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EuropeanIssuers' amendments on the Audit proposals

We are writing to you to propose some additional amendments to the audit proposals on behalf of EU quoted companies. Our concern is that these proposals could adversely affect our members, which are publicly quoted companies in Europe, at a time when the European economy needs to rely on them for future jobs and growth, by adding to the costs of listing and to the amount of management time required to run a listed company.

We propose an amendment to the scope of Article 2 to ensure that the legislation should follow the "Think Small First" principle, whereby EU smaller and mid-cap quoted companies (which we define as those under €1 billion market cap) should not be subject to the legislation in the first 2 years, until a review has been carried out of the effects of the proposals on the largest companies. We note that smaller quoted companies are still exempt from some requirements of the US Sarbanes-Oxley Act; European markets not offering such an exemption could become less attractive to companies choosing where to list. We note that the EESC opinion recommends total exemption for smaller companies, which would be our preferred option.

Our other proposals for amendments are set out in detail in the attached documents, together with more detailed explanations of the reasons for our concerns, but the key points for companies are:

1. **The role of audit committees (Articles 24, 31, 34, 46)**

We believe that the role of audit committees, as opposed to the audit firms themselves, should not be dealt with at EU level, since this is best dealt with in national company laws and corporate governance codes, respecting different national traditions.

Excessive delegation of powers creates capital markets based on ever more detailed, rather than principles-based regulation. This creates costs and disintermediation, and means that EU regulators will become ever more reliant on the audit firms and intermediaries, and further removed from the companies, many of which are unlikely to have the resources to engage with ESMA. This is not a vision for the EU that we share. We therefore oppose the delegation of power to ESMA as regards audit committees, as opposed to audit firms themselves.

We disagree with the trend towards binding EU regulation, without sufficiently taking into account the current state of development of legal frameworks in member states and the need for proportionality. A clear example of this point is that, in our view, the audit committee should be recognised as a committee of the Board as is currently the case in various member states, not treated as if it were entirely separate, with an independent status from the Board.

Furthermore, smaller quoted company boards may consist of only 6-8 people, who in reality may not find it easy to set up multiple committees, to follow detailed appointment procedures or to require 1/3 of the board to have specialist financial reporting skills.

We therefore propose amendments to the following Articles: 24, 31, 34, 46.3

2. **Audit report and lessons learned from Sarbanes-Oxley (Articles 22, 23)**

Quoted companies are strongly opposed to any public reporting by the auditor of the company's internal control system for financial reporting. We know that this unquestionably led to significant additional costs under the US Sarbanes-Oxley Act, and we see that the EU regulation is even more widely drafted than the US Act. The focus of the external auditor in the audit should be on the integrity (true and fair view) of the financial statements and its opinion should be based on this. US experience has shown that rigid rules on governance do not help companies to have better internal controls and audit systems in place (e.g. Lehman Brothers was subject to the Sarbanes Oxley Act), as this could easily lead to (very costly) tick-the-box behaviour. We therefore insist on the need for amendments to Article 22.

We also believe that the audit should focus on quality, not on the imposition of detailed compliance checks which will serve to increase audit bills and increase barriers to entry, without equivalent benefits to shareholders. We therefore propose further amendments to Article 22.

Furthermore, we support the proposed amendments to article 23, in particular amendment 121. We believe the auditor should be able to communicate openly with the Board. An important element of this communication is the additional report. The possibility of further disclosure of the additional report beyond the Board could have a negative impact on the quality of this report.

3. **Regulation of audit firms (Articles 9, 10, 33)**

We are not convinced that what are essentially concerns about competition can or should be dealt with via detailed regulation which may negatively affect companies. The current proposals will impose costs not only on the audit firms, but also on companies as their clients, with serious concerns if potential benefits do not outweigh the negative effects of the rules. A system of mandatory rotation of audit firms seems likely to reduce the number of audit firms available and lead to a more concentrated market, which we do not support. In addition, mandatory rotation is likely to lead to a temporary loss of expertise, as it takes the newly mandated audit firm time to get used to company specifics. We note that the rotation of audit partners was included in the 8th company law directive, which has only just been implemented in the Member States.

An introduction of regulation leading to pure Audit Firms (i.e. excluding consultancy) may lead to loss of quality, as the expertise necessary to audit large entities (especially listed) not only requires typical audit skills and knowledge, but also consultancy skills and knowledge. In addition, it is important to acknowledge that the choice of auditor is already extremely limited for certain companies, due to the specific businesses in which they are active. The proposal could also make the audit profession less appealing to graduates and thus lead to a loss of talent.

For more details, see our proposed amendments and position papers from August 2012 and our earlier response dated 22 December 2010 to the Green Paper. If you have any questions, please do not hesitate to contact me.

Yours sincerely

Susannah Haan
Secretary General