

**Report on the proposals relating to the reform
of the statutory audit in Europe**

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3 July 2012

On 30 November 2011, the European Commission published a proposal for a directive and a regulation concerning statutory audits¹. The proposals constitute an extension of the green paper published in October 2010 on audit policy and the lessons to be drawn from the crisis.

After replying to the initial consultation, in December 2010, the *Haut Conseil du Commissariat aux comptes* (H3C), in its capacity as the French public authority charged with the supervision of the audit profession, set out to bring together the various French stakeholders in order to gather their views regarding these proposals, before presenting its opinion and its recommendations as to the reforms proposed.

The results of the work performed by the stakeholder group are attached to the current report. The H3C would like to thank the representatives of the institutions that contributed to the work performed in this regard.

¹ *Proposal for a Directive amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts COM (2011)778 and Proposal for a Regulation on statutory audits of annual accounts and consolidated accounts of public-interest entities COM(2011)779*

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Introduction

The European Commission's initiative is aimed at strengthening and harmonising statutory audits at a European level. The H3C welcomes this initiative.

The H3C has identified a number of issues within the proposals that contribute to enhancing the quality and reliability of audits. We feel, however, that the scope of these provisions should be widened in order to cover statutory audits of entities that, even though they are neither financial institutions nor listed companies, nevertheless contribute to key sectors of the European economy. The implementation of specific regulations for certain entities and the firms that audit them should not hinder the process of harmonisation and reinforcement of the measures regarding audits in general.

The proposal includes a wide range of measures, each of which meets one of the proposed reform's objectives. However, the combination of all the measures, stemming from the regulation on the one hand and the directive on the other hand, could lead to application difficulties for certain categories of entities and their auditors which could, in turn, have the opposite effect of that intended. Accordingly, the H3C would like to underscore the necessity of assessing the measures not only individually, but also as a whole, in order to ensure that the objectives relating to audit quality are attained.

1 - Adoption of specific requirements regarding the statutory audit of public-interest entities

The H3C supports the use of a European regulation in order to harmonise the statutory audits of public-interest entities ("PIEs") in the European Union.

Nevertheless, we would like to draw the legislator's attention to the advantages of also strengthening and harmonising the statutory audit of entities not defined as "PIEs" and in particular the subsidiaries of "PIE" entities. The reliability of the financial statements of SMEs or those entities operating in sectors which contribute to the greater good of the general public, are as well worthy of particular attention. We would also like to highlight the fact that the notion of "general interest" (intérêt général) is not necessarily synonymous with the notion of "public interest"².

We are also in favour of the proposal to include within the scope of the revised directive those audit engagements concerning entities that are not required by law to appoint a statutory auditor³.

2 - Statutory auditors' reports – Regulation articles 21 to 23

Audit report

The H3C supports the proposals aimed at improving the harmonisation of audit reports. We would like to see this harmonisation extended to a global level.

The H3C is in favour of an audit report that contains more information, to the extent that such information is useful, relevant and fully understood by the users of the financial statements. In this respect, we consider information concerning the *key areas of risk of material misstatement*⁴ identified

² Proposed directive, article 2.13

³ Proposed directive, article 2.1 (c)

⁴ Proposed regulation, article 22.2 (k)

by the statutory auditors and the description of the *methodology*⁵ that they used to reach their conclusions relevant elements.

On the other hand, we have certain reservations as to the principle of describing, in the audit report, the *level of materiality applied*⁶, as that information, albeit important for the regulators, could be misinterpreted by the users of the financial statements. Indeed, the materiality threshold adopted by the statutory auditor to evaluate the impact of accounting errors on the reliability of the financial statements is likely to vary depending on the nature of the elements making up the accounts concerned. Furthermore, we also express reservations on the inclusion, in the audit report, of *the identity of each member of the team*⁷. This information could more usefully be set out in a specific document concerning independence for example, rather than in the audit report.

The H3C is in favour of the statutory auditor's role of alerting the relevant authorities should he identify circumstances that jeopardise an entity's capacity to continue as a going concern. Nevertheless, we consider it difficult for the statutory auditor to express an opinion as to the entity's situation and assess its ability to meet its obligations in the foreseeable future⁸, in the absence of detailed criteria against which to perform such analysis. Accordingly, we believe that an statement (attestation) covering specific ratios regarding the entity's financial situation, and based on historic data, would enable the statutory auditor to confirm information provided by the entity, which could be more objective than an assessment of the entity's ability to meet its obligations in the foreseeable future.

Concerning the inclusion in the statutory audit report of information regarding the evaluation of the *entity's internal control system*⁹, the H3C advises against widening the scope of the statutory auditor's obligations beyond the internal control elements relating to the financial information. We suggest moreover that the statutory auditor be entrusted with the task of corroborating the declarations made by the entity. Serving as a source of information regarding the internal controls of the entity audited would indeed fundamentally change the nature of the statutory auditor's engagement and accordingly his role regarding third parties.

Finally, with a view to maintaining the comparability of reports issued following the statutory audits of "PIE" and "non PIE" entities, we recommend providing for a common framework to drawing up the audit report¹⁰ providing for a core structure completed, where applicable, by paragraphs describing the additional duties required of the statutory auditors of "PIE" entities.

Additional report for the audit committee

The H3C is questioning the audit committee's role within the framework of the audit reform. We recommend clarifying, from a legal perspective, the nature of the relations between the statutory auditor and the audit committee.

Furthermore, we believe that the audit report should contain public information, whereas the additional report should be seen as a means of formalizing, with a view to improving, the dialogue between the entity's governance structures and the statutory auditors. Nevertheless, it would appear useful for the communications between auditors and the governance structures to cover information that is not of a public nature. Accordingly, providing for the possibility of making the second report available to the general public could lead the statutory auditors limiting its contents. Accordingly, the H3C recommends

5 Proposed regulation, article 22.2 (h)

6 Proposed regulation, article 22.2 (j)

7 Proposed regulation, article 22.2 (q)

8 Proposed regulation, article 22.2 (l)

9 Proposed regulation, article 22.2 (m)

10 Proposed directive, article 26

that the statutory auditors' second report as provided for by the regulation¹¹ should not be disclosed to the general meeting¹².

3 - Statutory auditors' communication with the supervisory authorities

The H3C is in favour of the proposals that improve communication between the statutory auditor and the oversight authorities. We believe it necessary for the statutory auditor to report to the authorities, within an appropriate timeframe, facts or circumstances brought to his attention during the audit, in particular those that may impact the ability of the entity to continue as a going concern¹³.

It would be advisable for such communication to be broadened to cover the situations of the subsidiaries or "having close links" with the entity being audited¹⁴, when the elements have been brought to the auditor's knowledge in the course of a statutory audit engagement carried out within a group including a consolidated public-interest entity.

Finally, we feel the nature of the oversight authorities' expected role within the framework of the information disclosed concerning *incidents which have, or may have, serious consequences for the integrity of the statutory audit activities*¹⁵ merits further discussion.

4 - Rules for the statutory audit of SMEs, proportionality - Directive articles 43 (a) and 43 (b)

The H3C supports maintaining a statutory audit with the same level of requirements, regardless of the size of the entity audited and an adaptation of the work performed in accordance with the profile of the entity audited. Accordingly, the auditing standards define requirements that take the entities' size and complexity into account.

In this respect we suggest that it would be useful to give further details as to the provisions set out in the proposed directive regarding the application of the principle of proportionality to the statutory audit of the financial statements of small and medium-sized entities¹⁶, in order to avoid a potential divergence of interpretations upon adapting the audit standards.

We are in favour of the adoption of a common text or a "good practice" summarizing the modalities governing implementation of the statutory audit requirements for smaller, less complex entities, with a view to guiding the statutory auditor in these situations. We would like such adoption, after consultation with the professional organizations, to come into effect at a European level rather than a national level¹⁷, in order to ensure harmonisation within the European Union.

If a Member State decides to replace the statutory audit of accounts for SMEs with a "limited review", we support the fact that standards other than those governing the statutory audit should be implemented for such "limited review"¹⁸. It is essential to avoid creating confusion as to what is a statutory audit. Any engagement involving fewer obligations than those included in an audit should not be erroneously construed as constituting a "statutory audit".

¹¹ Proposed regulation, article 22

¹² Proposed regulation, article 23 §1 par. 4

¹³ Proposed regulation, article 25.1 par. 1 and 2

¹⁴ Proposed regulation, article 25.1

¹⁵ Proposed regulation, article 17

¹⁶ Proposed directive, chapter Xa, articles 43bis (a) and 43ter (b)

¹⁷ Proposed directive, article 43bis (a) par.3

¹⁸ Proposed directive, article 43ter (b) par.2

5 – Auditing standards - Directive article 26 - Regulation article 20

The H3C is in favour of seeing the provisions of the clarified international standards on auditing (ISAs), as adopted in 2009, constitute the common requirements as regards the statutory audit of financial statements. We support the possibility of adding to the ISA standards additional requirements stemming from national or European law. In this respect, the proposed directive, which provides for the possibility of imposing audit procedures or requirements stemming from national legal requirements in addition to the ISA standards¹⁹, as well as the provisions of the proposed regulation that do not hamper any such further national or European requirements in addition to the applicable standards²⁰, seem satisfactory to us.

Furthermore, we believe it is essential to maintain an endorsement mechanism in the European Union for the standards before they become applicable: the Member States must be able to approve the changes made to the framework by the standard setter, before any such changes come into effect at a European level. To this end, a suitable mechanism must be implemented as regards the process of updating the standards, and for which the draft directive proposes a delegation to the European Commission²¹.

The list of the texts which would become applicable, beyond ISA standards, and in particular the "*related Statement and Standards*"²² could be included in the directive to facilitate an understanding of all the rules applicable to the statutory audit.

We would furthermore like to highlight that an access to the content of the applicable standards should be granted to all European citizens wishing to consult the professional rules applicable to statutory audit.

6 – Regulation of services other than audits - Regulation article 10

The H3C supports the measures regulating non audit services.

We note that lists have been compiled, defining those services that are prohibited, authorized, or authorized under certain conditions. However, we would like to draw attention to the fact that statutory auditors are required to carry out certain duties which go beyond the audit of annual or consolidated financial statements, as a result of requirements included in national or European law. These duties should be considered as authorized related services, as for other statutory duties imposed by the European Union legislation²³.

Furthermore, limiting the amount of fees chargeable for such related services to 10% of the fees payable for the statutory audit could be tantamount to preventing execution of some of the duties, even though they are required by law. Accordingly, to avoid such situations, we recommend that any limitation on the volume of fees²⁴ should be directed at non-mandatory services carried out by the statutory auditor at the entity's request.

¹⁹ Proposed directive, article 26.1 par.2

²⁰ Proposed regulation, article 20

²¹ Proposed directive, article 26.2 and 3

²² Proposed directive, article 26.2

²³ Proposed regulation, article 10.2(f)

²⁴ Proposed regulation, article 9.2

The H3C does not support the proposal that several otherwise prohibited services may be provided, subject to prior approval by the audit committee or the regulator²⁵. This proposal could lead to divergence in practice as to the services authorized, depending on the particular audit committees or regulators concerned. Furthermore, such an approval process could prove incompatible with the time constraints inherent in certain operations.

The H3C recommends broadening the scope of the prohibition placed on services relating to the design and implementation of information systems, irrespective of the entity concerned²⁶ and also prohibiting the provision of recruitment services of personnel on behalf of the entity by the statutory auditor²⁷.

Furthermore, we would like to see the provisions on non audit-services broadened to cover all statutory auditors.

7 - Limitation on the share of fees received from an entity - Regulation article 9.3

The H3C supports the principle of limiting the risk of financial dependence of audit firms vis-à-vis the audited entities and the entities they control. Accordingly, we approve of the proposed measure capping the share of the fees likely to be received from a given entity and its subsidiaries to 20% of the total amount of fees received per year, and to 15% over a two-year period, as a suitable harmonization measure²⁸.

Moreover, we would like to underscore the advantage of exemption measures that enable an audit firm, once the competent authority has expressed its approval, to continue the audit in spite of the fact that the audit firm has exceeded the thresholds²⁹. It is necessary to enable audit firms, including the smallest ones, to take on statutory audit engagements concerning increasingly large entities.

We are not convinced that it is appropriate to mandate the audit committee, as opposed to the statutory auditor, with the task of deciding whether or not the audit engagement shall be subject to a quality control review by another auditor, if the firm mandated with the statutory audit exceeds the financial dependence thresholds set³⁰. We recommend specifying the criteria that would trigger any such quality control review, in order to ensure a homogeneous application of such requirement.

8 - Composition and role of the audit committee - Regulation articles 24 and 31

The H3C would like to highlight the potential incompatibilities of the measures that define the role and composition of the audit committee³¹ with other measures set out in company law, at national and European levels. We feel that the reform of the audit committee should be addressed within the context of an overall review concerning company law, as opposed to a review limited to statutory audits.

25 Proposed regulation, article 10.3(b)

26 Proposed regulation, article 10.3(b)(iii)

27 Proposed regulation, article 10.3(b)(i)

28 Proposed regulation, article 9.2

29 Proposed regulation, article 9.3 par. 2

30 Proposed regulation, article 9.3 al 1

31 Proposed regulation articles 24 and 31

9 - Designation of the statutory auditors - Directive article 37 - Regulation article 32

The H3C is in favour of prohibiting any contractual clauses restricting the choice, for the appointment of the auditor, to certain audit firms.³²

We believe that it would be appropriate to organise appointment procedures that are open to even the smallest firms, provided that such a process is not merely formal, but rather encourages the taking into account of the quality of the audit. The proposed measures for defining the appointment process³³ do not, in our opinion, provide sufficient guarantees in this respect. Accordingly, we would suggest further developing the proposal in this regard.

The H3C is concerned about the smallest players' ability to obtain selection through a call to tender put out by "PIE" entities. We are concerned about their ability to mobilise the resources dedicated to preparation of their bids, as compared to larger firms that have specialized teams dedicated to carrying out such tendering tasks.

The proposed selection process would be more appropriate in the context of mandatory joint audits, thus enabling at least two firms to be appointed to perform the statutory audit. Furthermore, in case of joint audit, the mandatory selection process might be less frequent.

10 – Professional independence and scepticism - Regulation articles 5 –7 to 11 –15

The H3C supports the proposals for strengthening and harmonising the requirements covering independence, as set out in the proposed regulation.

We find particularly useful the provisions regarding the importance of professional scepticism³⁴.

Furthermore, we believe it would be helpful to define comparable requirements regardless of the engagement and the type of firms carrying out the audit. Accordingly, we recommend reproducing, within the directive, the requirements aimed at improving the independence and professional scepticism of statutory auditors as set out in the regulation, in order to make them applicable to all audit firms within the European Union.

11 – Pure audit / multidisciplinary firms - Regulation article 10.5

The H3C considers that it is not desirable for certain audit firms and their networks to be subjected to a prohibition from providing any services other than audits to those entities for which they do not carry out the statutory audit³⁵. We believe it necessary to be able to develop multidisciplinary and multiple competencies among statutory auditors and their teams when providing consulting services for entities, to the extent that the latter are not linked in any way with those for which the audit firm's network is the statutory auditor.

³² Proposed directive, article 37.3

³³ Proposed regulation, article 33

³⁴ Proposed regulation, article 15

³⁵ Proposed regulation, article 10.5

12 – Opening up capital in audit firms - Directive article 3

The H3C is opposed to any deregulation of the firms' capital structure, likely to lead to conflicts of interests that could affect the statutory auditor's independence. Doing away with the rules governing the minimum voting rights held by registered auditors³⁶ and increasing flexibility of the rules governing representation of registered auditors in the administrative or management body³⁷ is not desirable. The proposals imposing a majority of registered auditors in the firms' administrative or management body seem insufficient to counterbalance the pressure likely to be brought to bear by investors from outside the profession, who are not governed by comparable rules of ethics and independence.

13 - Transparency of audit firms - Regulation articles 26 - 27 - 28 - 29

The H3C supports the proposals leading to enhanced transparency of audit firms, and to the production of the reports described under the proposed regulation³⁸.

We would like to highlight the advantages of providing information, in the list of the "PIE" entities audited, concerning the fees charged to all the entities included in the scope of the consolidated financial statements³⁹.

14 - Rotation between audit firms - Regulation article 33

The mandatory rotation of audit firms limits on the possibilities of choices for entities, which cannot entrust their audits to a given firm for more than a certain period of time. For their part, periodic calls for tender, as well as information provided by the firms regarding the total continuous duration of their statutory audit mandate, are measures that, while not imposing changes, encourage entities and auditors to regularly review the relevance of continuing their relationship.

The H3C considers that the risk of familiarity between auditors and the audited entities can be reduced by requiring an effective rotation of the signing partners. This measure can be reinforced by having recourse to joint audit, by requiring a minimum engagement period spanning several years and by imposing a maximum period during which statutory auditors can exercise their role continuously. Regardless of the situation, a rotation of audit firms would only appear necessary in the event of an uninterrupted statutory audit engagement exceeding 12 years.

Concomitantly, a minimum engagement period should be required, on a longer period than the two-year⁴⁰ minimum currently proposed. As an example, the legal duration of the audit engagement period is currently six years in France.

Furthermore, the rotation of signing partners should be calculated over periods that are compatible with those regarding the rotation of audit firms. In the same way, the cooling-off period required for the signing partners⁴¹ should correspond to that set for the audit firms and their networks⁴².

³⁶ Directive 2006/43/CE article 3.4 (b), deleted from the proposed revised directive

³⁷ Proposed directive, article 3.4 (c)

³⁸ Proposed regulation articles 26, 27 and 28

³⁹ Proposed regulation, articles 27.2 (f) and 29

⁴⁰ Proposed regulation, article 33.1

⁴¹ Proposed regulation, article 33.4

⁴² Proposed regulation, article 33.2

This being said, we are convinced that the rotation of audit firms should not be required over the same periods when joint audit is being implemented. Joint auditing increases an objective and shared view of the audited entity's situation between the auditors and accordingly limits any undue influence that the entity could have on its auditors. In this respect, it would be appropriate to extend the authorised uninterrupted statutory audit engagement period for an audit firm for a further six years, if at least two auditors are appointed.

15 – Joint audit - Regulation article 32-9

The proposed regulation states that the joint statutory auditing of the financial statements can be compulsory for "PIE" entities, should a Member State so choose, and under conditions set out by each State⁴³. The H3C recommends that joint audit be made mandatory. The conditions that apply to the relationship between the joint auditors enhance the quality of the audit. They provide for a collegial, concerted execution of the engagement, by sharing the audit work and organising a mutual review of each other's work that enables each auditor to form his own opinion on the financial statements.

At a minimum, we would suggest that incentive measures be included in the proposal in order to bring to the fore the positive effects of joint statutory auditing on audit quality and on the reliability of the opinion. Extending the duration of the engagement before applying a rotation of firms and reducing the frequency of the mandatory selection process, constitute provisions that would enable the advantages of joint statutory auditing to be taken into account at enhanced levels, while rendering joint audit all the more attractive to the entities applying it.

16 - Limitation of the delegation by the competent authorities - Directive articles 29 - 32 and 32bis (a) - Regulation article 36

The measures proposed in the directive and the regulation enable enhanced harmonisation with regards to the organization of the public supervision at a European level and hence facilitate cooperation between the authorities in charge of oversight in the Member States.

Nevertheless, in practical terms, and taking into account the very large number of audit firms subjected to inspections, we believe that it would be appropriate that some inspections of audit firms which do not audit "PIE" entities, could be implemented, under the supervision of the public authority, either by the national institution representing the profession, or by practitioners. We are thus not in favour of limiting the possibility granted to the supervisory authorities of delegating solely the aspects linked to the registration and approval of statutory auditors⁴⁴.

We would like to highlight the advantages stemming from the fact that auditors can take part in the oversight body's deliberations, with a view to providing their professional experience, while ensuring that they remain in the minority. We are thus not in favour of practitioners being denied involvement in the governance of the public oversight system⁴⁵.

The current organisation of the H3C provides for the appointment of three statutory auditors to the board which is composed of twelve members. The statutory auditors thus appointed can be in professional practice. Furthermore, the rules of procedure include provisions to avoid conflicts of

⁴³ Proposed regulation, article 32.9

⁴⁴ Proposed directive, modifying article 32bis (a)

⁴⁵ Proposed directive, modifying article 32.3

interest and the cases presented to the board are entirely anonymous, including those related to inspections of audit firms.

17 – Sharing and exchange of information - Regulation articles 13 - 37 - 48 - 49 - 51 - 55 to 59

The H3C is in favour of enhanced European harmonisation of the rules governing the sharing of information within the context of audit engagements, in order to facilitate exchanges between statutory auditors on the one hand, and between the public authorities on the other, as provided for in the proposal.

We feel that the measures concerning the disclosure of working papers between statutory auditors, when an entity prepares consolidated accounts⁴⁶, should apply to all statutory auditors, including those providing services to "non PIE" entities.

It would also be advisable to include measures authorising some exchange of information between statutory auditors when the audited entities outsource some of their financial services to entities that are independent from the audited entity from a legal perspective.

18 - Cooperation within ESMA - Regulation articles 45 - 46 - 50 - 53 - 54

The H3C supports increased cooperation between public authorities. Nevertheless, the organisation of the cooperation must take into account the fact that the statutory audit is a subject that requires particular expertise, which has been developed within the EGAOB⁴⁷ and, more recently, the EAIG⁴⁸.

Furthermore, the regulation of audit cannot be reduced solely to the audits of listed entities or the largest auditing firms. A wide range of other economic players, investors and job-creating entities are equally concerned. The field of competence for audit regulators is different from that of market regulators. Accordingly, we would not wish to see the scope of the European audit regulation being limited as a result of cooperation that lies within the attributions of the European authority entrusted with the securities market, the ESMA. We believe it would be more appropriate to ensure effective coordination between the authorities, by giving pride of place to the audit and to the audit regulators who have developed their expertise in the matter. The creation of a level III committee known as the Lamfalusy Committee and the organisation of its exchanges with the new European authorities would constitute a progress that would enable all the aspects linked to the statutory auditor to be dealt with in a single forum.

19 - European certificates of quality - Regulation article 50

The H3C is not entirely convinced of the merits of a "quality certificate" for those firms auditing "PIE" entities⁴⁹. We recommend linking the question of a firm's ability to audit certain entities to the results of the quality control audits performed on those firms. This would avoid having to create a specific framework for such certification. Taking into account professional experience to deliver the certificate should not lead to excluding all possibility for a statutory auditor of obtaining a certificate that would be

⁴⁶ Proposed regulation, article 13

⁴⁷ European Group of Audit Oversight Bodies

⁴⁸ European Audit Inspection Group

⁴⁹ Proposed regulation, article 50

required to obtain a further engagement. Furthermore, we underline that "public-interest entities" do not constitute a homogeneous category as to their requirements regarding competencies. Auditing an unlisted insurance company requires different competencies to those required for the audit of an entity that publishes financial statements prepared in accordance with IFRSs for example.

20 – Monitoring progress and emergency plans - Regulation article 42 and 43

The monitoring of the audit market and its consequences on financial stability can form part of the regulator's remit. However, the aspects linked to competition laws should be entrusted to an authority that is specialized in that field. We recommend setting out guidance for the audit firms to establish the emergency plans as presented in the proposals⁵⁰. In this context, joint audit could be highlighted as a means of ensuring enhanced continuity of audit engagements in the event of a failure of one of the joint auditors concerned.

21 - Individual inspection reports - Directive article 29 – Regulation article 44

The H3C is in favour of enhanced transparency as to the results of the inspections of audit firms, and making available the conclusions of every audit firm inspected, in a summarised format.⁵¹ Nevertheless, we are not sure of the extent to which the results should be made available to the interested parties, and whether the provision is tantamount to forwarding the results of such inspections to anyone who requests them.

With a view to the publication of reports on inspections covering "PIE" firms⁵², a common report format by the European regulators could be planned. The information published in this respect should not negatively impact the entities audited by the audit firms that were inspected.

22 - Sanctions - Regulation articles 61 to 66

The H3C supports the proposal for a system of sanctions as defined by the regulation. These measures will entail reorganization at the national levels in order to enable enhanced harmonisation of practices at a European level.

⁵⁰ Proposed regulation, article 43

⁵¹ Proposed directive, article 29.1 (l)

⁵² Proposed regulation, article 44 (d)

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CONSULTATION OF THE STAKEHOLDERS
OF STATUTORY AUDIT IN FRANCE
ON THE PROPOSAL FOR A EUROPEAN REFORM
ON STATUTORY AUDIT OF ACCOUNTS

JUNE 2012

Olivier Charpateau – Jean-François Casta

with the Secretariat General of the Haut Conseil du Commissariat aux Comptes

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INTRODUCTION

The following report summarises the discussions between stakeholders of the statutory audit profession during the consultative procedure organised by the Haut Conseil du Commissariat aux Comptes (H3C).

CONTEXT OF THE CONSULTATION

Statutory audits play a fundamental role in the economy. They ensure the quality of financial information and help limit the risk that historical financial information, prepared in accordance with a given accounting framework, may contain significant anomalies. Audits are therefore one of the cornerstones of financial stability.

In the European Union, statutory audits have been partially regulated since 1984, following the adoption of a directive (Directive 1984/253/EEC) harmonizing the procedures for the registration of auditors. In 2006, a new directive 2006/43/EC of the European Parliament and the Council on statutory audits of annual accounts and consolidated accounts was adopted, amending Council directives 78/660/EEC and 83/349/EEC and repealing Council directive 84/253/EEC.

The recent financial crisis has led the European Commission to review the organisation and supervision of the profession. The Commission initiated a debate on the role of the auditor and on the regulation of the audit market. This debate covered the governance and independence of audit companies, the supervision of auditors, the configuration of the audit market, the timeliness of creating a single market for audit services, the simplification of rules applicable to small and medium-sized enterprises (SMEs) and small and medium-sized audit firms, as well as international cooperation on the supervision of auditors. It was set in motion when the European Commission published the "Green Paper on audit policy" on 13 October 2010 at the initiative of Mr Michel Barnier, Commissioner in charge of the internal market and services. The Commission received almost 700 responses from a wide variety of stakeholders.

Following this consultation, many of the questions raised were brought to the attention of the Member States. At the same time, the European Parliament adopted an own-initiative report in which it fully approved the approach favoured by the Commission and requested the conduct of an impact assessment in order to express a definitive opinion.

The impact analysis carried out by the European Commission listed the various options that were likely to be selected and led to the publication of two texts on 30 November 2011:

- the proposed directive of the European Parliament and Council amending directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts;
- the proposed regulation of the European Parliament and Council on the specific requirements applicable to the statutory audit of public interest entities.

The first proposal aims to amend certain provisions of directive 2006/43/EC on the approval and registration of auditors and audit firms, professional ethics, professional secrecy, independence and information to be provided, as well as on rules of supervision applicable to the audit of all the entities that are subject to it. The second proposal defines the terms and conditions of the statutory audit of financial statements of public interest entities (PIEs).

PURPOSE OF THE CONSULTATION

The purpose of the consultation carried out by the Haut Conseil du Commissariat aux Comptes (H3C) is to obtain feedback from stakeholders of the statutory audit profession concerning the proposal for a European directive and regulation. Three levels of reactions were expected. First of all, determine the extent to which the measures in the proposal would change the practices of statutory auditors, from the viewpoint of the statutory auditor as well as from that of the audited entity or the users of audited information. Subsequently, to identify the extent to which the various stakeholders approve the measures presented in the proposal. Finally, where the stakeholders disagree with the proposals, present possible modifications to the texts allowing the problematic proposals to be dealt with.

ORGANISATION OF THE WORK

The organisations identified by the H3C were invited to appoint representatives. The group was made up of:

- A representative of the Compagnie Nationale des Commissaires aux Comptes (National Institute of Statutory Auditors);
- Two representatives for the small and medium-sized audit firms;
- One representative for the large audit firms;
- One representative for large companies;
- One representative for listed companies;
- One representative for other companies;
- One representative for small and medium-sized enterprises;
- One representative for the preparers of corporate financial statements;
- Two representatives of companies from the banking and insurance sectors, large investors;
- Three representatives of the French supervisory and regulatory authorities;
- Two academic representatives;
- Two representatives from the French Ministries of Justice and Finance.

The list of participants is included as an appendix to this document.

All meetings were preceded by the definition of the topics to be covered and a presentation of the provisions of the proposal at the start of the meeting.

Each meeting was attended by representatives from the H3C and reporters assigned to summarise the discussions.

The six-session work programme consisted of one 3-hour session every three weeks between February and May 2012.

KEY POINTS IDENTIFIED

The stakeholders felt that some provisions of the reform represented positive aspects that improve the quality of the audit, whereas they disapproved of other provisions or expressed reservations as a result of their ambiguity.

Reform provisions that were considered favourably by the stakeholders concerned primarily:

- the harmonisation of statutory audit practices and the convergence of the audit profession at the European level,
- harmonisation of the rules concerning independence and the need for professional scepticism while conducting the audit,
- integration of international audit standards into the common framework, under certain conditions,
- adaptation of the terms and conditions of the audit engagement to small and medium-sized enterprises,
- the possibility of resorting to joint audits,
- the prohibition of contractual clauses that restrict the choice among firms,
- the improvement of communication between audit firms, the entity and the regulators,
- the principle that consists of harmonising the audit report.

The auditor representatives have general reservations about the proposal. Given that the primary idea was to deal with the issue of enterprises presenting a systemic risk at the European level, the current proposal strikes them as broader and more complex, with a much more extensive impact than what appears necessary to them for dealing with the issues.

Other reservations were formulated.

The question of a rotation of audit firms was also a cause for debate: the obligation of a rotation of firms is criticised by a majority of the representatives of auditors and companies. Their view is that the short cycle proposed fails to match the time required for learning the specificities of the entity and the costs incurred by the said learning process at the beginning of the appointment. According to the representatives of the regulators, the principle of a rotation of audit firms is necessary because the risk of familiarity is not entirely eliminated by the rotation of partners. They would nevertheless like the terms to be longer than the six years stipulated in the proposal. Terms of 12 to 14 years are mentioned as the desirable minimum terms by various members of the group, in the event that such a rotation is made mandatory.

The auditor representatives question the need to amend the current texts, given as how the previous audit reform, which is recent, is still at the implementation phase in some countries. Furthermore, according to them, other ongoing international work, particularly on the audit report, could be taken into account in view of the international harmonisation of future procedures.

The auditor and company representatives question their mutual responsibilities and the supervisory role of the audit committee as defined in the proposal. They are of the opinion that the respective roles and responsibilities of the auditors, the audit committee and management are increasingly unclear. Overall, the representatives of the supervisory authorities are in favour of increasing the role played by audit committees.

Although in favour of harmonising the audit report, they are of the opinion that the content of the report proposed is extremely voluminous, complex and potentially discloses some confidential information. They also feel that the proposed scope of the internal controls on which auditors would be involved is extremely, even excessively, wide-ranging, since it goes beyond the pure financial information context. The representatives of companies also consider the evaluative nature of the duties on the internal control to be undesirable.

The representatives of auditors and companies do not favour a limitation on non-audit activities, but would like a clear demarcation of prohibited services. In addition to the expression of an opinion on the end of year financial statements, duties the statutory auditor is in charge of according to law should be systematically authorised. Finally, companies and auditors fear that the procedures for the prior request for approval to the audit committee or the regulator will slow down the work, which usually require a high level of responsiveness to meet the expectations of the audited entity.

The consultation group expressed concerns about authorising access to a larger part of the capital of audit firms than is currently the case to investors from outside the audit profession, by pointing to the potential risks of conflicts of interest, of pressure on professionals and of the impact on the quality of the audit.

Some representatives of auditors, investors, companies and regulators of the consultation group find the "pure audit" system risky since there is a danger of creating two future professions and, more particularly, preventing pure audit firms from benefiting from the skills acquired during consulting engagements, which are useful for enhancing the quality of the audit.

According to the consultation group, it is not appropriate to introduce a distinction in treatment between PIE audit firms and others, with respect to professional ethics, independence and professional scepticism.

The auditor representatives are concerned about the measure aimed at excluding professionals from the governing bodies of the profession's oversight authorities. According to the company representatives, such a measure could result in "ivory tower" authorities that, being operationally distant from the profession, would lack of direct knowledge in the grass roots issues of the profession.

The procedures for amending regulations, which allow a delegation to the European Commission so as to amend them without the prior approval of the Member States, are perceived negatively by the consulted stakeholders. They would like the implementation of a system which would enable them to express their point of view.

More generally, some representatives of the consultation group argued that the combination of measures could block the statutory audit market in the short-term. In this regard, the auditor representatives would like the proposal to take fuller account of the joint audit as a measure, which, by improving quality and independence, should enable entities and firms using it to do away with certain other measures proposed and considered as complex or obstructive.

REVIEW OF PROVISIONS

THEME 1: PROPOSAL OF A SPECIFIC REGIME FOR PIE AUDITS

Summary of the European proposal

The proposal plans amendments to directive 2006/43/EC, which is currently applicable to statutory audits in Europe and proposes a new regulation, which defines the requirements that are specific to the statutory audit of public interest entities (PIEs).

The list of PIE entities is fixed by the draft directive (art. 2.13).

The participants highlight the risk introduced by the proposal of a regulation that is specific to PIEs, which could lead to a "two-speed" audit. Some of the regulation's measures, such as those regarding professional scepticism, are fully applicable in any audit and should not be limited to PIEs.

Furthermore, the scope of the reform proposal does not necessarily correspond to all entities deserving "general interest".

It was also found that the definition of PIE did not include the "subsidiaries" of PIEs and that the proposals did not systematically specify the treatment to apply to these subsidiaries.

Several stakeholders regretted that the definition of "PIEs" does not factor in a size criterion, particularly for investment firms, UCITS and insurance companies.

THEME 2: AUDIT REPORT

Summary of the European proposal

The proposal aims to standardise the content of the audit report issued for PIEs. The regulation (art. 22) defines the information that must be included in the report. The length of the report is limited to 4 pages or 10,000 characters. An additional report for the audit committee of the audited entity is also drawn up (art. 23). If the management of the entity so decides, this report can be disclosed to the general meeting.

The directive proposal does not specify the content of the audit report for non PIEs. It does, however, stipulate that the auditors must comply with international audit standards (art. 26), as long as these standards are in conformity with the requirements of the regulation and the directive.

It should also be noted that the accounting directives currently under revision stipulate a minimum content for the audit report.

Harmonisation of the report

Some auditors of the consultation group consider the idea of harmonising the audit report at the European level interesting, if somewhat premature. Two audit standard setters, the IAASB and the PCAOB, are currently working on the improvement of the audit report. Their view is that it would be unfortunate if the European Union decides on a report that is different from the one used in other jurisdictions and it would

be desirable to take into account work going on at the international level. The auditors in the consultation group are of the opinion that the audit report should not differ between PIEs and non PIEs if the audit service provided is identical.

Although formatting of the report has been criticised by some auditors in the group, other participants view the provision as necessary in order to avoid producing excessively voluminous reports in which truly useful information would be lost. In some cases, additional information, beyond the limit of a number of characters, may be required when issuing the opinion.

The content, as stipulated by the reform proposal, could make the report difficult to understand and could be misleading for less educated readers or those who are unable to put the information in perspective.

The group emphasises that the justification of assessments applied in France to the audit report makes it possible to provide more appropriate information to the reader of the report without distracting his attention with secondary aspects.

The regulators in the group are strongly in favour of harmonising the information provided in the audit report and ensuring it is of better quality, provided that the information communicated is truly useful to the reader and effectively contributes to reducing the "expectation gap". They feel that this is not the case with all of the suggested sections in the current proposal. They believe that the model report should better highlight the risk areas, where the auditor has had to exercise his judgement, as well as the audit procedures that he has carried out to arrive at his conclusion.

Assessment of the internal control system

The auditor and company representatives in the group do not agree with the suggestion of amending the audit report on the assessment of the audited entity's internal controls. The statutory auditor's stance on the internal control system as advocated by the regulation would be far more stringent than the current practice in France. Since the auditor is not always present in the audited company, the auditor may not have the information necessary for expressing an opinion ("direct reporting") on the overall internal control system. They felt the current model applicable in France, where the statutory auditor gives an opinion on the content of the chairperson's report on the internal controls ("indirect reporting") is more appropriate: the auditor's report remains brief and does not disclose any additional information regarding the audited company. According to the auditor representatives, a precise standard on procedures required with respect to internal controls would be necessary in any event.

The large firm representatives feel, in this regard, that the proposal would be far more stringent than the American Sarbanes Oxley Act, which only deals with the internal controls linked to financial information, as opposed to the European proposal, which does not specify this scope limitation.

Some regulator representatives are in favour of an auditor's duty regarding the internal control system, but also feel that, given the current state of the law, this obligation should be limited to internal control systems related to the preparation of financial statements.

According to some of the participants, the introduction of a provision that does not limit the scope of internal controls to be addressed would impact the audited company, which would bear the additional costs of and the effects on the organisation of audits.

Going concern

The auditor and company representatives feel that the assessment of the statutory auditor with regards to going concern is currently implicit, unless there is a risk of putting the audited company in jeopardy (information becoming necessary in this case). Providing positive assurance regarding going concern would require additional work by the statutory auditor, which remains to be defined by standards. Company representatives also question the auditor's capacity to evaluate the forecasts and assumptions contained in a "business plan".

The regulator representatives are in favour of the auditor providing better information with respect to going concern. However, the elements to include in the audit report on this topic should be precisely defined.

Detailed report for the audit committee

The auditor and company representatives in the group agree on the need to respect the confidentiality of work and exchanges between the auditor and the audit committee. They believe that the information provided in the detailed report for the audit committee generally corresponds to that currently exchanged between auditors and audit committees, in a non-standardised format. However, according to the companies represented, any stipulation that this additional report can be disclosed at the general meeting would necessarily place it in the public domain. According to the auditor representatives, if the additional report is published, there is a risk of self-censorship, which would undermine the quality of information exchanged between the auditor and the audit committee.

The regulator representatives in the group resolutely support the principle of submitting an additional written report to the audit committee, which would help formalise the currently diverse practices for drafting and feed-back reporting. Receiving this report would be extremely valuable to them. However, considering the possible impact on its content, they share the reservations expressed regarding the risks related to making the report public.

Report in the case of a joint audit

In the case of a joint audit, the measure specifying that the most negative opinion prevails should the two audit firms appointed disagree was welcomed by the authorities in the group but dismissed by some of the auditor and company representatives.

THEME 3: THE RELATIONSHIP BETWEEN THE STATUTORY AUDITOR AND THE AUTHORITIES

Summary of the European proposal

Communication between the auditors and the authorities is introduced by the proposal for PIE audits, especially in cases of suspected fraud or irregularities, breaches of law, to the continuous functioning, refusal to certify or the expression of reservations (art. 17, 23 and 25). Upon appointment of the audit firm, the banking/insurance supervisory authority may veto the choice put forward by the entity (art. 32).

Principle of dialogue between auditors/authorities

For the regulator representatives in the group, the principle of dialogue between auditors and authorities is necessary and must be improved. In this respect, having routine discussions with the auditors of each entity on an annual basis would appear to be difficult and of sometimes limited value. However, dialogue should be initiated if required, especially where there is a specific problem or if the auditor feels that the situation

is likely to justify the qualification of his opinion. The representatives' expectations are based on the need for a "two way" dialogue, for which the procedures and frequency should be determined by the parties concerned. To this effect, it is important to provide for an appropriate lifting of the respective obligations of professional secrecy applicable to the regulator and the statutory auditors.

Rapidity of action

According to the audit firm representatives and a regulator in the group, the French system of dialogue established with the regulatory authorities is effective. The regulator representatives in the group emphasise the importance of their being rapidly notified of the difficulties encountered by the auditor, since the purpose of such an exchange is to increase the possibility of implementing effective preventive measures. They feel it is necessary to more clearly specify this point in the proposal.

European passport

An academic representative in the group feels that it would be advisable to better define what constitutes "an occasional intervention" by a statutory auditor in another Member State.

The auditor representatives warn of the risk of not being sufficiently knowledgeable of the local law when awarding European passports. If the idea of allowing the free circulation of services is considered viable, the implementation of a European passport appears challenging since the laws to which the audited companies are subject are not identical. Such a measure would require prior harmonisation of the law.

The regulator representatives raised the question of the nature of the appointment implemented "temporarily or occasionally" by the auditors intervening in other Member States, especially since the term of appointments is fixed by national laws. Furthermore, they questioned how they could be sure of the competence and experience of the auditors, benefiting from the European passport procedures, when delivering their opinion before appointment of PIE auditors.

THEME 4: RULES SPECIFIC TO SMEs

Summary of the European proposal

The directive does not determine the scope of the entities subject to statutory audit, but stipulates provisions that are specific to SMEs, if a Member State chooses to implement statutory audit for these entities: the statutory audit must then comply with the requirements of the directive, including an application of audit standards proportionate to the scale and complexity of the companies (art. 43 et seq. of the directive).

The auditor representatives in the group feel that the proposal would change the scope of statutory auditing, since this scope is defined by the accounting directives. Furthermore, they feel that adapting the procedures to the size of the audited entity is a principle which is already explicitly included in the international standards on auditing (ISAs).

Nevertheless, the auditor representatives see an advantage in the existence of a standard, like the "Small Enterprises" standard in France, which compiles in a single document the procedures that fulfil the objective of adapting auditing procedures to the size of SMEs. The advantage of endorsing the standards, so as to strengthen the legal security of prescriptive texts in this matter, is also highlighted by some auditor representatives.

The SME representatives raised the question regarding the cost/benefit ratio of this proposal. They are asking for a precise evaluation of the economic impact of the said proposal. According to the auditor representatives, the proposal does not lead to excessive costs related to the measures proposed for the audit of the SMEs insofar as the existing room for adapting the implementation of audit procedures to the complexity of the entity, is already foreseen in the ISA standards.

According to the consultation group, the concept of "SMEs", especially vis-à-vis the concept of "PIEs" is not defined in the proposed directive, and more detail could be provided, particularly to take into account the existence of "SMEs" which are themselves "PIEs".

THEME 5: AUDITING STANDARDS

Summary of the European proposal

The auditors must carry out the statutory audit in accordance with the ISA standards clarified in 2009, while taking into account the specific, domestic legal constraints related to statutory auditing. It is the Commission's responsibility to amend the description of the applicable standards (art. 26 of the directive) by means of a delegated act. The standards apply to PIEs, if they comply with the requirements of the regulation (art. 20).

The auditor representatives in the group indicated that harmonisation with ISA standards is already in progress and that the proposal is in keeping with this change. Some of the auditor and company representatives would like the proposed regulation and directive to be more precise in terms of the audit standard framework applicable. They would prefer the ISAs to follow a process of endorsement by the European Commission, as stipulated by the current directive.

The applicable or non applicable nature of the standard on quality control ISQC1 seems unclear in the proposal. For the representatives of the large audit firms, it would be logical to incorporate this standard into the common framework applicable at the European level. Other auditor representatives specify that this standard is not appropriate for smaller audit firms.

The ministerial representatives emphasised that delegation to the Commission would make it possible to amend an element of the framework without the mandatory opinion of Member States. Furthermore, they are not in favour of reducing the possibility of adapting the standards at national level.

Some representatives of the regulators also believe that, although greater harmonisation of rules is desirable, this harmonisation should allow for amendments to be maintained, when the national legal framework requires specific procedures or duties from the statutory auditor.

The regulator, ministerial and company representatives emphasised the need for a governance method, which allows stakeholders to express their views before the endorsement and application of ISA standards.

THEME 6: FRAMEWORK FOR NON-AUDIT SERVICES

Summary of the European proposal

The statutory auditor of a PIE and its network can only provide statutory audit services and the restrictively defined (art. 10.2) "related financial audit services" to the audited entity, its parent undertaking and controlled undertakings.

The portion of "related financial audit services" is limited to 10% of the fees paid by the audited entity for the audit of its financial statements (art. 9.2).

The following are among the "non-audit" services that the auditor cannot provide to the audited entity or to the entities that belong to the same group:

- a list of services entailing conflict of interest in all cases (art. 10.3.a),*
- a list of services which may entail conflict of interest (art. 10.3.b).*

As an exception, some of these services can be provided by the statutory auditor subject to prior approval by the competent authority (design and implementation of financial information systems for PIEs; due diligence), or subject to prior approval by the audit committee (human resources services; provision of comfort letters to investors in the context of the issuance of an undertaking's securities).

Principle of setting a framework

The auditor representatives noted that the proposed regulation is more stringent than the current texts applicable in France.

Threshold for related financial audit services

According to the auditors and companies represented, restricting the fees of related services to 10% of the audit fees is not justified and inconsistent with the reality of the audit market. There is not necessarily any recurrence in the related services and business requests can evolve very rapidly from year to year depending on their specific circumstances. For these same stakeholders, the 10% restriction is not justified if the authorised related activities are precisely defined, or if, in the case of a group, this limit is calculated with regard to the audit fees of the parent company. They point out that the 10% threshold would apply at the "PIE" entity level and not for all entities included within the scope of the consolidated financial statements.

The company representatives confirmed that the proposed method for calculating the threshold does not seem entirely relevant for evaluating the extent of services provided, apart from the certification of the financial statements. Their view is that the wide variety of related services seems incompatible with the establishment of such a low threshold of fees. Furthermore, they consider that this threshold should not be applicable to mandatory duties prescribed by law, or to optional services required for improved transparency, such as, for example, certificates concerning interim financial information.

On the other hand, for certain regulator representatives, the principle of setting a threshold for the extent of related services would be a positive development because it helps to limit the services that the audited company requires its auditor to carry out and which may potentially impair its independence. However, they emphasise that the Commission's proposal creates an issue with regards to the mandatory services required by French law. They caution the need to ensure that the establishment of overtly stringent

thresholds does not lead to reclassifications of services or fees. They believe that the 10% threshold should not be applicable to duties that are mandatory by law (such as, for instance, related party transactions, capital increases, etc.) or at the request of the authorities, such as the issuance of review or certificates at the request of the supervisor. In this regard, the definition of related financial audit services concerning the provision of assurance or certificates of regulatory information should not only include information intended for the supervisor but also information published in accordance with laws or regulations and whose audit would be made mandatory or conducted at the request of the supervisor. All these tasks should be considered as part of the basic engagement to "audit the financial statements". The 10% threshold should, however, apply to all the other related financial services, including those performed by the network.

The auditor representatives also disagree to defining legal engagements while simultaneously subjecting them to a fee threshold.

Content of the non-audit services

The company representatives highlighted the impact of this proposal on certain services that auditors are sometimes required to perform in France with regard to declarations concerning the governance practices and social and environmental responsibilities of companies. The proposal refers to the assurance given on the subject, which would represent an increased level of due diligence with regard to current practices, closer to a clearance.

They feel that the proposal, which in certain cases provides for referring the matter to the regulator before "due diligence" procedures, seems inconsistent in some cases with the deadlines for the issuance of securities and mergers/acquisitions, and may undermine confidentiality in the planned engagements. In this case, instead of being subject to the prior approval of the audit committee (as proposed with respect to comfort letters) or the competent authority (for prior "due diligence" services on potential mergers and acquisitions or the provision of assurance on the audited entity as part of a financial transaction), representatives of some companies advocate that such services be reviewed by the audit committee, in agreement with the board of directors, in the following manner: approval of the nature of additional interventions performed by the statutory auditor, system of delegation to management and informing the audit committee upon implementation of the described services.

The representatives of the auditors in the group feel that a prior agreement requested from the authorities or the audit committee could raise issues concerning the confidentiality of the proposals (comfort letter and due diligence).

Some regulator representatives noted that the list of non-audit services is different from that indicated in the French code of ethics for statutory auditors and includes some services not currently permitted by the French standards "DDL" defining tasks directly related to the audit engagement that the auditor is entitled to perform for his audit clients. They point out that the proposed list does not refer to the essential concepts of self-review and involvement in management. They believe that the services that are currently prohibited by the French code of ethics should not be allowed and that statutory auditors should not be able to have a greater discretion in determining the risk of impaired independence, merely because the services are provided by their network to a subsidiary established outside the European Union. Finally, the reasons for a distinction between banks and listed companies for prohibiting certain non-audit services does not seem justified. Such services, according to the regulatory authority, should be prohibited in any event.

For some company representatives, the division of roles leads to a risk of divergent views between the regulators or audit committees.

For one of the regulators as well as the chief financial officers of some companies in the consultation group, it would be possible to include a provision whereby exceeding the threshold would trigger a warning intended for the audit committee. However, the reaction time of the latter would remain an issue, when the audit committee does not meet frequently.

For some auditor representatives, the relationship between the internal obligations imposed on the European Union and on third countries is not addressed in the proposal and there would be a need to develop an international framework in this area, as is the case for accounting and auditing standards.

Company representatives regret that services, as defined by the "ISAE 3402" standard, are not covered in the proposal. A regulator representative stated, however, that these engagements should be subject to the threshold.

Some audit firm representatives regret the proposal's lack of uniformity as well as the failure to factor in operational measures taken in France. They also question the feasibility of the proposal for smaller "local" audit firms.

Auditor representatives are concerned that the proposed delegation to the European Commission may lead to the list of services being amended, without formalising the prior agreement of the stakeholders. Some representatives of companies share the concern expressed about an increasingly widespread recourse to delegated acts but stress the importance of this procedure in terms of responsiveness, for purely technical elements. In fact, it would be hard to modify the list of approved services by means of the joint decision-making procedure. However, they would like the delegated acts to be identified and would also like to ensure that they only concern a limited number of purely technical elements, exempt of political implications.

THEME 7: RESTRICTING THE SHARE OF FEES RECEIVED FROM AN ENTITY

Summary of the European proposal

The share of fees that may be received from a PIE, with regards to the total fees of the firm, is limited to a threshold of 20% or 15% for two consecutive years. If this threshold is exceeded, the audit committee should be informed. The audit committee must decide on the need to carry out a quality control of the engagement by another auditor before publishing the audit report. If the 15% threshold is exceeded for two consecutive years, the statutory auditor shall inform the competent authority, who will then decide whether the firm can continue the audit for an additional period.

Limitation principle

The regulator representatives consider that the 15% threshold is high and that it should apply to the total fees paid that is, not only to the entity but also to the entities controlled by the former (the notion of a group should be taken into account).

One of them considers that imposing such a threshold would improve the current situation, in which the French Code of Ethics provides for a criterion of materiality, with no threshold figure, thereby making it difficult to verify. He nevertheless emphasises that the challenge in this area, as in other aspects of the proposal, lies in the ability to strike a balance between the desire to promote competition, which would lead to establishing a high threshold for opening the market to smaller audit firms and the need to reduce the risk of impaired quality of the audits, potentially linked to the financial dependence of the firms, which

leads him to consider that a threshold of 15% is high. His view is that the quality and independence of the audit should be given priority.

Implementation of the limitation

Company representatives question the relevance of the proposed mechanism when the audit firm is financially dependent on the entity. They believe that entrusting the audit committee with the task of determining whether or not to implement quality control of the appointment by an independent reviewer is an inappropriate mechanism, especially considering the limited time frame for listed companies to publish financial information. In their opinion, it is the audit committee which should define the adequate safeguards.

Some auditor representatives consider that it is for the audit firm to decide which safeguards should be adopted and that the decision should not be the responsibility of the audit committee. Some believe that getting an audit committee to supervise an audit firm which exceeds the 15% threshold would not strengthen the audit firm's independence.

Other auditor representatives feel that exceeding the threshold has no impact on either quality or independence. They would prefer a situation whereby overrunning the threshold triggers an alert, rather than a total prohibition. They suggest that the authorities implement more regular or targeted inspections when the threshold of financial dependence is exceeded.

Some of the auditors represented in the consultation group question the effectiveness of the measure, in terms of market fluidity. They feel that this measure would restrict market access for moderate sized audit firms. The case of joint audits with firms which have reached the threshold also needs to be dealt with.

Regulator representatives point out that in the event of exceeding the threshold, bringing in another auditor to review the quality of work of the statutory auditor would be difficult to implement in practice, just like the action of the supervisory authorities within the framework of an appointment whose term is prescribed by law. They feel that these procedures do not resolve the question of exceeding the threshold in the longer term.

THEME 8: AUDIT COMMITTEE – COMPOSITION AND ROLE

Summary of the European proposal

The regulation (art. 31) uses the provisions of the current directive on audit committees and amends them. The composition of the audit committee of PIE entities is specified: it must include a member with competence in auditing and a member with competence in accounting. A majority of the members should be independent.

The mandate of the audit committee is extended (art. 31) notably by including supervision of the completeness and integrity of the draft audit reports and participation in the selection procedure of auditors. The audit committee must also "monitor" the statutory audit (art. 24).

The company representatives raise three points. To what extent should the question of an audit committee be treated in a text on statutory audits? How does this proposal relate to the other European proposals in progress on governance and company law? And to the current national regimes, including in French law? According to them, expanding composition of the audit committee to include members appointed by the general meeting of shareholders, should be excluded, along with rules referring to the specialisation of

committee members, which would raise doubts about the basic functioning principles of boards: specialised committees originating from the board and operating collectively under its sole responsibility. The rules concerning the composition or make-up of the audit committee, and more broadly of all the specialised committees of the board, necessarily have a significant impact on the composition of boards of directors or supervisory boards, even more significant when the size of the board decreases, especially for small listed companies.

Company representatives also highlight confusion in terms of the responsibilities of the audit committee, the auditor and management. The role of the committee cannot consist of supervising the work and draft reports of the auditors, as this would undermine the independence of the auditor. Moreover, they argue that the role of the audit committee is to monitor the financial information process and not to provide recommendations and proposals as to the integrity of such a process, since this management and supervisory role should clearly be played by senior management or the board of directors. A regulator representative does, however, consider that the audit committee could make useful recommendations to management without interfering in their duties. In this regard, they stress that the English version of the regulation proposal should use the term "monitor", which they think is more in keeping with the concept of the current role of the audit committee even though the French version of the proposal uses the term "supervision", which they consider undesirable.

Constitution of audit committees

Some regulator representatives state that a single member of the audit committee may possess both auditing and financial skills. These regulators do not advocate a "verification" of the audit engagement by the audit committee but stress that the French translation of the regulation differs from the English version, which refers to "monitoring" of the auditor's work; this monitoring would seem more in keeping with the possibilities opened up by French law, by allowing the audit committee to monitor the work of the auditor without placing it under its responsibility. They further suggest that certain provisions would be worth clarifying, such as the renewal of the statutory auditor for example.

Company representatives would like the financial functions that prepare the financial statements to be more routinely involved in the work of the audit committee, particularly in the context of calls for tender initiated for the appointment of statutory auditors. They feel that the audit committee's chairman should be appointed by the board of directors, which would thereby ensure its legitimacy.

The role of audit committees

An academic representative highlights the fact that the possible application to a court for the dismissal of the auditor (art. 34 of the regulation) presupposes that the latter has a legal personality, which is not presently the case in France.

Representatives of the auditors add that the principle of dismissal of the statutory auditor provided for in the regulation is problematic since an application for dismissal could be made at the initiative of a single shareholder, with no minimum share holding requirement.

A regulator representative favours the development of the role of audit committees and stresses that since the European proposal lays down numerous possibilities for an exception to the requirement to establish audit committees, a large number of PIEs could de facto continue to be exempted from it. He feels that logically, the exception related to the size of the concerned entity should be extended to all categories of PIEs (Art. 3.d), but on the other hand, he would hope that the exception laid down in Article 4 could not be implemented by the largest groups. Another regulator representative seeks clarification on the scope of "controlled" undertakings (group or entity).

THEME 9: PROCEDURES FOR APPOINTING STATUTORY AUDITORS

Summary of the European proposal

A selection procedure for audit firms implemented by the audit committee is defined (art. 32). The PIE should organise a call for tenders, after having defined beforehand the characteristics for assessing the proposals received, except in the case of a first renewal of appointment. At least one firm with a market share below 15% of the large PIE entities should be invited to bid. Any decision of the board of directors regarding the choice of the statutory auditor that diverges from the recommendations of the audit committee must be justified.

SMEs are not subject to this obligation (art. 32.4).

Any contractual clause that restricts the choice of the auditor is null and void (art. 32.7).

Company representatives do not support the routine use of calls for tender. Moreover, routinely involving a small firm would lead to the creation of token calls for tenders merely aimed at complying with the law. In order to safeguard audit quality in large companies, it is necessary not only to match the characteristics of the audit firm with those of the company being audited, but also to build a lasting and sufficiently long relationship with the audit firm when major projects are under way. Nevertheless, some company representatives could conceive of a recommendation for a call for tenders every second appointment, with a system of "comply or explain".

Auditor representatives would prefer to see the option of calls for tender being left to the company to decide. They explain that the mandatory call for tender procedure would increase the market pressure on prices, endangering the inherent quality of the audit by limiting the auditor's means of action. It would also be a factor for market concentration because few small and medium audit firms boast the expertise needed to respond effectively to calls for tender.

Other auditor representatives believe that if the mandatory call for tender measure were to be adopted, the obligation to consult a small firm would be a positive factor. They also want to clearly identify the requirements as regards calls for tender in respect of small entities.

The representative of one of the regulators tends to favour the principle of a call for tender method, because it enhances transparency in the selection method of the audit firm and, more broadly, in the selection process; however he considers that this issue should be examined with regard to the systems which will be adopted in terms of the rotation of audit firms and which will determine the frequency of the process. He points out that the provision that allows the supervisor to oppose the appointment of an auditor (right of veto) would be a step backwards for France, which replaced the method of veto with that of prior notice in 1999, in a bid to further empower the decision-making bodies of the audited entity. He also feels it necessary for the provision to not only cover the audit firm but to also apply to changes in signing partners. This provision should be applicable to auditors of all PIEs and not only to credit institutions and insurance agencies.

THEME 10: INDEPENDENCE, ETHICS AND PROFESSIONAL SCEPTICISM

Summary of the European proposal

The regulation includes various measures concerning the independence of statutory auditors.

The regulation also stipulates that the statutory auditor should exercise professional scepticism throughout the audit (art. 15).

Auditor, certain company and one regulator representatives believe that there should be no differentiation in the treatment of independence based on the size of the company being audited. At best, the regime meant for PIEs could be adapted to non-PIEs.

In the same vein, the auditor and regulator representatives hope that there will be no difference in treatment between PIEs and non-PIEs as regards the implementation of the principle of professional scepticism, since this rule of professional conduct should be applicable to all audits carried out.

A regulator representative stresses that the interaction of the various legal texts is complex on these aspects, between regulation and directive, or on the scope of the national ethical rules within the new system. Aspects pertaining to the financial ties that are particularly important in the case of credit institutions (holding accounts or loans) and insurance companies (underwriting of insurance contracts) are not addressed within the proposed regulation although they are included in the current French code of ethics.

The auditor and company representatives question what precisely is meant by the notion of "potential" conflicts of interest mentioned in the proposal. In the absence of a clear definition of the term "potential", they believe that the constraint laid down in Article 5 could become excessive.

THEME 11: PURE AUDIT FIRMS

Summary of the European proposal

The proposal defines a threshold beyond which certain firms belonging to networks would be compelled to limit their activity exclusively to statutory audits.

The firms and networks affected by the measure are defined in relation to their fees with regard to "large PIEs" (art. 14) with reference to the ten largest issuers of shares in each Member State, listed entities whose market capitalisation exceeds 1 billion euros, unlisted PIEs whose total assets exceed one billion euros and PIE investment funds whose total assets under management exceed 1 billion euros.

Audit firms achieving more than a third of their audit turnover with these "large PIEs" and whose network earns more than 1.5 billion euros of combined annual audit revenues within the European Union should commit to becoming "pure audit firms".

According to the auditor representatives, entities covered by the definition of "large PIE entities", which serve as a basis for determining which firms would be affected by the "pure audit" measure are, in France, entities that make up the SBF 120 index and a number of other companies. Although they are not aware of any detailed studies, they consider that the number of French entities which fit the definition of "large PIEs" is somewhere between 100 and 300.

Some auditor representatives consider that the measure aimed at introducing pure audit firms is inappropriate. They argue that:

- this would be an infringement of the European right of establishment;
- the current practice of the profession requires such a wide range of skills that no single individual possesses on a stand-alone basis. It is possible to entrust some aspects to external experts outside the audit firm, but such a practice could be inconsistent with the requirement of independence sought by the proposed reform, since independence rules for the use external experts in audit engagements are not specified in the proposal;
- regarding engagements requiring a high level of expertise, there is a higher risk of not being able to control or guarantee the quality of the audit if this competence is outsourced;
- the expertise of statutory auditors is maintained through consulting assignments and that denying audit firms the opportunity to perform other assignments apart from auditing would undermine the skill sets of auditors. Such a step could have an impact on the cost of audits and would be contrary to the objective of opening up the market to mid-sized structures.

Some company representatives confirm that the quality of the statutory audit is linked to a thorough understanding of the complexity of businesses, which is enhanced through the provision of skills acquired through consultancy, especially in sectors such as banking and insurance. In their view, there is a risk of "bureaucratisation" of the practice if firms confine themselves to pure audit.

Company representatives are concerned about the risk of poorer quality statutory audits and the impossibility, in the longer term, of finding the expertise or the level of geographical coverage necessary to audit international companies. The measure seems contrary to the objective. It is necessary to ensure that the resources of the audit firms match the characteristics of the companies they audit. Their view is that small and medium firms do not have the resources required to replace large firms, although they may be useful in other engagements. They worry about the additional cost incurred by the search for experts outside the statutory auditor's firm.

Regulator representatives believe that the primary aim of this measure is to improve competition. While recalling the need to limit the consulting activities of the statutory auditor provided to the entity being audited and the related entities, they believe that the proposed measure concerning specialisation of the professional activity of the largest firms in statutory audits could lead to poorer quality audits on the largest institutions. In the context of the financial crisis, they recall that audit firms should bolster their technical expertise in areas such as the auditing of fair values that are determined using valuation models. Therefore, they find it important to strengthen the impact assessment in this regard so that the final proposal will not impact negatively on the quality of audits.

Some auditor representatives regret the fact that a specific part of the profession may be blamed in connection with the introduction of such a measure. In reality, this measure would only affect large firms because of the market concentration on the appointments of "large PIEs".

Auditor representatives and some company representatives stress that the measure leading up to the creation of two types of firms is incompatible with the French system of joint statutory audit. According to them, firms that cannot claim a pure audit activity would be driven out of the market.

Auditor representatives are concerned that there may be a decrease in quality recruitments because of the limited opportunities for career development and diversity of engagements within the framework of pure audit activities.

THEME 12: OPENING UP THE CAPITAL OF FIRMS

Summary of the European proposal

The proposal eases the rules regarding the capital structure of pure audit firms by (1) eliminating the 50% minimum holding quotas for the voting rights of approved persons in audit firms, (2) by prohibiting the Member States from imposing other conditions for holding voting rights or capital (Art. 3.4. 2nd directive) and (3) by relaxing the rules on the presence of statutory auditors within the management bodies of firms, which would fall from a minimum of 75% to 50% (Art. 3.4.c. directive).

Although some auditor and company representatives are not against the principle of opening up of the audit firm's capital to people without the status of statutory auditor, they emphasise that this measure would not be sufficient to ensure the growth of firms. Indeed, large firms have been built over the long term and not through the influx of capital but through acquired experience. They also note that the risk of a loss in independence linked to opening up the firm's capital is not addressed in the proposal and that this process may have a negative impact on the independence, and also on the appearance of independence of the audit firms.

According to auditor representatives, the current profitability of a firm is low and uninviting for an outside investor.

The auditor representatives recall that the development of firms is primarily related to their ability to find customers and not to their financial capacity. They are currently supported by the banks when it comes to their financing needs. The legal solidarity of professionals and owners of capital is advisable. Because the incoming shareholders seek profitability, the measure will lead to considerable pressure on the quality.

Some auditor representatives feel that the measure is contrary to the aim of deconcentration. If investment funds entered the audit market, only a large firm would be able to subsequently buy their shares in a firm that will have grown thanks to private capital.

Company representatives also believe that the proposed ratio of 50% of statutory auditor executives may not suffice to deal with risks to independence, the confidentiality of information and the quality of auditing, mainly because of the pressure on returns that investors outside the profession could require. They consider that such a measure should always be complemented by safeguards that make it possible to meet these objectives.

Regulator representatives also note that although the proposed measure should facilitate firms' access to funding and foster the creation of new firms, opening up the capital of audit firms to third parties in search of a return on their capital would very likely have a negative impact on the quality of audits and auditor independence, if some of those buying in should find themselves linked to the audited entities. At the very least, the new rules for incompatibilities laid down in this respect should be significantly strengthened.

A ministerial representative recalls that the statutory audit profession is regulated and that independence remains a priority. The proposed measure may prove contradictory to this objective. A risk of contagion to other regulated professions should also be taken into account.

An academic representative gives the example of training institutions. The opening up of some training courses to private capital could lead to the deterioration in the quality of degrees and in their recognition.

According to the representatives of small and mid-sized firms, the "local" audit firms, i.e., the ones working with SMEs, which will be hit hardest by this measure.

THEME 13: TRANSPARENCY OF FIRMS

Summary of the European proposal

The proposal states that PIE audit firms should publish their annual financial reports and a transparency report, which is already required by the present Directive. Some firms, which earn more than a third of their audit revenue from large PIEs, would also be required to publish a corporate governance statement. The contents of these three documents are laid down in Articles 26, 27 and 28 of the proposed regulation.

Some auditor representatives indicate that only the corporate governance statement would be a new contribution (as the transparency report and financial statements are already published by PIE firms), and that it is not clear whether this document will provide users with better information. Moreover, the corporate governance report meant for the shareholders of the firm would be of little interest to the audit partners. According to them, the current reports produced by the audit firms, including the one on transparency, already provide most of the required information.

Company representatives are not opposed to receiving additional information on the firms, but they have not precisely defined their needs in this area. Nevertheless, they do consider that the organisation and functioning of the audit firms are important elements for transparency.

For the sake of transparency, regulator representatives are in favour of audit firms publishing additional information, including financial details, especially for large networks and also for the smallest firms, which will come within the scope subject to the publication of a transparency report as a result of the extension, by its definition, of the population of PIEs. They point out that while this information may not necessarily be read by all the stakeholders, it is of interest to companies that wish to select a firm and also to regulators particularly in the context of their opinion procedure.

Regarding the corporate governance statement, representatives of the regulators query the value of detailing the internal control of the firm's financial reporting process in a public document. This statement should contain information that meets a real need among users.

THEME 14: FIRM ROTATION

Summary of the European proposal

The proposal provides for a rotation of audit firms on PIE engagements, in the following manner:

The audit engagement (art. 33-1):

- *cannot be shorter than two years the first time,*
- *may only be renewed once,*
- *cannot exceed six years for the same audit firm within a PIE, with a possibility of extension up to six years however, if there is a joint statutory auditor.*

Exceptions to these durations are provided (art. 33-2): two additional years are possible upon consent of the competent authority, or 3 additional years upon consent of the authority if there is a joint statutory auditor.

This procedure comes in addition to the rotation requirements for signatories, every 7 years.

A provision is also made for the rotation of the most senior personnel in firms.

Auditor representatives are not in favour of the rotation imposed upon firms. However, some concede that certain engagements are too long.

They do, however, agree with the pre-existing principle of rotation of the partners: the aim of reduced familiarity seems legitimate and they believe that the risk of familiarity concerns individuals and not firms.

The auditor representatives put forth the following arguments. According to them, the audit market within those Member States that have imposed the firm rotation is no less concentrated than within other States and indeed some countries have abandoned it. They believe that there is a running-in phase between the firm and the entity in order to gauge the complexity of the latter. The incidents that down-grade the quality of the audit mostly occur during this initial running-in phase. These risky periods for the quality of the audit would become more frequent because of rotation which will incur an additional learning curve cost for firms as well as an additional cost for clients, since the organisation of the company must be explained to the new auditors. In their opinion, the obligation to change audit firms at an imposed pace when the company may be in a period of crisis or in the process of acquiring a subsidiary, for example, is not desirable: it disempowers the audit committee and the board of directors.

Some auditor representatives believe that this rotation system would cover 2,800 companies in France and that along with the procedure of mandatory calls for tenders, it would result in a greater concentration of the audit market. It would profoundly change the profession, by marginalising non-PIE audits and would tarnish the image of non-PIE audit firms. They are against breaking up the profession.

They highlight the difficulty in organising the rotation system because of rules of independence laid down in terms of self-review. In fact, the constraints that are accumulating will greatly limit opportunities for hiring firms and achieve a result contrary to what is actually desired, namely, the fluidity of the audit market. Furthermore, the rules in terms of self-review may in fact lead to the creation of pure audit firms with all the inconveniences associated with them.

Some company representatives are also against mandatory audit firm rotation. They note that the small current number of firms with the kind of expertise and international presence which is sufficient for addressing the needs of certification and additional engagements would be incompatible with mandatory rotation. They stress the complexity of changing auditors at all the legal entities around the world for an international group.

They find it inconceivable that a legal mechanism could be proposed and justified for its potential psychological effect on the investors, when the actual benefits have not been demonstrated. They are opposed to the rotation system for the reasons outlined by the auditors, especially if it is combined with the cooling off period, with the rotation of signatories and for short engagement periods: there would no longer be any firms in a position to carry out "due diligence".

Some company representatives feel that the decision regarding whether or not to retain the auditor should be up to the company. The company should explain the reasons for its choice to shareholders. They believe that the board of directors and the audit committee should either apply a rule of rotation, or justify to the shareholders why there is no change in auditors ("comply or explain").

Some company representatives, while opposing the principle of mandatory rotation, do feel that the proposed time frames are not relevant. It appears to them that stable periods of 12 to 14 years are in any event necessary.

Other company representatives accept the proposal for a mandatory rotation from 12 years but without mandatory rotation of the signatory within the period. They also recall that the cost incurred by new teams familiarising themselves with the entity similarly exists in the context of an appointment that continues over time, due to the frequent natural rotation of the auditors who make up the audit team.

One academic representative points out that according to some studies, if the rotation does not affect the actual quality of the audit, it has a psychological effect on users of the financial statements. Disclosing the appointment date of the auditors, proposing an engagement cycle of up to 14 years (6+4+4) and proposing joint audit as a possible answer to the concerns of the Commission would be measures that could improve the proposal.

Another academic representative also suggests that in the framework of the joint audit, the rotation of auditors should be staggered in order to avoid rotating the two firms simultaneously. One solution would be to coordinate the firm rotations with the joint audit. By only changing one of the two firms, the rotation is less of a wrench for the audited company. The auditor representatives share this opinion.

For one of the regulators represented, the proposed general framework with regard to the term of engagement is too complex and does not permit the required harmonisation of practices at the European level; this is an area in which the clarification and harmonisation of proposals would be advisable. Generally speaking, the possibility for companies of opting for a short appointment seems likely to reduce the independence of the auditors' judgement. This regulator is in favour of rotating partners, but feels that the risk of familiarity is not totally eliminated in this case, since the new partner is likely to have more confidence in the work of his predecessor if the latter belongs to the same audit firm. Therefore he feels that a change in audit firms is a step towards improving the quality of audits, since it reinforces scepticism. He nevertheless recognises that the addition of an overly rapid rotation requirement and use of a call for tender procedure, combined with strict rules regarding conflicts of interest, is likely to have a negative effect on the auditor's knowledge of the entity, as in-depth understanding is a key to risk identification and the quality of the audit. He recommends a rotation of the firms every 12 years (6-year appointment renewable once) and of the signatory partners every 6 years.

A regulator observes that the purpose of harmonisation pursued by the Commission has not been achieved in this part of the project. With regard to the duration of the engagement, the idea of a rotation every two years is not realistic and the proposed benefit of the shift between the term of the firm's appointment (six years or nine years) and that of the partner (seven years) is not clear, and it seems necessary therefore to coordinate the rotation dates. The recommended solution consists in providing a one-time renewable appointment of 6 years for the audit firm, with a mandatory rotation of the partner when renewal is called for.

A ministerial representative recalls that according to the proposal's stipulation, the entity should choose the pace of renewal, by imposing a minimum appointment of two years only. The representative of another ministry indicates that he is not against the introduction of a system of mandatory rotation, but only on condition of extending the duration, which is too short in the European proposal, and maintaining a longer term of office in the case of joint audit.

Some audit firm representatives would like the mechanism to include the possibility for a Member State to extend the term of the engagement beyond the two years retained in the proposal.

THEME 15: JOINT AUDIT

Summary of the European proposal

The proposal does not impose a joint statutory audit at the European level, but allows (art. 32-9) the Member States the possibility of imposing the designation of a minimum number of statutory auditors on PIEs under certain circumstances, and defining the conditions that are applicable to the relations between the designated auditors.

The rotation periods of audit firms within PIEs increases from 6 to 9 years in the case of a joint audit.

Some auditor representatives regret the fact that joint audits have not been made mandatory at the European level. According to them, since joint audits provide an answer to many problems highlighted by the Commission, its implementation at the European level would have made it possible to eliminate other more contentious elements from the proposal.

Auditor representatives believe that it is imperative to retain the option of resorting to joint audit, which is provided for within the regulation in Article 32-9.

Some auditor representatives want the practice of joint audits to be better valued, which means that opting for a joint audit should lead to a substantial decrease in the constraints of other mechanisms. In fact, combining the effects of the joint audit with some other measures makes it difficult to implement.

Company representatives are in favour of maintaining a joint audit option, as laid down in Article 32.9, but only after reviewing the way in which it is valued because in the present proposal, a joint audit is impracticable due to the accumulation of other constraints. Some company representatives highlight the scarcity of supply for auditing major international companies.

An academic representative suggests that the term "joint audit" should be replaced by the term "College of Auditors" in order to break away from the history of "joint audit", which received an unenthusiastic response within some European countries. He stresses that the proposals do not specify what is covered in the joint audit, as the proposal refers to non-harmonised national mechanisms.

One ministerial representative states that the term "joint audit" is no longer even mentioned within the proposal. He is nevertheless satisfied with the impact of the practice in France and would like to maintain it.

The auditor representatives point out that large companies would like to use the same firm to audit all their activities at the international level, enabling efficiency and economic gains as well as standardised reporting.

A regulator representative confirms that it is necessary to retain Article 32-9 of the proposal, which provides an opportunity for Member States to opt for the "joint audit" principle and to set its rules of application.

THEME 16: LIMITING THE DELEGATION BY THE COMPETENT AUTHORITIES

Summary of the European proposal

The proposal stipulates that the system of public oversight of auditors depends on a single authority, which must be independent from the profession (art. 29 amended directive).

Practitioners would not be allowed to be involved in the governance of the public oversight system (art. 32.3 of the directive).

Only the registration and the approval of statutory auditors can be delegated by the authority to legally designated bodies (art. 32.a of the directive).

Auditor representatives are concerned about the risk of being excluded from the governance of the quality controls of the audit. Why maintain the company representatives and not the audit firm representatives? They interpret this measure as a lack of faith in the monitored profession. The oversight body in France is developed in collaboration with experts. The text does not mention the possibility for the practitioners to make their views known to the regulators, although different levels of intervention (quality control, discipline, general policy, standardisation) exist. The issue cannot be addressed generally and free from discrimination. They want the practitioners to be involved in controls and governance. If provisions were laid down in the text to define the regular relationship between authorities and professionals, the text would be perceived as being more balanced.

Company representatives consider that the different stakeholders in the audit, particularly the auditors and companies, should be represented in the governing bodies of the profession's supervisory authorities.

A regulator representative underscores that the proposal aims to harmonise practices that exist at the European level by promoting the independence of the supervisory system, which is positive.

For one of the ministerial representatives, the proposal would have an impact on the current provisions of the French Commercial Code. According to this Ministry, the goal of improving independence is indeed desirable but attention should be paid to the implementation procedures.

When asked by way of comparison about the organisation that exists within other supervisory authorities, a regulator representative points out that the organisation in force in the authority he represents is not based on the participation of professionals in the quality control of institutions. This regulator has an independent supervisory body whose staff and experience are appropriate to the supervisory assignment with which it is entrusted. There are no practitioners on the board but people from the profession are appointed because of their skills. The functioning of the board is governed by strict conflict of interest management rules, including a step-down requirement. Moreover, the association of professionals functions through advisory committees, in particular for the purpose of drafting texts and instructions.

The company representatives believe that a minority presence of professionals in the governing bodies can be organised without compromising independence. It ensures greater responsiveness in terms of changes in the profession.

One of the ministerial representatives points out that the other authorities operate without practitioners within governance. He proposes considering the involvement of professionals who are no longer practising. The opinion is shared by another ministerial representative who emphasises the need for addressing actual and apparent independence.

The company representatives, however, highlight the risk that non-practitioners are less in a position to demonstrate the operational reality of the profession in a world where issues and practices are evolving rapidly.

THEME 17: COMMUNICATION OF INFORMATION BETWEEN PIE AUDIT FIRMS AND BETWEEN SUPERVISORY AUTHORITIES

Summary of the European proposal

The transmission of information for auditing consolidated financial statements provided to the statutory auditor of the group located in a third country is made possible by the regulation (art. 13) for PIE statutory auditors, respecting European and national rules for personal data protection

Furthermore, the transmission of audit documents to a third country authority must be guided by the provisions of Article 47 of the directive: a working arrangement must necessarily exist between the authorities of both countries (Article 13.2).

The company representatives are in favour of improving the flow of information between the statutory auditors, essential in the case of group audits.

The regulator and audit firm representatives see no reason to address in a different manner the issue of information transmission and thus that of lifting professional secrecy with respect to this information, by an auditor of a subsidiary to the auditor of the parent company, depending on whether the company is a PIE or not. Moreover, a regulator representative highlights that it is important, in general, for all the auditors who exchange information as part of a consolidated group to be subject to equivalent rules on professional secrecy and reciprocity. He reminds that, under some specific directives, the various European supervisory authorities can exchange information on the entities that are under their supervision. Bilateral agreements may be signed, if necessary, with other authorities of third countries, subject to equivalent rules of professional secrecy and reciprocity.

This regulator representative questions the scope of the targeted competent authorities, between which the exchange of information could take place within Europe, as the regulation is not clear-cut on this matter. In this regard, he considers that it is not appropriate for the regulation to provide for the establishment of direct communication between the supervisory authorities of banks and insurance companies of a country and the authorities overseeing the auditors of another European country. This type of communication would pose practical difficulties, given that the prudential directives already deal with relations between European supervisors. In this type of communication of information, which is by nature confidential and sensitive, it would be advisable to reinforce existing channels, while on the other hand allowing the retransmission of information.

At this stage, auditor and company representatives have not identified any particular difficulty in the proposals that govern the exchange of information between supervisory authorities.

THEMES 18 AND 19: COOPERATION WITHIN ESMA – EUROPEAN QUALITY CERTIFICATE

Summary of the European proposal

The proposal stipulates that ESMA should coordinate cooperation of the audit supervisory authorities (art. 46), by creating a permanent internal committee for this purpose. ESMA is also in charge of issuing various guidelines for standards to regulate the content of reports, supervision by the audit committee, rotation of firms, removal of firms, quality assurance reviews, information exchange, inspections. Article 50 also stipulates that ESMA establishes a European quality certificate for PIE statutory auditors, and fixes the terms of the certificate.

A regulator representative draws attention to the fact that the choice of ESMA as the European authority responsible for overseeing the audit does not take into account the fact that a very large proportion of PIEs is made up of insurance companies and unlisted financial institutions. For example, the majority of insurance companies are not listed (about 1200 entities in France). In this context, he is surprised at the prominent role given to ESMA in determining guidance and standards. Indeed, even if certain consultation procedures are planned with the supervisory authorities of banks and insurance companies, the final decision still rests with the ESMA. This supervisor believes that the terms of the EBA and EIOPA association should at the very least be strengthened and it would seem more logical for a specific authority to be in charge of audit issues in collaboration with the three current European authorities.

One ministerial representative is opposed the idea of entrusting the coordination of audit supervision to ESMA, the European authority responsible for financial markets.

Auditor representatives recognise the quality of work of the EGAOB. They have concerns about the possibility of ESMA producing new standards in the field of audits, without involving auditors and companies. This concern also applies to the proposed creation of a European certification of quality, whereas many controls already exist. Besides, this certification would divide the profession and lead to market concentration. The negative reaction on the part of the auditors is primarily aimed at the creation of new standards by ESMA allowing this certification.

One regulator representative is, however, in favour of certification to ensure, in advance, the capacity of a firm to practice with a PIE (quality control, human resources and technical competence in IFRS). The certification should be based on inspections and should not necessarily be issued by ESMA but rather by the national authority in charge of the audit, together with the financial market regulator, if it is involved. This regulator thinks that a certificate of this kind would not give rise to market concentration but would eliminate those firms which are unwilling to enter the PIE market, it being specified that France currently has about 600 PIE firms.

Another regulator representative, while agreeing in substance with the idea of a certificate, notes that the proposed text focuses on the quality assurance system and does not address the central points necessary for the issuance of this kind of certificate such as experience, human resources or training. Furthermore, he believes the benefit of "PIE" certification can be questioned as a means of gauging an audit firm's capacity to audit the financial statements of an entity with strong characteristics. In any event, it should be made clear that the acquisition of a certificate by an auditor should not exclude the possibility for regulators of vetoing the choice of this auditor.

The company representatives are in favour a certification system for audit firms that can make the European market more fluid but they point out that in the selection of an audit firm, such a certificate would be just one of several factors, such as international coverage, reputation, expertise in the company's business, operational resources and the ability to manage the work of audit firms involved in consolidated subsidiaries.

THEME 20: CONTINGENCY PLANS

Summary of the European proposal

The authorities are responsible for monitoring trends in the market for the provision of statutory audit services. They assess the risks arising from a high concentration and the overall stability of the financial sector, the need to adopt measures to mitigate these risks, and issue a report on this subject. A European Union level report is drawn up by the three European authorities (financial markets, banks, insurance companies) (art. 42 of the regulation).

In each Member State, the six largest firms working with "large PIEs" draw up a contingency plan to deal with a possible event that could threaten the continued operation of the firm, which envisages steps to prevent the interruption of statutory control of PIEs. The plans are forwarded to the competent authorities that can issue an opinion on them (art. 43 of the regulation).

For certain auditor representatives, planning and communicating contingency plans to the regulator is a disproportionate and expensive measure, due to the absence of systemic risk in the event of default by a firm. They point out the existence of specific effective measures in France such as joint auditors and substitutes.

A regulator representative feels it necessary for every company, including audit firms when they are of a significant size and in view of the number and nature of their appointments, to develop a response capacity for dealing with contingencies. This is particularly relevant in the context of major international networks, as well as for responding to operational difficulties.

THEME 21: INDIVIDUAL INSPECTION REPORTS

Summary of the European proposal

For PIE audit firms, the proposal states that the authorities should publish an annual activity report, an annual report on the results of all the audits, findings and conclusions of the individual inspection reports (art. 44).

More broadly, the directive stipulates that the main conclusions of the quality assurance reviews should be made available to the interested parties (art. 29).

Auditor representatives feel that the possibility of disclosing the inspection reports compiled by the supervisory authority to the audit committee is high risk because they contain confidential data. The elements that can be disclosed should be defined.

A regulator representative feels that the term "make available to the interested parties" laid down in Article 29 of the directive is too vague. There should be an explicit and perhaps restricted list of stakeholders to whom the inspection report could be disclosed. This list should include the French prudential supervisory authority. Similarly, the content of the publications issued by the competent authority on the findings of inspections of PIE firms (Article 44 of the regulation) is unclear. As this is an exception to the principle of confidentiality, the rules for publishing the reports should be clearly defined, and they should provide assurance of the confidentiality of information contained in these reports, especially that related to the PIEs themselves. The auditor representatives share this view.

According to a regulator representative, the system could lead to the provision of two levels of feedback reporting. The first, which could be made available to relevant parties upon request and the second, intended for the audit firm inspected. This then raises the question of information contained in each of them and requires a debate to be launched on the format of the inspection report.

Auditor representatives identify three levels of information that could be published or made available: those relating to the firm, to the audited client and to the signatory of the report. Auditor representatives feel it necessary to maintain the anonymity of the client and the signatory within the framework of a publication of the inspection results.

THEME 22: SANCTIONS

Summary of the European proposal

The regulation states that Member States shall draw up rules regarding sanctions. It defines the infringements of the regulation and lists the sanctions that can be imposed (art. 61 et seq). Mechanisms to report infringements to the competent authorities have to be set up by the Member States (art. 66).

One regulator and an academic representative together note a certain ambiguity in the text concerning the sanctions. A regulator representative specifically highlights the fact that sanctions are applicable to persons who have committed infringements of the provisions in the regulation as listed in the Appendix thereto, which is intended to be exhaustive. However, there is no order of priority in the list and certain infringements may have been omitted from it. Moreover, some of the listed infringements involve the audited entity and not the audit firms. This results in a problem regarding the allocation of responsibilities among supervisors that has to be dealt with in the interests of clarification, which involves the exclusive jurisdiction of the supervisor for infringements committed by the establishments that have an impact on

the performance of his own supervisory assignment. Moreover, if it is advisable to foresee hefty financial penalties, it does not seem appropriate to base the sanction on the turnover of the companies since the potential impact of such a sanction on the financial health of such a company has to be taken into consideration. In addition, the principle of publication should be limited solely to disciplinary sanctions and anonymity should be ensured for publications that jeopardise financial stability. Finally the implementation of whistle blowing mechanisms laid down by the regulation merits a separate discussion, relating in particular to the legal difficulties in implementing these procedures (concerning for instance, the issue of the level of protection to be granted to the "whistleblower" or the processing of personal data).

Auditor representatives question the role of this mechanism in relation to the current system. They believe that if the sanctions were added to mechanisms currently in force, this would amount to an excessive increase in the number of sanctions.

APPENDIX : COMPOSITION OF THE GROUP

PRÉSIDENTY :

- Haut Conseil du Commissariat aux Comptes : Christine Thin

MEMBERS :

- Association française des entreprises privées (AFEP) : Francis Desmarchelier
- Association nationale des directeurs financiers et de contrôle de gestion (DFCG) : Jean-Luc Peyret
- Autorité de contrôle prudentiel (ACP) : Jean-Jacques Dussutour, Christine Martin
- Autorité des marchés financiers (AMF) : Etienne Cunin
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