

Opinion of the European Economic and Social Committee on the ‘Proposal for a Directive of the European Parliament and of the Council amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts’

COM(2011) 778 final — 2011/0389 (COD)

and the ‘Proposal for a Regulation of the European Parliament and of the Council on specific requirements regarding statutory audit of public-interest entities’

COM(2011) 779 final — 2011/0359 (COD)

(2012/C 191/12)

Rapporteur: **Mr MORGAN**

On 13 December 2011 the European Parliament and on 26 January 2012 the Council of the European Union decided to consult the European Economic and Social Committee, under Article 50 of the Treaty on the Functioning of the European Union, on the

Proposal for a Directive of the European Parliament and of the Council amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts

COM(2011) 778 final — 2011/0389 (COD).

On 15 December 2011 the European Parliament and on 26 January 2012 the Council of the European Union decided to consult the European Economic and Social Committee, under Article 114 of the Treaty on the Functioning of the European Union, on the

Proposal for a Regulation of the European Parliament and of the Council on specific requirements regarding statutory audit of public-interest entities

COM(2011) 779 final — 2011/0359 (COD).

The Section for the Single Market, Production and Consumption, which was responsible for preparing the Committee’s work on the subject, adopted its opinion on 17 April 2012.

At its 480th plenary session, held on 25 and 26 April 2012 (meeting of 26 April), the European Economic and Social Committee adopted the following opinion by 110 votes to 18 with 63 abstentions.

1. Conclusions and recommendations

1.1 Following its Green Paper Opinion (GPO) on Audit Policy⁽¹⁾, the EESC expected that the existing Audit Directive 2006/43/EC⁽²⁾ would be updated. In the event, the Commission proposes to update the directive in part but also to produce a regulation for the other part.

1.2 The EESC endorses the draft directive. It is consistent with the Committee’s GPO. There are also many aspects of the regulation which the EESC does endorse.

1.3 The purpose of the regulatory format appears to be two-fold: to introduce fundamental changes onto the audit market and to prescribe in considerable detail the procedures relative to company audits and the relationships between the board and the audit committee.

1.4 Little account has been taken of the EESC recommendation that audit reform should be integrated with the recommendations on corporate governance. There is no discussion of the way in which both statutory auditors and audit committees should improve stakeholder and shareholder communication.

1.5 The Commission proposes to bring about fundamental changes to the audit market by mandatory rotation of statutory auditors after six years and by structural provisions involving non audit services aimed at capping the market share of specific firms in certain Member States.

1.6 Rather than addressing the state of the audit market with a regulation, the Committee proposed that there should be a reference to the competition authorities. These authorities are equipped to undertake full scale economic assessments and formulate appropriate remedies. In recent months the situation in the UK has been referred to the UK Competition

⁽¹⁾ OJ C 248, 25.8.2011, p. 92.

⁽²⁾ OJ L 157, 9.6.2006, p. 87.

Authority. As outlined in our GPO, the EESC would encourage Germany and Spain to take the same course of action. Nevertheless, the Committee recognises that the regulation will allow for more consistent audits of PIEs in Europe, which it considers to be of paramount importance for financial stability and a stronger internal market.

1.7 In its GPO the EESC did not support mandatory rotation of Statutory Auditors (SA). Instead, it proposed mandatory retendering of the contract every six to eight years. After due consideration of the new proposals, the EESC maintains that position, but welcomes other aspects of the regulation. Since the key audit partner is to rotate after seven years, the EESC proposes that the period for mandatory retendering should also be seven years.

1.8 In its GPO, the Committee expressed a very clear view on non-audit services: statutory auditors should not provide to their statutory audit clients any services which could create a conflict of interests for the statutory auditor, in other words, situations where the statutory auditor would be reviewing its own work. At the same time, statutory auditors should be free to provide the full range of non-audit services to non audit clients. The benefits of the experience gained would accrue to both audit and non audit clients.

1.9 The EESC disagrees with the proposal for audit only firms. The formula to determine when an audit firm is disbarred from offering any non audit services should be discarded. The Commission is concerned about the possible risks from firm dominance in three territories. The EESC recommends that the Commission tackle these few cases directly or via the relevant competent authorities and/or competition authorities.

1.10 As in any EESC opinion, the position of SMEs has to be considered. If an SME has shares listed on a stock exchange, it is defined as a public interest entity and therefore subject to the extensive and prescriptive provisions of the regulation which are clearly designed for the audit of banks. Point 4.1.1 contains an analysis of firms listed on the London Stock Exchange. London is further advanced than other EU exchanges in providing equity capital to small firms. Equity is more flexible than bank loans. Half of the firms listed in London should either have an exemption or derogation from this regulation, as should listed SMEs elsewhere in Europe.

1.11 Importantly, the EESC highlights that paragraph 2 in Article 14 strictly limits what stakeholders might otherwise have expected from the statutory audit and it raises a question about what the role of audit should be.

1.12 The regulation also cuts across the ethical, accounting and quality standards already operating in the industry and makes no reference to relevant standards development. Does the Commission intend to sideline the work of these bodies?

1.13 In conclusion, the EESC is fully supportive of the revised directive and it finds much in the regulation which it can support. The EESC has a major concern about the applicability of the regulation to SMEs and it recommends that the more radical proposals be given further consideration.

2. Introduction

2.1 This opinion responds to two parallel Commission proposals: a regulation to increase the quality of audits of financial statements of public interest companies and a directive to enhance the single market for statutory audits. These proposals were developed following a wide ranging consultation based on the *Green Paper on Audit Policy: Lessons from the crisis* (3). The EESC made a full response to the Green Paper and so this opinion draws upon that response.

2.2 There is an existing Audit Directive in place (2006/43/EC) (4). The Commission proposes to amend that directive with the new directive and to reinforce the audit of Public-Interest Entities (PIE) with the new regulation. As a consequence, it is proposed that the provisions on the statutory audits of PIEs in Directive 2006/43/EC (5) be deleted from that directive with statutory audits of PIEs being regulated by the new regulation.

2.3 Everything that the EESC would choose to say about the societal role of audit, the role of audit in the financial crisis, the market for audit services, etc., was said in the Committee's response to the Green Paper. This opinion concentrates on the detailed proposals included in the new legislative drafts.

3. EESC perspective on the Directive

3.1 The main modifications to the Statutory Audit Directive are:

3.1.1 **Articulation between the Statutory Audit Directive and an additional legal instrument on specific requirements for the statutory audit of PIEs;**

3.1.2 **Definition of 'statutory audit' in order to take account of the new accountancy directive;**

3.1.3 **Modification of the ownership rules;**

Member States should no longer require that a minimum amount of capital in an audit firm is held by statutory auditors or audit firms, provided that only the statutory auditors or audit firms involved

(3) COM(2010) 561 final.

(4) OJ L 157, 9.6.2006, p. 87.

(5) See footnote 4.

have influence over the issuance of audit reports. Member States should nevertheless be able to decide on the appropriateness of such external equity participation with respect to national conditions.

- 3.1.4 **Passport for audit firms;**
- 3.1.5 **Passport for statutory auditors and ‘softening’ the conditions for a statutory auditor to be approved in a different Member State;**
- 3.1.6 **Requirements to competent authorities to cooperate regarding educational requirements and aptitude test;**
- 3.1.7 **Auditing standards and audit reporting;**
- 3.1.8 **New rules regarding competent authorities;**

The EESC supports the establishment of Member State Competent Authorities to be the national independent regulators and supervisors and to be the national counterparties to ESMA. However, where competent independent auditor supervisory bodies (including chambers of public accountants and auditors) are already working well in Member States, the EESC would like to see these bodies equivalently enclosed into the new supervisory framework, and not abandoned.

- 3.1.9 **Prohibition of contractual clauses influencing the appointment of statutory auditors or audit firms;**
- 3.1.10 **Special rules for the statutory audit of small and medium-sized undertakings.**

3.2 The EESC supports all these changes. Most are consistent with the EESC GPO.

4. EESC perspective on the Regulation

This section follows the structure of the regulation. Important paragraphs from the text have been reproduced or summarised and then annotated as needed with the opinion of the EESC.

TITLE I: SUBJECT MATTER, SCOPE AND DEFINITIONS

4.1 Articles 1 to 3 - Subject matter, Scope and Definitions

The Regulation applies to auditors (SA) that carry out statutory audits of Public Interest Entities (PIEs) and to the audited PIEs, e. g. rules on the audit committee (AC) which a PIE is required to have. As the financial sector evolves, new categories of financial institutions are created under Union law and it is thus appropriate that the definition of PIEs also encompasses investment firms, payment institutions, undertakings for collective investment in transferable securities (UCITS), electronic money institutions and alternative investment funds.’

4.1.1 In addition to credit institutions, insurance undertakings and all other financial services firms, PIEs are defined as all companies with shares listed on public stock exchanges. The EESC believes that the requirements of this regulation are excessive for SMEs. SMEs are defined by employment, revenue and or balance sheet. The Regulation uses market capitalisation to define large companies and the EESC proposes that market capitalisation should also be used to define SMEs for statutory audit purposes. Exemptions or derogations should be permitted for companies with market capital of up to EUR 120 m. An analysis of the companies listed on the London Stock Exchange is given below. The market capitalisation distribution will be similar in other EU exchanges. Similar consideration should also be given to financial SMEs whose activities are unlikely to have a systemic significance.

Constituent Company Equity Capitalisation
(Converted at £1 = EUR 1,20)

Range (EURm)	Main market: 985 companies Equity value: EUR 2 336 055 m			AIM Market: 1 122 companies Equity value: EUR 85 107 m		
	Number of companies	% of companies	Market value %	Number of companies	% of companies	Market value %
Over 2 400	116	11,8	86,2	1	0,1	4,2
1 200-2 400	87	8,8	6,4	6	0,5	13,1
600-1 200	91	9,2	3,4	16	1,4	16
300 – 600	106	10,6	2	34	3	15,4
120 – 300	169	17,2	1,4	92	8,2	20,4
60 – 120	101	10,3	0,4	133	11,9	13
30 – 60	79	8	0,2	200	17,4	9,9

Constituent Company Equity Capitalisation (Converted at £1 = EUR 1,20)						
Range (EURm)	Main market: 985 companies Equity value: EUR 2 336 055 m			AIM Market: 1 122 companies Equity value: EUR 85 107 m		
	Number of companies	% of companies	Market value %	Number of companies	% of companies	Market value %
12 – 30	88	8,9	0,1	229	20,4	5,3
6 – 12	40	4,1	0	156	13,9	1,5
0 – 6	61	6,1	0	240	21,4	0,9
Other	47	4,7		15	1,3	
> 120	569	57,7	99,4	149	13,2	69,3
< 120	369	37,5	0,6	958	85,4	30,7
< 60	268	27,2	0,2	825	73,5	17,7
< 30	189	19,2	0,1	625	55,7	7,8

Source: London Stock Exchange Web Site / Statistics

4.2 Article 4 - Large public interest entities

'a) The largest 10 issuers of shares in each Member State measured by the market Capitalisation and all issuers of shares that had an average market capitalisation of more than EUR 1 000 000 000 for the previous three calendar years;

b) and c) Any finance industry entity which on their balance sheet date has a balance sheet total exceeding EUR 1 000 000 000;'

4.2.1 These definitions relate to the provisions of Article 10 paragraph 5.

TITLE II: CONDITIONS FOR CARRYING OUT STATUTORY AUDIT OF PUBLIC-INTEREST ENTITIES

CHAPTER I: Independence and Avoidance of Conflicts of Interest

4.3 Articles 5 to 8

4.3.1 The EESC supports these 4 articles in principle.

4.4 Article 9 - Audit fees

'2. When the SA provides to the audited entity related financial audit services, as referred to in Article 10(2), the fees for such services shall be limited to no more than 10 % of the fees paid by the audited entity for the statutory audit.

3. When the total fees received from a PIE subject to statutory audit represent either more than 20 % or, for two consecutive years, more than 15 % of the of the total annual fees received by the SA carrying out the statutory audit, such auditor shall disclose this to the AC.

The AC shall consider whether the audit engagement shall be subject to a quality control review by another SA prior to the issuance of the audit report.

When the total fees received from a PIE subject to the statutory audit represent, for two consecutive years, 15 % or more of the total annual fees received by the SA carrying out the statutory audit, the auditor or firm shall inform the competent authority.'

4.4.1 The EESC supports the proposals for transparency. However, the 10 % limit in paragraph 2 is arbitrary. The EESC proposes that services related to the audit (see 10.2 below) be part of the audit plan (see paragraph 4.16.2 below) and priced without arbitrary limits in the context of the audit overall.

4.5 Article 10 - Prohibition of the provision of non-audit services

'1. An SA carrying out statutory audit of PIEs may provide to the audited entity audit services and related financial audit services.

2. Related financial audit services shall mean:

- a) the audit or review of interim financial statements;
- b) providing assurance on corporate governance statements;
- c) providing assurance on corporate social responsibility matters;
- d) providing assurance on or attestation of regulatory reporting for financial institutions;
- e) providing certification on compliance with tax requirements;
- f) any other statutory duty related to audit work.

3. An SA carrying out statutory audit of PIEs shall not directly or indirectly provide non-audit services to the audited entity. Non-audit services shall mean:

- a) services entailing conflict of interest in all cases
 - (i) expert services unrelated to the audit, tax consultancy, general management and other advisory services;
 - (ii) book keeping and preparing accounting records and financial statements;
 - (iii) designing and implementing internal control or risk management procedures and advice on risk;
 - (iv) valuation services, providing fairness opinions or contribution-in-kind reports;
 - (v) actuarial and legal services, including the resolution of litigation;
 - (vi) designing and implementing financial information technology systems for PIEs;
 - (vii) participating in the audit client's internal audit and the provision of services related to the internal audit function;
 - (viii) broker or dealer, investment adviser, or investment banking services.

b) services which may entail conflict of interest:

- (i) human resources services;
- (ii) comfort letters for investors in the context of the issuance of an undertaking's securities;
- (iii) designing and implementing financial information technology systems;
- (iv) due diligence services to the vendor or the buy side on potential mergers and acquisitions.'

4.5.1 In its GPO the EESC said that SAs should not provide to their statutory audit clients any services which would entail a conflict of interest. While there should be some debate about the nature of the services detailed in 3 (a) and (b) above, the EESC supports the intention of the regulation.

4.5.2 It is not possible to exclude the possibility that there will be circumstances in which it may make overwhelming sense for the SA to provide a service from items (i) to (v) of list (a) to its statutory audit client. An unavoidable event – force majeure – can occur; corporate catastrophes do happen. Services from list (b) may be provided at the discretion of either the AC or the competent authority. The same discretion should be available for items on list (a) in exceptional circumstances.

'5. Where an audit firm generates more than one third of its annual audit revenues from large PIEs and belongs to a network whose members have combined annual audit revenues which exceed EUR 1 500 million within the European Union, it shall comply with the following conditions:

- a) it shall not directly or indirectly provide to any PIE non-audit services;
- b) it shall not belong to a network which provides non-audit services within the Union;
- e) such audit firm shall not directly or indirectly hold more than 5 % of the capital or of the voting rights in any entity which provides the services listed in paragraph 3.'

4.5.3 The EESC understands that the purpose of these provisions is to address the 'dominant' market positions of a Big 4 firm in the UK, Germany and Spain (a different firm in each case) and to act as a deterrent to building such positions in future. In its GPO the EESC proposed that market dominance be

addressed by reference to competition authorities. An investigation is already under way in the UK. The EESC proposes that Germany and Spain should follow suit, pending the adoption of this Regulation.

4.5.4 The EESC does not support audit only firms. In our opinion, such a change is likely to have a detrimental effect on the quality of audit staff and on the quality of statutory audits. The EESC maintains its position that auditors should be free to provide a full range of non-audit services to entities other than statutory audit clients.

4.5.5 In its GPO, the EESC said that it supported the provision of certain non-audit services to statutory audit clients who were SMEs. Small firms will get better quality, service and value from a single advisor. The EESC maintains its position.

4.6 **Article 11- Preparation for the statutory audit and assessment of threats to independence**

4.6.1 Provisions supported by EESC.

CHAPTER II: Confidentiality and Professional Secrecy

4.7 **Articles 12 and 13**

4.7.1 Provisions supported by the EESC.

CHAPTER III: Performance of the Statutory Audit

4.8 **Article 14 - Scope of the statutory audit**

'2. Without prejudice to the reporting requirements as referred to in Articles 22 and 23, the scope of statutory audit shall not include the assurance on the future viability of the audited entity nor the efficiency or effectiveness with which the management or administrative body has conducted or will conduct the affairs of the entity.'

4.8.1 The EESC calls attention to the paragraph above because it strictly limits what stakeholders might otherwise have expected from the statutory audit and it raises a question about what the role of audit should be.

4.9 **Article 15 - Professional scepticism**

The SA shall maintain professional scepticism throughout the audit. "Professional scepticism" means an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud and a critical assessment of audit evidence.'

4.9.1 As in our GPO, the EESC supports the emphasis on professional scepticism.

4.10 **Articles 16 to 20**

4.10.1 The EESC supports the use of ISAs and the other provisions of Articles 16 to 20.

CHAPTER IV: Audit Reporting

4.11 **Article 21 - Results of the statutory audit**

The SA shall present the results of the statutory audit in the following reports:

— an audit report in accordance with Article 22;

— an additional report to the audit committee in accordance with Article 23.'

4.12 **Article 22 - Audit Report**

'2. The audit report shall be in writing. It shall at least:

- k) identify key areas of risk of material misstatement of the annual or consolidated financial statements, including critical accounting estimates or areas of measurement uncertainty;
- l) provide a statement on the situation of the audited entity, especially an assessment of the entity's ability to meet its obligation in the foreseeable future and therefore continue as a going concern;
- m) assess the entity's internal control system, including significant internal control deficiencies identified during the statutory audit, as well as the bookkeeping and accounting system;
- o) indicate and explain any violation of accounting rules or violation of laws or the articles of incorporations, accounting policy decisions and other matters that are significant for the governance of the entity;
- q) where the statutory audit was carried out by an audit firm, the report shall identify each member of the audit engagement team and shall state that all members remained completely independent and had no direct or indirect interest in the audited entity;

t) give an opinion which shall state clearly the opinion of the SA as to whether the annual or consolidated financial statements give a true and fair view and have been prepared in accordance with the relevant financial reporting framework;

u) refer to any matters to which the SA draws attention by way of emphasis without qualifying the audit opinion;

4. The audit report shall not be longer than four pages or 10 000 characters (without spaces).'

4.12.1 This report replaces the audit opinion which is presently published as part of the PIE's Annual Report and Accounts. Paragraph 2 specifies 23 elements (a) to (w) to be included in the 4 pages of this report. In its GPO the EESC was critical of the meaningless and boiler plate content of audit opinions, showing little variation from firm to firm and industry to industry. This report will reveal more, perhaps to the discomfort of the audited entities.

4.12.2 There is a requirement to name the audit team. For the largest PIEs, this could involve 100s of people. A report for a very large enterprise must surely be differentiated in scale and scope from that for a company 100th of its size. A number of the requirements seem to be out of step with international accounting standards. The regulation makes no reference to these standards.

4.13 Article 23 - Additional report to the audit committee

'1. Additional report shall be disclosed to the general meeting of the audited entity if the management or administrative body of the audited entity so decides.'

4.13.1 In the view of the EESC, it is improbable that audited entities would make a full disclosure of this report. The EESC considers that it should be communicated to the company's social partners, in compliance with the different national systems for the involvement of workers.

'2. The additional report shall explain in detail and explicitly the results of the statutory audit carried out and shall at least:

f) indicate and explain judgments about material uncertainty that may cast doubt about the entity's ability to continue as a going concern;

g) determine in detail whether the bookkeeping, the accounting, all audited documents, the annual or consolidated financial statements and possible additional reports show appropriateness;

h) indicate and explain in detail all instances of non-compliance, including nonmaterial instances as far as it is considered to be important to the AC in order to fulfil its tasks;

i) assess the valuation methods applied to the various items in the annual or consolidated financial statements including any impact of changes of such;

j) provide full details of all guarantees, comfort letters and undertakings that have been relied upon when making a going concern assessment;

k) confirm the attendance at stock takes as well as other instances of physical verification;

n) indicate whether all requested explanations and documents were provided.'

4.13.2 This report is based on the long form report used by audit firms in Germany. Its use throughout the EU should improve both the quality of the statutory audit and the audited entity's response to the audit. The EESC supports this report.

4.14 Article 24 - Oversight of the statutory audit by the audit committee Article 25 - Report to supervisors of public-interest entities

4.14.1 Articles 24 and 25 are consistent with the EESC GPO.

CHAPTER V: Transparency Reporting by Statutory Auditors and Record Keeping

4.15 Articles 26 to 30

4.15.1 Chapter V is consistent with the EESC GPO.

TITLE III: THE APPOINTMENT OF STATUTORY AUDITORS BY PUBLIC INTEREST ENTITIES

4.16 Article 31 - Audit Committee

'1. The AC shall be composed of non-executive members of concerns the administrative body and/or members of the supervisory body of the audited entity and/or members appointed by the general meeting of shareholders of the audited entity.

At least one member of the AC shall have competence in auditing and another member in accounting and/or auditing. The audit committee members as a whole shall have competence relevant to the sector in which the audited entity is operating.

A majority of the members of the AC shall be independent. The chairman shall be appointed by AC members and shall be independent.'

4.16.1 Paragraph 1 is completely in line with the recommendations of the EESC in its GPO, given that 'as a whole' does not mean 'all'.

4.16.2 Paragraph 5 details the responsibilities of the audit committee. The EESC suggests two further responsibilities: approval of the plan for the audit, including the provision of audit related services and approval of the related budgets.

4.17 **Article 32 - Appointment of the statutory auditors**

'2. The AC shall submit a recommendation for the appointment of the SA. The recommendation shall contain at least two choices for the audit engagement and the committee shall express a duly justified preference for one of them.

3. The recommendation of the AC shall be prepared following a selection procedure organized by the audited entity respecting the following criteria:

a) the audited entity shall be free to invite any SA to submit proposals on the condition that at least one of the invited auditors is not one who received more than 15 % of the total audit fees from large PIEs in the Member State concerned in the previous calendar year;

b) the audited entity shall be free to choose the method to contact the invited statutory auditor(s);

c) the audited entity shall prepare tender documents which shall be used by the audited entity to evaluate the proposals made by the SA;

d) the audited entity shall be free to define the selection procedure and may conduct direct negotiations with interested tenderers in the course of the procedure;

f) the audited entity shall evaluate the proposals made by the SA in accordance with the selection criteria predefined in the tender documents;

g) the audited entity shall be able to demonstrate to the competent authority that the selection procedure was conducted in a fair manner.

5. If the proposal of the administrative or supervisory board departs from the recommendation of the AC, the proposal shall justify the reasons for not following the recommendation of the AC.

6. In the case of a credit institution or insurance undertaking, the administrative or supervisory board shall submit its draft proposal to the competent authority.

10. In order to facilitate the exercise of the task of the audited entity to organize a selection procedure for the appointment of an SA, EBA, EIOPA and ESMA shall issue guidelines.'

4.17.1 Whatever the duration of the audit assignment, these guidelines are potentially useful for large PIEs but, as they stand, they are excessively prescriptive for SMEs. SMEs will often not follow the process at (a) and will usually employ second, or third, tier firms. SMEs will feel that they have the freedom at (b) and (d). SMEs will not usually prepare formal tender documents, may often not solicit competitive tenders and will feel no responsibility for explaining themselves to competent authorities. Paragraph 5 does not apply to SMEs. These rules are designed for banks, not SMEs. SMEs will not require input from the galaxy of institutions cited in para 10 in order to arrange their affairs.

4.17.2 There is a requirement that the invitation to tender be sent to at least one second tier firm. This can give second tier firms access to larger clients but there are clearly many issues to be resolved by all the second tier firms which collectively only have the resources to respond in a limited number of instances.

4.18 **Article 33 - Duration of the audit engagement**

'1. The PIE shall appoint a statutory auditor for an initial engagement that shall not be shorter than two years. The PIE may renew this engagement only once. The maximum duration of the combined two engagements shall not exceed six years. Where throughout a continuous engagement of 6 years two SAs have been appointed, the maximum duration of the engagement of each statutory auditor or audit firm shall not exceed nine years.'

4.18.1 In its GPO the EESC did not support mandatory rotation of SAs. Instead, it proposed mandatory retendering of the contract every six to eight years. After due consideration of the new proposals, the EESC maintains that position, but welcomes other aspects of the regulation.

4.18.2 Since the key audit partner is to rotate after seven years (4 below), the EESC proposes that the period for mandatory retendering should also be seven years. There is an issue as to whether the incumbent SA should have a fixed tenure of seven years. In many Member States, the SA is

reappointed each year and the Regulation should contain the option to continue this practice. Accordingly there should be flexibility relative to tenure in the seven year period, but mandatory retendering would be required after seven years of continuous tenure. The EESC emphasises that when the mandatory retender is triggered, the proceedings must be transparent and that, in the case of credit institutions, the competent authority must approve the outcome.

'4. The key audit partner(s) responsible for carrying out a statutory audit shall cease his, her or their participation after a period of seven years. The SA shall establish an appropriate gradual rotation mechanism with regard to the most senior personnel involved.'

4.18.3 This rotation was supported in the EESC GPO but the gradual rotation of the rest of the team should be at the discretion of the statutory auditor.

4.19 Article 34 - Dismissal and resignation of the statutory auditors

TITLE IV: SURVEILLANCE OF THE ACTIVITIES OF AUDITORS AND AUDIT FIRMS CARRYING OUT STATUTORY AUDIT OF PUBLIC-INTEREST ENTITIES

CHAPTER I: Competent Authorities

4.20 Articles 35 to 39

4.20.1 The EESC supports the provisions relating to competent authorities.

CHAPTER II: Quality Assurance, Investigation, Market Monitoring, Contingency Planning and Transparency of Competent Authorities Tasks

4.21 Article 40 to 44

The tasks of the competent authorities include:

- undertaking quality assurance reviews on the statutory audits carried out.
- investigating with a view to detecting, correcting and preventing inadequate statutory audits;
- monitoring the developments in the market for the provision of statutory audit services;
- regularly monitoring the possible threats to the continuity of the operations of large audit firms, including the risks arising from high concentration and requiring large audit firms to establish contingency plans to address such threats;

4.21.1 The proposal that the competent authorities should work with the largest firms in each jurisdiction to develop contingency plans is consistent with the EESC GPS.

CHAPTER III: Cooperation between Competent Authorities and Relations with the European Supervisory Authorities

4.22 Articles 45 to 56

a) The regulation requires that the EU-wide cooperation between competent authorities takes place within ESMA, thus taking over the current EU-wide cooperation mechanism under the aegis of the European Group of Auditors' Oversight Bodies (EGAOB).

ESMA should issue guidance on several issues: e.g. on the content and presentation of the audit report and the additional report to the audit committee, on the oversight activity of the audit committee or for conducting quality assurance reviews.

b) Under the auspices of ESMA, A "voluntary" pan-European audit quality certification is to be introduced to increase the visibility, recognition and reputation of all audit firms having capacities to conduct high quality audits of PIEs.'

4.22.1 The EESC endorses this proposal.

CHAPTER IV: Cooperation with third country auditors and with international organisations and bodies

4.23 Articles 57 to 60

The competent authorities and ESMA may conclude cooperation agreements on the exchange of information with the competent authorities of third countries only if the information disclosed is subject to guarantees of professional secrecy and provided data protection rules are respected.'

4.23.1 The EESC endorses the proposals contained in Chapter IV.

TITLE V: ADMINISTRATIVE SANCTIONS AND MEASURES

4.24 Article 61 - Administrative sanctions and measures

4.25 Article 62 - Sanctioning powers

'1. This Article shall apply to breaches of the provisions of this Regulation identified in the Annex.

2. Competent authorities shall have the power to impose at least the following administrative measures and sanctions:

- b) a public statement which indicates the person responsible and the nature of the breach, published on the website of competent authorities

- f) *administrative pecuniary sanctions of up to twice the amount of the profits gained or losses avoided because of the breach;*
- g) *in respect of a natural person, administrative pecuniary sanctions of up to EUR 5 000 000;*
- h) *in respect of a legal person, administrative pecuniary sanctions of up to 10 % of its total annual turnover in the preceding business year;*

4.26 Article 63 - Effective application of sanctions

'1. When determining the type of administrative sanctions and measures, competent authorities shall take into account all relevant circumstances, including:

- a) *the gravity and the duration of the violation;*
- b) *the degree of responsibility of the responsible person;*
- c) *the financial strength of the responsible person;*
- d) *the importance of the profits gained or losses avoided.'*

4.27 Article 64 - Publication of sanctions and measures

'Every administrative measure or sanction imposed for breach of this Regulation shall be published without undue delay, including at least information on the type and nature of the breach and the identity of the persons responsible for it, unless such publication would seriously jeopardise the stability of financial markets.'

4.28 Article 65 - Appeal

4.29 Article 66 - Reporting of breaches

4.29.1 In its GPO the EESC had envisaged the establishment of a professional disciplinary body in each Member State. The Committee supports these proposals. In effect, these proposals provide for 'naming and shaming' in cases of malfeasance.

TITLE VI: DELEGATED ACTS, REPORTING AND TRANSITIONAL AND FINAL PROVISIONS

4.30 Articles 68 to 72

4.30.1 A transitional regime is introduced regarding the entry into force of the obligation to rotate audit firms, the obligation to organise a selection procedure for the choice of audit firm and the establishment of audit firms that only provide audit services.

4.31 ANNEX: I. Breaches by statutory auditors or key audit partners

The breaches envisaged are essentially procedural and administrative relating to: conflicts of interest, organisational or operational requirements, the performance of the statutory audit, audit reporting, disclosure provisions, the appointment of statutory auditors or audit firms by public-interest entities and quality assurance. It is not clear how an auditor failure (such as the recent failure to pick up JP Morgan mishandling of client funds) will be handled under these provisions.

4.32 ANNEX II. Breaches by PIEs

The breaches envisaged relate to the appointment of statutory auditors or audit firms.

Brussels, 26 April 2012.

The President
of the European Economic and Social Committee
Staffan NILSSON

APPENDIX

to the Opinion of the European Economic and Social Committee

The following paragraph of the section opinion was amended to reflect the amendment adopted by the assembly but received more than one quarter of the votes cast (Rule 54(4) of the Rules of Procedure):

Point 3.1.8**3.1.8 New rules regarding competent authorities;**

The EESC supports the establishment of Member State Competent Authorities to be the national independent regulators and supervisors and to be the national counterparties to ESMA. However, where competent independent auditor supervisory bodies are already working well in Member States, the EESC would like to see these bodies brought into the new supervisory framework, and not abandoned.

Outcome of the vote on the amendment:

Votes in favour: 88

Votes against: 60

Abstentions: 37
