);
- Issuers of asset backed securities (required to explain to public why no need for an AC)
- Credit institutions that are not listed or listed only for debt securities of less than 100 mln EUR

MS may require or allow PIEs not to have an AC – if other bodies perform AC’s functions – disclose to public which body and how it is composed
**Functions of AC**

- inform admin./superv. body on audit outcome, explain how the audit contributed to the integrity of financial reporting and what the role of the audit committee was in that process
- monitor the financial reporting process and submit recommendations or proposals to ensure its integrity;
- monitor the effectiveness of the internal quality control and risk management systems and its internal audit, regarding the financial reporting of the audited entity (*without breaching its independence*)
- monitor the statutory audit performance, including quality inspections findings & conclusions
- review and monitor the independence of the statutory auditors or the audit firms, especially non-audit services (in line with regulation on PIE audits);
- be responsible for selection and recommendation of statutory auditor(s) or audit firm(s)
CHAPTER XI:
INTERNATIONAL ASPECTS
Third country auditors

» Approval of auditors from third countries
  - Subject to reciprocity - may be registered in MS if satisfy good repute and qualification requirements (art 4, 6-13), and
  - Adaption and aptitude test requirements (art 14)

» Registration and oversight of third-country auditors and audit entities
  - Auditors of companies registered outside the EU, but listed in the EU (some exception for small issuers of debt securities only)
  - Registration information updated (art 18-19)
  - For audit firms – the same rules as in the directive are complied with (governance arrangements, ISA application, transparency report, etc.)
  - MS – their POS/QAS, investigations and penalties for those auditors, except if third country system is recognized as equivalent and performed PO and QA for at least 3 years
  - Audit reports by un-registered auditors – no legal effect in the MS
Derogation in the case of equivalence

» MS may disapply or modify the requirements on registration and the need for MS oversight of third country auditors on the basis of reciprocity only if the third-country auditors or audit entities are subject to equivalent systems of public oversight, quality assurance and investigations and penalties in the third country.

» By the way of implementing acts – fully or partially rely on third country systems.

» MS should notify the EC – their assessments & key elements of their agreements with third-country systems of public oversight, quality assurance and investigations and penalties.
MS can transfer working papers

- for auditors of companies registered in MS but listed in third countries, or
- Company is registered in a MS but is part of the group and consolidated FS are prepared and audited in a third country
- Transfer between competent authorities
- Competent authorities of third country meet requirements and considered adequate
- working arrangements on the basis of reciprocity agreed between the competent authorities concerned
- Personal data protection is ensured
Working arrangements

- Requests for working papers are justified
- Staff of competent authority – subject to obligation on profession secrecy
- Commercial interests and intellectual property of audited entity – protected
- Use of working papers only for POS/QAS, sanctions
- Refusal – in cases of issues with state security, judicial processes initiated against same people or entities
- MS already passed final judgments about same auditors or audit firms

EC may decide on adequacy – implementing acts – if equivalent systems
In exception cases MS may allow auditors & audit firms to transfer directly working papers to competent authorities of third countries:

- investigations have been initiated by the competent authorities in that third country
- No conflict with the obligations to their home competent authority;
- Working arrangements between competent authorities allowing direct access to similar papers in third countries;
- Competent authority of home country (MS) is informed;
- conditions on use of working papers are respected.

MS shall communicate to the EC the working arrangements
CHAPTER XII:
TRANSITIONAL AND FINAL PROVISIONS
» EC should be assisted by a Committee – for implementing powers – in line with other relevant EU legislation

» Every 3 years the EC – report to the EU parliament on implementing powers, and the need for changes to the directive

» Exercising the delegation – details in art 48a
Transition and harmonisation

» Audits before the directive was transposed – considered adequate

» MS can impose more stringent requirements

» Transposition

» June 2008 (June 2016 for changes) - MS shall adopt and publish the provisions necessary to comply with this Directive

» EC should be informed on adoption

» Legal provisions should contain reference to the Directive

» MS shall – inform the EC on the texts of legislation in the field covered by this Directive.
Q&A