

Company law: statutory audit of annual and consolidated accounts (amend. Directives 78/660/EEC and 83/349/EEC, repeal. Directive 84/253/EEC)

2004/0065(COD) - 28/09/2005 - Text adopted by Parliament, 1st reading/single reading

The European Parliament adopted the resolution drafted by Bert **DOORN** (EPP-ED, NL) making several amendments to the Commission's proposal. (Please see the summary of 21/06/2005.) The principal points are as follows:

- Commission proposals for all publicly-listed companies to have a separate audit committee to supervise financial reporting procedures were deleted. The amendments give Member States the possibility to determine themselves the way in which firms are to supervise their internal auditing reporting. The Member States could allow a number of exemptions from the obligation to have an audit committee and would also be given discretion to maintain national bodies similar to an audit committee;

- the Directive aims at high level -though not full - harmonisation of statutory audit requirements. The Member State requiring the statutory audit can impose more stringent requirements, unless otherwise indicated in the text of the Directive.

- Parliament has expanded on the matter of an auditor's independence: examples of threats to the independence of a statutory auditor or audit firm are a direct or indirect financial interest in the audited entity and the provision of additional non-audit services. Also, the level of fees received from one audited entity and/or the structure of the fees can threaten the independence of a statutory auditor or audit firm. Types of safeguards to be applied to mitigate or eliminate these threats include prohibitions, restrictions, other policies and procedures and disclosure. Statutory auditors and audit firms should refuse to undertake any additional non-audit service that compromises their independence. The Commission may, as minimum standards, adopt implementing measures on independence. In order to determine the independence of auditors, the concept of a "network" in which auditors operate needs to be clear. In this regard, various circumstances have to be taken into account such as instances where a structure could be defined as a network because it is aimed at profit or cost sharing. The criteria for demonstrating that there is a network should be judged and weighed on the basis of all factual circumstances available, such as whether there are common usual clients;

- Parliament has amended many of the definitions in the text and inserted new ones, such as "Non-practitioner" and "Key audit partner(s)";

- amendments were also made to the obligation for a public interest company to change auditors every five years and audit firm every seven. The legislation now requires rotation every seven years, only for key audit partner/statutory auditor, and not for the audit firms themselves. Member States must ensure that the key audit partner(s) responsible for carrying out the statutory audit shall rotate from the audit engagement within a maximum period of seven years after the date of appointment and shall be allowed to participate in the audit of the audited entity again after a minimum period of two years.

- In cases of self review or self interest, where appropriate to safeguard the statutory auditor's or audit firm's independence, it should be for the Member State rather than the statutory auditor or the audit firm to decide whether the statutory auditor or audit firm should resign or abstain from an audit engagement with

regard to its audit clients. However, this should not lead to a situation where Member States have a general duty to prevent statutory auditors or audit firms from providing non-audit services to their audit clients. For the purposes of determining whether it is appropriate, in cases of self interest or self review, that a statutory auditor or audit firm should not carry out statutory audits, so as to safeguard the statutory auditor's or audit firm's independence, the factors to be taken into account should include the question whether or not the audited public interest entity has issued transferable securities admitted to trading on a regulated market.

-with regard to public oversight, the system of public oversight must be governed by non-practitioners who are knowledgeable in the areas relevant to statutory audit. Member States may however allow a minority of practitioners to be involved in the governance of the public oversight system. These non-practitioners may be specialists who have never been linked with the audit profession or former practitioners who have left the profession.

-on the issue of auditors' liability, the Commission shall before the end of 2006 present a report on the impact of the current national liability rules for carrying out statutory audits on the European capital markets and on the insurance conditions for statutory auditors and audit firms, including an objective analysis of the limitations of financial liability.

-with regard to the adoption of technical implementing rules by committee procedure, upon expiry of a two-year period following the adoption of the Directive and on 1 April 2008 at the latest, the application of its provisions requiring the adoption of technical rules, amendments and decisions shall be suspended. Acting on a proposal from the Commission, the European Parliament and the Council may renew the provisions concerned in accordance with the codecision procedure and to that end they must review them prior to the expiry of the period above.

Lastly, the date of transposition has been put back to 24 months of entry into force of the Directive, rather than 1 January 2006.