

Statutory audits of annual accounts and consolidated accounts

2011/0389(COD) - 03/04/2014 - Text adopted by Parliament, 1st reading/single reading

The European Parliament adopted by 339 votes to 256, with 27 abstentions, a legislative resolution 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.

Parliament adopted its position at first reading following the ordinary legislative procedure. The amendments adopted in plenary are the result of an agreement negotiated between the European Parliament and the Council. They amend the proposal as follows:

Recognition of audit firms: an audit firm that wishes to carry out statutory audits in a Member State other than its home Member State should register with the competent authority in the host Member State. The competent authority in the host Member State **should register the audit firm if it is satisfied that the audit firm is registered with the competent authority in the home Member State.**

Where the approval is withdrawn for any reason, the competent authority of the home Member State where the approval is withdrawn should communicate that fact and the **reasons for the withdrawal** to the relevant competent authorities of host Member States where the statutory auditor or the audit firm is also registered.

Approval of statutory auditors already approved in other Member States: those procedures should not go beyond the requirement to complete an **adaptation period** or to pass an **aptitude test**. The host Member State should decide whether the applicant seeking approval is to be subject to an adaptation period or an aptitude test.

Statutory auditors who have been approved should be entered in a **public register**.

Continuing education: according to the amended text, statutory auditors are required to take part in appropriate programmes of continuing education in order to maintain their theoretical knowledge, professional skills and values at a sufficiently high level, and failure to respect the continuing education requirements is subject to appropriate sanctions.

Ethics and “professional scepticism”: audit firms should maintain professional scepticism – a questioning mind – throughout an audit. Auditors should recognise the **possibility of a material misstatement due to facts or behaviour indicating irregularities, including fraud or error**, notwithstanding past experience of the honesty and integrity of the audited entity's management.

The statutory auditor or the audit firm should maintain professional scepticism in particular when reviewing management estimates relating to fair values, the impairment of assets, provisions, and future cash flow relevant to the entity's ability to continue as a going concern.

Independence and objectivity: Parliament and the Council sought to strengthen the independence of audit firms, a key element when carrying out statutory audits.

Statutory auditors and audit firms should be independent when carrying out statutory audits of audited entities, and **conflicts of interest should be avoided**. In order for the independence of statutory auditors and audit firms to be determined, the concept of a network in which statutory auditors and audit firms

operate has to be taken into account. An amendment stipulates that firms should not solicit or accept pecuniary and non-pecuniary gifts or favours from the audited entity unless an objective, reasonable and informed third party would consider the value thereof as trivial or inconsequential.

The independence of the auditor with respect to the audited entity should at least be fulfilled during the period covered by the audit report, including both the period covered by the financial statements to be audited and the period during which the statutory audit is carried out.

Audit firms and their employees should refrain from carrying out the statutory audit of an entity **if they have a business interest or financial interest** in it, and from trading in financial instruments issued, guaranteed or otherwise supported by an audited entity. They should abstain from participating in the **internal decision-making processes** of the audited entity and should be prevented from taking up duties in the audited entity at managerial or board level until at least **two years** have elapsed since the end of the audit engagement.

Confidentiality and professional secrecy: Parliament considered that audit firms should be bound by **strict rules** on confidentiality and professional secrecy. However, these rules should not impede the proper enforcement of the regulation nor the cooperation with the group auditor during the performance of the audit of consolidated financial statements when the parent undertaking is in a third country

Internal organisation of audit firms: adequate internal organisation of statutory auditors and audit firms should help to prevent any threats to their independence. The following organisational requirements have been laid down:

- appropriate policies and procedures to ensure that its **owners or shareholders**, as well as the members of the management of the firm, or of an affiliate firm, do not intervene in the carrying-out of a statutory audit in any way which jeopardises the independence and objectivity of the statutory auditor who is carrying out the statutory audit on behalf of the audit firm;
- an audit firm should have **sound administrative and accounting procedures**, internal quality control mechanisms, effective procedures for risk assessment, and effective control and safeguard arrangements for information processing systems;
- employees and any other persons who are directly involved in the statutory audit activities, have **appropriate knowledge and experience** for the duties assigned;
- **outsourcing** of important audit functions should not be undertaken in such a way as to impair the quality of the statutory auditor's or the audit firm's internal quality control;
- an audit firm should use appropriate systems, resources and procedures to ensure **continuity and regularity** in the carrying out of its statutory audit activities;
- adequate **remuneration policies**, including profit-sharing policies, are in place to provide sufficient performance incentives to secure audit quality.

These policies and procedures should be documented and communicated to the employees of the statutory auditor or the audit firm and should be proportionate in view of the scale and complexity of the activity of each statutory auditor or audit firm.

Organisation of work: the amended text provides that when the statutory audit is performed by an audit firm, this firm must **designate at least one key audit partner**. Securing audit quality, independence and competence should be the main criteria when the audit firm selects the key audit partner(s) to be designated.

Moreover, the audit firm should (i) keep records of any breaches of the provisions of this Directive; (ii) maintain a client account record; (iii) create an audit file for each statutory audit; and (iv) keep records of any complaints made in writing about the performance of the statutory audits carried out.

The audit file should be **closed no later than 60 days** after the date of signature of the audit report.

Auditing standards: it is stipulated that statutory audits should be carried out in compliance with **international auditing standards adopted by the European Commission**. The Member States may apply national auditing standards, procedures or requirements as long as the Commission has not adopted an international auditing standard covering the same subject-matter.

Statutory audits of consolidated financial statements: in the case of consolidated financial statements, there should be a clear definition of the responsibilities of statutory auditors who audit different entities within the group concerned. For this purpose, the **group auditor** should bear full responsibility for the audit report.

Audit reporting: the audit firm should present the results of the statutory audit in an audit report prepared in accordance with the requirements of auditing standards adopted by the Union. The amendments stipulate the necessary contents of the report. The audit report should be signed and dated by the statutory auditor. In the case of disagreement among the audit firms, each audit firm should submit its opinion in a separate paragraph of the audit report and state the reason for the disagreement.

Sanctions: Parliament and the Council agreed to **enhance the powers** of the competent authorities to enable them to adopt supervisory measures and impose sanctions. The measures taken and the sanctions imposed on auditors are to be disclosed to the **public**. The disclosure of sanctions should however respect the legislation on personal data protection.

Furthermore, the amended text provides for the setting in place of effective mechanisms to **encourage the reporting of breaches** to the directive.

Audit committee: each public-interest entity should have an audit committee. The audit committee should be either a stand-alone committee or a committee of the administrative body or supervisory body of the audited entity. Parliament proposed **enhancing the audit committee's independence and technical competence** by requiring that the majority of its members should be independent and that at least one of its members should have competence in auditing and another in accounting and/or auditing.