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PROPOSAL FOR MODERNISING THE 8TH COMPANY LAW DIRECTIVE ON STATUTORY AUDIT

UNICE COMMENTS

I. GENERAL COMMENTS

UNICE has taken note of the Commission proposal released on 16 March 2004 to modernise the 8th company law Directive on statutory audit of annual accounts and consolidated accounts.

We agree that certain industries should fulfil more stringent independence and transparency requirements as far as statutory audit is concerned, but the requirements should be limited to specific and clearly defined industries such as financial institutions, insurance undertakings and listed companies.

UNICE fully disagrees with the provision for mandatory corporate governance rules by means of a directive on statutory auditing.

Regarding the requirement to create audit committees (Art. 39), we are concerned that a prescriptive approach would prevent the mission of audit committees changing according to market requirements as such is currently the case. For example, if originally the audit committees mission was mainly to review accounts, they are now increasingly involved in decisions regarding the appointing and superseding external auditors, monitoring their independence etc.

Furthermore, Article 39 provides that 'public interest entities shall have an audit committee, composed of non-executive members of the administrative body or members of the supervisory body of the audited entity with at least one independent member with competence in accounting and/or auditing'.

We believe that audit committees should remain part of national codes and should not be prescribed in a Directive at EU level.

We do not agree that more detailed provisions on the audit committee's composition, role, operation and transparency are needed neither in this particular Directive nor in a Recommendation on non-executive or supervisory directors.

Therefore, UNICE believes it more appropriate that the directive set forth a general principle according to which the appointment of statutory auditors - as well as the determination of their remuneration - should not be within the competence of the administrative body of the company.

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It should be then for national corporate governance rules to implement the general principle and provide oversight of outside auditors independent of management.

II. SPECIFIC COMMENTS

1. Definition of "Public interest entities"

According to the proposed Directive the so-called public interest entities are defined as: "entities that are of significant public relevance because of the nature of their business, their size or their number of employees, in particular companies … whose securities are admitted to trading on a regulated market, banks and other financial institutions and insurance undertakings".

This definition is too broad and vague, thereby lacking the necessary legal certainty, fundamental when assessing the exact scope of the Directive.

UNICE cannot accept that companies in general could be subject to burdensome regulation, *a fortiori* without any clear limitations of scope. We believe that the term public interest entities should be abandoned and a more precise definition preferred.

2. Independence (Article 23 to 25)

Auditor's independence is of paramount importance in corporate governance. Effective corporate checks and balances rely on an audit that is independent from the management of a company. Market confidence furthermore requires independence of the statutory auditors not only in fact but also in appearance.

UNICE, therefore, strongly supports provisions that effectively ensure the auditor's independence. In this context, we support a principle-based approach which combines flexibility with rigour in a way that is unattainable with a rules-based approach. In particular, it:

- allows for the almost infinite variations in circumstances that arise in practice;
- can cope with the rapid changes in the modern business environment;
- prevents the use of legalistic devices to avoid compliance;
- requires auditors to consider actively, and to be ready to demonstrate the efficiency of arrangements for safeguarding independence, especially regarding relationships or proposed services which are not specifically prohibited or restricted.

For additional guidance on the interpretation of this principle, one should refer to the Commission Recommendation of 16 May 2002 on Statutory Auditors' Independence[1]

[1] OJ L 191, 2002/590/EC of 16 May 2002, 19.7.2002, pp. 22 – 57.

3. Appointment, dismissal and communication (Articles 35 to 37)

UNICE appreciates the principle of dismissal on "proper grounds". Nevertheless, some Member States already have such restrictions in their national frameworks. The determination of "proper grounds" should remain at national level.

4. Special provisions for the statutory audit of public interest entities (Article 38 to 43)

As stated above, UNICE is not opposed to establishing an oversight system for public interest entities. We acknowledge that a credible system of supervision requires members of the oversight body to be sufficiently independent. In small countries, however, there is only a limited number of persons available that have the required knowledge and expertise to efficiently and swiftly conduct the investigations. This should be taken into account in the Directive. We would therefore favour more flexible provisions on who may govern a system of public oversight. In particular Art. 42 should not disallow (a minority of) practitioners to participate in the governance of the public oversight system.

5. Rotation of auditors (Article 40)

UNICE does not favour a system of rotating auditors. Such a system will increase costs particularly for small listed companies. It is largely accepted and empirical evidence shows that in such a system, the quality of the audit could decrease, the new auditor lacking knowledge of the history of the company and experience with its operation.

If in the event of such a system being maintained, it must be clear that in the case of internal rotation, the person designated to rotate should be the main responsible for the audit and not the whole team assisting him.

6. Predetermination of audit fees (Art. 25, 50):

The above-mentioned Articles of the proposal could lead to the determination of audit fees by the member states. In respect of a supporting market mechanism this would not be reasonable. The assessment whether the audit fees are adequate should be remain in the remit of the audit committee/supervisory board.

7. Access to the working papers of the auditor' (Art. 22 II, 34, 47)

The access to the internal working papers on a national as well as an international basis is very problematical. Compliance with national regulations regarding for example data protection and secrecy would be essential requirements. Regarding this requirement or the indispensable basic principle of 'reciprocity' no guarantee can be given. If access to internal company data is needed in the case of national enforcement measures, consequently, national legislation should deal with this.

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