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REFORM OF STATUTORY AUDIT
EUROPEANISSUERS POSITION ON THE AMENDMENTS IN THE LEGAL AFFAIRS COMMITTEE

In preparation for the discussion on compromise amendments in the European Parliament's Legal Affairs Committee, we would like to share our views on the amendments tabled in JURI Committee on the reform of Statutory Audit.

1. INDEPENDENCE OF STATUTORY AUDITORS, PURE AUDIT FIRMS, ROLE OF THE AUDIT COMMITTEE

Certain **rules limiting non-audit services should be amended**.

Firstly, **large audit firms should not be prohibited from providing non-audit services**. Companies need their expertise and experience both for the statutory audit and for non-audit services. Creating pure audit firms would also lead to an increase in the costs of non-audit related services because of reduced competition. Therefore, we support amendments deleting article 10(5) of the Regulation and oppose amendments, which limit the provision of non-audit services by large audit firms.

We support the following amendments to the REGULATION: 19, 70, 206, 240, 241, 393 to 398.

We oppose the following amendments to the REGULATION: 306, 309, 399 to 406; DIRECTIVE: 148

Secondly, the **conditions under which a statutory auditor may carry out related financial audit services should be amended**. The ceiling proposed by the European Commission (10 % of the statutory audit fees in article 9(2) of the Regulation) for the provision of certain related financial audit related services is extremely problematic. In our view, these fees should exclude those earned from the statutory auditors' work required by European or national laws or regulations and / or those linked to the statutory audit (audit or limited review of interim financial statements, obligation related to the audit required by European legislation). In addition, when a company publishes consolidated accounts, a cap, if any, should be determined by reference to the group, and not to the parent company alone. Services that are part of the statutory audit should not be considered as related services. Finally, some flexibility is needed to adapt the list of related financial audit services and the list of non-audit services.

We support the following amendments to the REGULATION: 33, 40, 61, 77, 207, 263 to 267, 299, 300, 741, 742, 744 and 745.

We oppose the following amendments to the REGULATION: 76, 269, 408 to 411, 728 to 730.

Thirdly, the **independence rules applicable to certain services should take into account the role of the audit committee – as a non-permanent sub-group of the board – and the time constraints of corporate financial transactions**.

The audit committee should not be primarily responsible for identifying / assessing the relationships of the statutory auditors and audit firms, as well as their networks, and therefore their independence

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vis-a-vis the audited entity or related entities. In the first place, the statutory auditor or audit firm should assess threats to independence and take all necessary steps to ensure that the audit is not affected by any existing or potential conflict of interest or business or other relationship involving the statutory auditor, the audit firm or its network. It should then provide a statement on its independence to the audit committee, allowing the audit committee to monitor the statutory auditor's or the audit firm's independence.

Moreover, rather than being subject to prior approval by the audit committee (comfort letters; article 10(3)(b)(ii) of the Regulation) or by the competent authority (due diligence services on potential mergers and acquisitions; assurance on the audited entity to other parties at a financial or corporate transaction; article 10(3)(b)(iv)), these services should be reviewed by the audit committee (in agreement with the board), as follows: approval of the nature of the work to be carried out by the statutory auditor; system of delegation to senior management; ex post information of the audit committee on the work carried out.

Requiring prior approval by the audit committee or by the competent authority for non-audit services, or requiring a selection and tendering procedure for such services, would have serious drawbacks:

- this would deprive European companies of timely and well-tailored non-audit services and lead to a deterioration in the quality and costs of these services;
- this would cause the audit committee to deviate from its strategic missions (see part "Audit committee");
- this would likely be differently assessed and applied across entities and countries.

We support the following amendments to the REGULATION: 61, 62, 302, 303, 369 to 374.

We oppose the following amendments to the REGULATION: 7, 76, 77, 112, 205, 216, 229, 250, 346, 351, 352, 360, 361, 365, 366, 375, 383, 413 and 414.

The possibility to hold almost 50 % of the **capital or** of the **voting rights of audit firms** already enables small and medium-size practices to finance their growth. The deletion of any minimum amount of capital or of voting rights may impair the independence of auditors, the quality of their work and eventually be detrimental to investors and audited entities.

We support the following amendments to the DIRECTIVE: 26, 27, 63, 66 to 69.

2. SELECTION, NOMINATION, DURATION OF THE AUDIT ENGAGEMENT AND DISMISSAL

Companies support the long-term development of a reliable alternative offer to that of the large audit firms, ultimately making it possible to remedy the current oligopoly on the audit market for large companies. However, the offer must not be developed in haste, to the detriment of the audit quality. Audit quality would inevitably decline if a group auditor did not have sufficient means at his disposal and if the maximum duration of his engagement was too short to fully understand the activities, organization and inner workings of large international groups, which can be very complex.

As the audit offer is **very limited for large companies, the selection of statutory auditors would be excessively constrained by the introduction of mandatory rotation of firms, the excessive reduction**

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of the maximum duration of the audit engagement − to 6 years, or 9 in the case of a joint audit −, **and the introduction of a cooling-off period of 4 years** (Art. 33 of the Regulation). Therefore, we support the amendments deleting or altering the rotation obligation and opposes all measures aiming at tightening further the proposed rotation system (e.g. through too frequent calls for tenders or reduced maximum duration of engagement) or referring to it, as well as the amendments tightening further the existing rotation mechanism for key audit partners.

Furthermore, we consider that the statutory auditor or the audit firm should be appointed by the shareholders. Its engagement should be renewable upon their decision without additional conditions and without prior evaluation of the audit quality by the audited entity.

Finally, if **more than one auditor or audit firm** has been appointed according to national legislation, the allocation and rotation of tasks should be specified by the relevant national provisions, and not by European legislation or standards.

We support the following amendments to the REGULATION: 224 to 226, 228, 240, 241, 551, 557, 568 to 571, 574 to 578, 586 to 591, 594, 600 to 604, 686, 744 and 745.

We oppose the following amendments to the REGULATION: 215, 218, 227, 425 to 427, 493, 495, 535, 536, 541, 542, 553, 558 to 566, 572, 573, 579, 580, 582, 583, 585, 616 to 619, 626 to 628, 722, 734 and 735 (except, for those two last amendments, if the rotation obligation is deleted), 736. We strongly oppose amendment 606.

Should the audit offer be sufficient, **which currently is not the case**, rotation could take place after a period of 15 to 18 years (from the entry into force of the Regulation), with a transitional period extended to 12 to 15 years. This would allow mid-tier audit firms time to grow and compete in all audit market segments. In addition, the maximum duration of a single and renewable audit engagement should be extended to 6 years[1] and should be computed from date of entry into force of the Regulation. If rotation were mandatory under a joint audit regime, companies should be allowed to appoint and / or renew their statutory auditors with staggered terms.

We could support the following amendments to the REGULATION: 567, 581, 593, 595, 607 to 614

3. AUDIT COMMITTEE

Where applicable, the committees of the Board, which are **non-permanent** — like the administrative or supervisory body —, are **sub-groups of the board** and appointed by the Board. They are tasked with preparing its work, but the Board, as a collegial body, remains collectively accountable for the performance of its duties. **The audit committee should be recognized as a committee of the Board and not treated as if it were separate**, **with an independent status from the Board.**

The role of the board and of its committees is to set the company's strategy and main policy lines and/or to oversee their implementation by senior management. In the field of statutory audit, based on the essential information received from the statutory auditor or the audit firm and from the senior management and without prejudice to their responsibilities, the board or the audit committee

[1] The current proposal refers to a minimum duration of 2 years, but some amendments foresee a duration of one year or shorter than 6 years.

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may "challenge" it if they consider that the main independence policies defined, decided and implemented by the statutory auditor or audit firm and the management are not appropriate, or if they do not obtain a clear understanding of the statutory audit findings on the annual and consolidated accounts. **It would be counter-productive to transfer to the board the responsibility for defining, deciding and implementing auditor independence policies and the responsibility for auditing accounts**, which require a significant presence in the company and frequent decisions and actions.

The **change in certain provisions relating to the audit committee** (Articles 31 and 34 of the Regulation) **would be contrary to the allocation of competences between the board and the senior management**.

We believe that the **role of audit committees should not be dealt with at EU level, since it is best dealt with in national company laws** and corporate governance codes, respecting different national traditions and board structures.

Therefore, we support amendments deleting provisions that assign additional and inadequate functions to the audit committee (e.g. approval, or prior approval of services that can be performed by the auditor, or of related fees; definition and application of the selection procedure). Furthermore, we oppose amendments granting more competences to the audit committee, deleting the possibility to use a body performing equivalent functions or conferring functions of the audit committee to the "supervisory or administrative body"(the obligation to have an audit committee as such is particularly irrelevant for companies whose board comprises few directors. Companies with a market capitalization under EUR 1 000 000 000 have on average only five to six directors.)

We support the following amendments to the REGULATION: 61 and 62, 77, 376 to 381, 420, 449,514 and 684.

We oppose the following amendments to the REGULATION: 7, 76, 112, 152, 271, 282, 283, 287, 288, 368, 382, 416 to 419, 421, 448, 459, 461, 464, 465, 469, 472, 479, 486, 487, 494, 497, 499, 517, 520, 527, 528, 543, 544, 546, 556; DIRECTIVE: 147.

We are concerned by a potential **excessive specialization of committee members**, which would contradict the principles of collegiality and collective responsibility of the board (Art. 31(1) of the Regulation). This is a particular concern for smaller quoted companies, who may only have 5 or 6 board members in total. Such companies make up 85% of the capital markets by number, although not by market capitalization.

We support amendment 151 to the REGULATION.

We oppose the following amendments to the REGULATION: 211 and 516; DIRECTIVE: 31.

Shareholders already have the right to appoint and dismiss directors and so can already vote against directors on the audit committee. There is thus no need for additional provisions regarding appointment of members of the audit committee, which would be an unnecessary additional burden on companies.

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We strongly support amendment 515 to the REGULATION.

The mission of the audit committee is to monitor the statutory audit: **extending this role to the oversight or to the assessment of the work of the statutory auditor and to the supervision of the completeness and integrity of the draft audit reports would be incompatible with the principle of independence** of the statutory auditor (Art. 24 and 31(5) of the Regulation). If needed, the audit committee "may" only – and not "shall" — submit recommendations or proposals to ensure the integrity of the financial reporting process. Therefore, we only support amendments guaranteeing this principle of independence.

We support the following amendments to the REGULATION: 521, 524 and 526.

We oppose the following amendments: DIRECTIVE: 145; REGULATION: 492, 496, 519, 523, 534, 552, 554, 596 and 605.

Lastly, the audit committee does not have the power to act on behalf of the audited entity (Article 34.2 of the Regulation). This power belongs to the administrative body in a one-tier system and to the management body in a two-tier system. Therefore, the audit committee does not have the capacity to stand in justice and should not be granted powers to engage in legal proceedings in place of the administrative body or the management body.

We support the following amendments to the REGULATION: 230 and 630.

We oppose the following amendments to the REGULATION: 631 and 633.

4. AUDIT REPORTS AND SCOPE OF THE STATUTORY AUDIT

The legal audit reform aims at improving the quality of the controls performed by the statutory auditor, NOT at extending their scope. Audit reports can be more detailed than they currently are. However, statutory audit must remain focused on avoiding material misstatements in the financial statements.

The proposed content of the long form audit report (Art. 22 of the Regulation) and the additional report to the audit committee (Art. 23) would imply detailed compliance checks, which would go well beyond the control of accounts, and increase the work and costs of the statutory audit. Furthermore, it would inevitably increase the barriers to entry to the statutory audit market, which is contrary to the objectives of the reform. We therefore **support amendments that reinforce the audit report, that do not extend the scope of the statutory audit and that do not make the reports more complex**.

We support the following amendments to the REGULATION: 9, 104, 105, 107, 127 to 129 and 456.

We oppose the following amendments to the REGULATION: 245, 444 to 446, 450, 460, 477 and 483; DIRECTIVE: 112

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It would be **inappropriate that the management, administrative or supervisory board may decide to disclose the additional report to the general meeting of shareholders**: an important premise for the dialogue between the auditor and the company is that the auditor's findings should not be disclosed beyond the company (Art. 23(1) of the Regulation). The possibility of further disclosure of the additional report beyond the Board could have a negative impact on the quality of this report.

We support amendment 121 to the REGULATION.

We oppose the following amendments to the REGULATION: 466 to 468.

Companies have **two major concerns** with regard to the scope of the reports.

Firstly, they are strongly opposed to the statutory auditor assessing the company's **internal control** (IC) (Art. 22(2)(m) of the Regulation). IC is supervised by the company's IC functions more frequently, comprehensively and effectively that a statutory auditor would ever be able to do. It is essential to avoid the excess witnessed in the US, where experience demonstrates that detailed regulations, such as under the Sarbanes Oxley Act, did not prevent failings in IC systems. The consequences would be even worse in Europe as, in contrast to the US, the scope would include non-financial internal control. This would lead to excessive costs for companies, without increasing protection for investors and stakeholders. Companies' experience in the US was that their audit costs in some cases doubled.

We support amendment 109 to the REGULATION.

Secondly, the role of the auditor should not be extended to **functions**, which are **under the competence of the company and / or other third parties**, such as financial analysts (statement on the situation of the company beyond a statement on the going concern...) or independent third-party bodies (for the control of non-financial and CSR information, for instance).

In particular, the audit report should remain focussed on the audited entity's current situation in terms of risks and uncertainties, without extending to its likely future development or business opportunities.

Moreover, the auditor should not verify the compliance of the management report with the applicable legal requirements or the consistency between the financial statements and other documents than the management report (this would include documents that are the subject of other legislation or regulation, such as prospectus).

Due to the lack of appropriate skills, such extensions would be detrimental to the independence of the control carried out by the auditor (involvement in the audited entity management and decision-taking), generate confusion (e.g. where financial analysts or rating agencies use, or lawyers verify financial information), lead to increased risks for auditors and investors and to increased costs for companies. Finally, the disclosure of sensitive information would lead to major risks for the international activities and competitiveness of European companies.

We support the following amendments to the REGULATION: 108, 110, 111.

We oppose the following amendments to the REGULATION: 99, 243, 423, 434, 438, 439, 454, 483, 490.

5. INTERNATIONAL STANDARDS ON AUDITING (ISAs)

The International Standards on Auditing (ISAs) (Art. 26 of the Directive) should only be adopted if they are principle-based, do not increase audit costs and do not describe corporate responsibilities (particularly if such responsibilities do not correspond to the European legal environment). Therefore, a European system of assessment and / or adoption of ISAs should be established and implemented. It should provide in this regard the best warranties, by allowing where appropriate the rejection of provisions that would prove problematic. We therefore **support amendments reintroducing a European ISAs' adoption system and oppose amendments easing their application without appropriate checks**.[2]

We support the following amendments: REGULATION: 429; DIRECTIVE: 17, 29, 48, 100, 101, 111.

We oppose the following amendments: REGULATION: 81, 86, 92, 96, 97, 99, 103, 430 and 431; DIRECTIVE: 2, 15, 23,107, 109.

6. PROTECTION OF COMMERCIAL INTERESTS AND CONFIDENTIALITY

According to Article 23 of the proposal for a Directive, the working arrangements with third-country authorities should ensure the protection of the commercial interests of the audited entity, including its industrial and intellectual property. This objective of protection, which is imperative for companies, needs however to be strengthened upstream by the non-transfer to such authorities of information that could affect companies' legitimate interests or business secrecy. The cooperation of ESMA with third-country authorities should lead to mutual recognition and mutual trust, while respecting the confidentiality of information concerning companies or provided by companies.

Also the obligation of professional secrecy should apply to persons employed or formerly employed by competent authorities, as foreseen in the legislative proposals.

We support the following amendments to the DIRECTIVE: 35, 36, 161, 162, 167; REGULATION: 718

We oppose the following amendments: REGULATION: 653; DIRECTIVE: 138, 139, 163, 164.

7. ESMA VS. EGAOB

The Commission proposal grants powers to ESMA in the field of audit supervision. Companies believe that it would be more appropriate to confer them to EGAOB, considering the broad scope of statutory audits (beyond listed companies and other public interest entities) and the coordination role in this field already played by EGAOB. ESMA should not be given powers to describe corporate responsibilities in this field.

We support the following amendments: REGULATION: 232, 233, 235, 236, 239; DIRECTIVE: 75, 77, 87 and 88.

[2] Please note that our UK representative association, the Quoted Companies Alliance, does not support the position on International Standards of Auditing presented here.

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We oppose amendment 234 the REGULATION.

8. PUBLIC OVERSIGHT

Companies believe that the involvement of practitioners in the governance of the public oversight system is a necessity and provides added value. It should therefore not be excluded.

We support the following amendments: REGULATION: 176; DIRECTIVE: 3, 20, 125.

We strongly oppose amendment 136 to the DIRECTIVE.

9. SMALLER ISSUERS

We believe there should be amendment to the Regulation ensuring that the legislation follows "Think Small First" principle, whereby **EU small and mid-cap quoted companies** (which we define as those under €1 billion market capitalisation) **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 small and mid-cap quoted companies are still exempt from some requirements of the US Sarbanes-Oxley Act and that the EESC opinion on the Audit Directive and Regulation proposals recommends a total exemption for smaller companies, which would be our preferred option.

Most importantly, small and mid-cap quoted companies do not pose a systemic risk and additional compliance burdens with regard to audit could be a brake on growth and European economic recovery.

***EuropeanIssuers** was set up to represent the interests of quoted companies across Europe. Our members include both national associations and companies from all sectors in 14 European countries.*

We aim to ensure that EU policy creates an environment in which companies can raise capital through the public markets and can deliver growth over the longer-term. We seek capital markets that serve the interests of their end users, including issuers.

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