Statutory audits of annual accounts and consolidated accounts

2011/0389(COD) - 30/11/2011 - Legislative proposal

PURPOSE: to enhance the internal market for statutory audits to allow small and medium-sized firms to grow and encourage the entry of new players.

PROPOSED ACT: Directive of the European Parliament and of the Council.

BACKGROUD: in a crisis where EUR 4 588.9 billion of taxpayer money was committed to support banks between October 2008 and October 2009 and where such aid accounted for 39% of EU 27 GDP in 2009, all components of the financial system need to be improved. **Robust audit is key to re-establishing trust and market confidence**. It contributes to investor protection by providing easily accessible, cost-effective and trustworthy information about the financial statements of companies. It also potentially reduces the cost of capital for audited companies by ensuring more transparency and reliability of financial statements.

It is also important to stress that auditors are entrusted by law to conduct statutory audits.

EU rules have partially regulated statutory audit through Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts. However, the high degree of concentration in audit market and the multitude of approval procedures necessary to provide cross-border statutory audits prevent small and medium-sized audit firms from benefiting from the internal market.

The following problems are examined:

§ a high level of administrative burden resulting from **fragmented national regulation**;

§ the **provision of cross-border statutory audits** is allowed only if an auditor passes an aptitude test and gets approved and registered in every Member State;

§ a lack of **common standards** across the EU on audit practice, independence, internal control of audit firms;

§ auditing standards do not take into account the size of the audited companies, in particular of SMEs;

§ associated problems regarding **supervision** of non-PIEs.

This proposal on amending Directive 2006/43/EC aims to improve the internal market on statutory audits. It will coexist with a proposal for a regulation on the specific requirements on the statutory audit of public-interest entities. The two proposals are part of the ongoing regulatory reform in various domains of the financial sector.

IMPACT ASSESSMENT : the impact assessment concluded that the best options to improve the existing situation would be:

§ facilitation of the cross-border recognition of audit providers' competence;

- § streamlining of the standards on audit practice, independence and internal control of audit firms across the Union;

- § adaptation of audit standards to the size of the audited entity by requesting Member States to ensure that a proportionate and simplified audit for SMEs is possible.

LEGAL BASIS: Article 50 TFEU.

CONTENT: the proposal contains amendments to the provisions on the approval and registration of auditors and audit firms, on the existing principles in Directive 2006/43/EC regarding professional ethics, professional secrecy, independence and reporting as well as the associated supervision rules that remain applicable for the audit of non-public-interest entities (non- PIEs).

The main modifications to the Directive are:

Articulation between the Directive and an additional legal instrument on specific requirements for the statutory audit of PIEs: the proposal deals with the applicability of the amended Directive to the statutory audit of PIEs. Certain provisions apply to statutory auditors and audit firms, irrespective of the type of audited entity. However, for the rest of the Articles of the Directive, the situation is different: clauses on independence and objectivity, audit fees, audit reporting, quality assurance, investigations and penalties would not apply to the statutory audit of PIEs. On these specific issues more detailed rules would be enacted in the Regulation.

Definition of "statutory audit" in order to take account of the new Accountancy Directive: the new definition will continue to cover the instances where different Union legal texts impose an obligation on some undertakings to have their financial statements audited, depending on their legal form or on their activity. In order to guarantee the “unicity” of audit, the definition of "statutory audit" should also cover situations where Member States decide to impose an obligation on small undertakings to have their financial statements audited. Lastly, where a small undertaking decides voluntarily to have its financial statements audited, such audit should also be considered a statutory audit.

Modification of the ownership rules: currently, the Directive requires that a majority of the voting rights in an audit firm is held by licensed accountant practitioners. This requirement is no longer stipulated in the proposed amendment and Member States are forbidden to require that a minimum of capital or of voting rights in an audit firm is held by statutory auditors or audit firms. However, the proposal maintains the existing requirement that a majority of the members of the administrative or management body of the audit firm are audit firms or statutory auditors.

Passport for audit firms: the proposal for an amended Directive would allow audit firms to provide statutory audits in Member States other than the Member State in which they have been approved, provided that the key audit partner leading the audit is approved as an auditor in the Member State concerned. However, once approval is obtained in the home Member State, the host Member State may require some form of registration of audit firms from other Member States.

Passport for statutory auditors and "softening" the conditions for a statutory auditor to be approved in a different Member State: the proposed modifications regarding the approval of statutory auditors from other Member States are aligned with the provisions of the Directive 2005/36 on the recognition of professional qualifications.

- § The proposal would allow statutory auditors to provide cross-border statutory audit services on a temporary or occasional basis. The conditions set out in the Professional Qualifications Directive would apply, notably the obligation to communicate the intention to provide the services in question to the relevant competent authority.

- § A Member State will be able to offer the statutory auditor who is approved in another Member State the choice between an adaptation period and an aptitude test, if such auditor wants to set up a permanent establishment in that Member State. The test should be aimed at assessing the statutory auditor's knowledge of the laws and regulations of that Member State that are relevant for the carrying out of the statutory audit.

- § During the adaptation period, which should be offered to the applicant as an alternative to the aptitude test, the statutory auditor would be allowed to conduct statutory audit in the Member State, other than the one in which he or she is approved, under the supervision of a local auditor. The length of the adaptation period is three years.

Requirements to competent authorities to cooperate regarding educational requirements and aptitude test: in order to ensure more convergence of the educational qualifications of auditors at Union level, the competent national authorities in charge of the public oversight for statutory auditors must cooperate. Cooperation at Union level is also necessary to harmonise the requirements of the aptitude test.

Auditing standards and audit reporting: the proposal requires Member States to ensure that statutory auditors and audit firms carry out audits in accordance with the international auditing standards.

New rules regarding competent authorities: currently, the Directive requires Member States to organise a system of public oversight for statutory auditors and audit firms. The new amendment states that the competent authority responsible for public oversight will be a public authority that will be also responsible for approval, registration and quality assurance.

The competent authority responsible for the public oversight may delegate some of its tasks to other authorities or bodies with regard to the approval and registration of the statutory auditors and audit firms. Such delegation must be subject to several conditions and the body that bears the ultimate responsibility is the competent authority. Prohibition of contractual clauses: the proposal prohibits clauses according to which a third party suggests, recommends or requires the audited entity to appoint a specific statutory auditor or audit firm.

Special rules for the statutory audit of small and medium-sized undertakings: following the recent Commission proposal, small undertakings would no longer be required by EU law to have their financial statements audited, although Member States may still require it. However, the requirement will continue to apply to medium-sized undertakings.

When medium-sized undertakings are audited pursuant to EU law, the amended Directive requires Member States to ensure that the way in which the auditing standards are applied are adapted to the dimension and scale of those undertakings.

BUDGETARY IMPLICATIONS: the proposal has no impact on the European Union budget.

DELEGATED ACTS: the proposal contains provisions empowering the Commission to adopt delegated acts in accordance with Article 290 of the Treaty on the Functioning of the EU.