



MEPs on the Economic and Monetary Affairs
Committee (ECON)

22 February 2013

Dear Member of the European Parliament,

I would like to share with you some serious concerns which we have on the forthcoming vote in your Committee on the Report on the proposed Regulation on Audit.

BUSINESSEUROPE supports the efforts to ensure that European companies have access to high quality audits and that auditors operate independently. The proposed Regulation includes a number of initiatives that will have a beneficial effect on the market, including the prohibition of "Big 4" clauses and the required internal report from auditors to those charged with governance.

However, in BUSINESSEUROPE's view, a number of complementary measures in the proposed Regulation on Audit will have undesirable consequences, for example they will significantly lower the overall quality of audits, needlessly restrict companies' freedom to lay out their internal governance and they will increase the cost of audits.

This is especially true for the proposed mandatory rotation of audit firms and the cap on the provision of "related financial audit services", but also extends to the definition of prohibited non-audit services and the detailed regulation of the Audit Report.

As for the provision of non-audit services, we believe that the definitions should use the Code of Ethics of the International Ethics Standards Board for Accountants (IESBA) as a starting point. Furthermore, we believe that the regulation on the Audit Report should be principle-based allowing for the alignment of the report with the International Standards on Auditing.

Instead of the aforementioned proposals on auditor's independence, BUSINESSEUROPE would support strengthening the focus on corporate governance relating to audit, i.e. the supervisory role of the Supervisory Board / Board of Directors and the Audit Committee: a comply-or-explain approach would build on the initiatives already taken in the area of corporate governance. The Audit Committee could report to the Supervisory Board / Board of Directors at least every 4 years on its monitoring of the auditor's work and independence. As a result of this report, the company could include their conclusions in the mandatory corporate governance report in the annual report, as well as the length of auditor tenure and the date of the last tender. This would also address the concerns perceived to exist.



To respect different Member States' corporate governance and company law regulatory frameworks, BUSINESSEUROPE opts to transfer best practices concerning corporate governance and auditing from the audit regulation to the Audit Directive.

BUSINESSEUROPE does not support additional restriction on the composition of the Audit Committee. It should be left to the companies themselves to elaborate on the required expertise in the Audit Committee to be able to fulfill an adequate role in assessing the functioning of auditors and the engagement of audit firms. Regulating this part of the company's internal corporate governance system will be counterproductive.

Finally, BUSINESSEUROPE believes that the regime for Administrative Sanctions in the proposed regulation is disproportionate and does not take into account the different legal environments in the Member States. BUSINESSEUROPE is especially concerned about having a level of administrative pecuniary sanctions of up to 10% of the total consolidated annual turnover.

We explain these issues in more detail in the appendix to this letter.

We hope that you share our concerns and recommendations and remain at your disposal should you wish to discuss this subject further.

Yours sincerely,

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Director
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Appendix

Mandatory rotation

Mandatory rotation is a massive intervention into freedom of contract and the Audit Committee's decision-making authority. The introduction of mandatory rotation thus contradicts the proposal's intention of strengthening the competencies of the Audit Committee.

Also, mandatory rotation of audit firms on a very short rotation, combined with a cooling off period of 4 years, effectively reduces the number of independent audit firms that are available and qualified to bid for an audit. Moreover, the rotation of audit firms will not improve audit quality since it will lead - regardless of the time frame chosen - to a significant loss of knowledge of the audit. Large international groups are so complex that the audit firm needs time to understand all the related intricacies. The proposed requirements for auditor selection will restrict the existing competition between audit firms and will lead to revolving-door contracts with no consideration of competition. A handover file would not compensate for extensive loss of know-how and the resulting loss of audit quality. Considerable cost increases can be expected due to slower and error-prone financial reporting and regulated price-setting.

Moreover, when audit firms know that they will have to rotate, the incentive to perform a high quality audit is reduced and it could lead audit firms to reduce their investment in audit files. Thus neither audit quality nor increased competition in the market is served by a mandatory rotation.

Concerning internal rotation the proposal stipulates mandatory rotation not only for key audit partners, but for all statutory auditors. This requirement has to be restricted to key partners because each rotation leads to a loss of know-how, and personal constancy would be impossible. There are no independence issues regarding non-partners. Further, we are convinced that a transfer of paragraph 33.4 on internal rotation to the Directive 2006/43/EC is necessary as individual Member States' legislation would help to tailor rotation requirements to the local environment and combine it appropriately with other measures to achieve the desired objective.

BUSINESSEUROPE would support strengthening the focus on corporate governance relating to audit, i.e. the supervisory role of the Supervisory Board / Board of Directors and the Audit Committee: a comply-or-explain approach would build on the initiatives already taken in the area of corporate governance. Audit Committee could report to the Supervisory Board / Board of Directors at least every 4 years on its monitoring of the auditor's work and independence. For this end Audit Committees should be able to make use of the results of the audit regulators' enforcement activities related to the companies external auditor. As a result of the report the company could include their conclusions in the mandatory corporate governance report in the annual report, as well as the length of auditor tenure and the date of the last tender. This would also address the concerns perceived to exist.



Cap on the provision of "related financial audit services"

Related financial audit services are services that by definition do not interfere with the independence of the auditor. Most of these services are services where the auditor is required to be independent and issues an audit opinion. A considerable portion of audit related fees are spent for the review of interim financial statements which is an integral part of the year-end audit. This ensures the quality of interim financial statements and enhances the overall quality of yearly statutory audit and the resulting external financial reporting. As the same auditor is reviewing interim financial statements during the year, knowledge and information is preserved for the year-end audit, allowing the company to work in an efficient and cost saving manner. We also believe it to be very difficult engaging an audit firm which takes responsibility for the review of interim financial statements without auditing year-end financial statements, as a review also requires a good knowledge of the company. Consulting another auditor would therefore not only result in higher audit and review fees, but also in more time spent on the audits and reviews, possibly leading to delayed publication dates for companies financial information. Other related financial audit services (for instance on internal control or assurance on regulatory reporting) may also contribute in a positive way to the general work of the auditor and, for that reason, the proposed cap may have counterproductive effects.

With the proposed 10% cap on related financial audit services, a company will be blocked from using its auditor to provide assurance for instance on interim financial statements or other statements to the public. BUSINESSEUROPE believes that the Audit Committee should be responsible for defining and approving a services catalogue and a fee policy statement to be adopted by all subsidiaries to be able to survey and monitor the audit-related services provided by the statutory auditor. All services for which the auditor shall be engaged are frequently reported to and monitored by the Audit Committee, respectively. We consider this process to be adequate to avoid potential conflicts of interest of the auditor and to safeguard the independence of the auditor in respect of such activities.

In order to ensure both the quality of financial reporting and the auditor's independence, we strongly recommend deleting Article 9.2 and instead to introduce under Article 31.5 a specific obligation for the Audit Committee to approve and review audit related services. We believe that sufficient measures to ensure independence of the auditor would exist if full responsibility concerning audit services is assigned to the Audit Committee.

The definition of prohibited non-audit services and the Code of Ethics

The proposed regulation includes a list of prohibited non-audit services as well as lists of related financial audit services and services in a grey area. BUSINESSEUROPE believes that a list should build on the IESBA Code of Ethics and the wording should be similar to the Code to the extent possible. If it is deemed necessary to extend the list beyond the services prohibited in the Code of Ethics, it should be clearly stated that the item is not a part of the current Code of Ethics.



Today, the IESBA Code of Ethics is the international reference. Almost all of the companies covered by the regulation operate internationally. Therefore if the list is based on the IESBA Code of Ethics and it is clearly highlighted if there are additional services being prohibited in Europe, then this will provide for a clear communication throughout the group.

Further, we believe that due diligence services as well as tax compliance work should not be transferred to the prohibited list, but should be allowed subject to approval and supervision from the Audit Committee. This is due to the fact that the need for these services arises very fast and that a very good knowledge of the company is needed in order to assist the company in their deliberations and evaluation of the target company. If information about the work becomes public knowledge, then most often the deal will be lost. The regulation's proposal would thus constitute a difficulty for European companies in their international development. With regard to tax compliance work (tax returns, etc.), a general prohibition of these services would potentially cause a decrease of quality in the audit of financial statements due to the fact that a profound knowledge of tax issues is frequently essential to assess the accurateness of deferred taxes.

Audit Report and the International Standards on Auditing (ISAs)

Generally, BUSINESSEUROPE finds it very important that audit regulation is based on international accepted principles. BUSINESSEUROPE welcomes suggestions to formally introduce ISAs directly within the European auditing framework, binding auditors how they conduct their audit.

For BUSINESSEUROPE it is very important that the Auditor's Report is in line with the International Standards on Auditing as companies subject to the regulation operate internationally. They need to be able to attract investments on a global level and a globally accepted Auditor's Report is an important aspect to support the transparency and thereby the access to investments. Therefore, Auditor's Reports should be in conformity with international regulations and principles and should be governed by a global level framework in order to increase global transparency. Audit reports should be short and to the point. It should be clear whether they are qualified or not, and the audit report should not address issues that rightfully should be addressed by accounting or other reporting standards.

In short, we recommend that the regulation on the Audit Report will be principle based allowing for the alignment of the report with the International Standards on Auditing. This will also allow for possible future changes in the audit report to be incorporated without having to reopen the regulation.

No regulation of Audit Committees as part of corporate governance systems

Audit Committee provisions (Article 31) can only work properly once adjusted to individual Member States' regulation. The reason is still differing governance models in Member States' company laws which basically are the one tier board structure versus two tier management and supervisory bodies. The best solution would be a move to

the Directive 2006/43/EC by means of a reinstatement of article 41 of this Directive. This offers a flexible and workable solution to companies regarding Audit Committees.

The composition of the Audit Committee is decisive on the effectiveness of control and in the interest of companies. We do not believe that there is a benefit in having auditors speaking with auditors. Therefore, BUSINESSEUROPE does not support the requirement for two members of the Audit Committee to have competence in auditing and accounting.

In general it should be up to the companies to choose the number of participants in the Audit Committee. Combined with the fact that different governance models set different requirements leads us to believe that the existing requirement, where one member has to be independent and have competence in auditing/accounting should be maintained. It should be left to the companies themselves to elaborate on the required expertise in the Audit Committee to be able to fulfill an adequate role in assessing the functioning of the company's auditors and the engagement of audit firms. BUSINESSEUROPE supports the view that companies should aim at having as broad a coverage as possible in the Audit Committee, but the composition of the Audit Committee should not be too prescriptive as this could limit considerably the availability of qualified potential Audit Committee members and may also cause conflicts in independency.

In short, BUSINESSEUROPE does not support the requirement for two members of the Audit Committee to have competence in auditing and accounting.

Regime for Administrative Sanctions

BUSINESSEUROPE finds that the regime for Administrative Sanctions in the proposed regulation is disproportional and does not take into account the different legal environments in the Member States. BUSINESSEUROPE is especially concerned about having a level of administrative pecuniary sanctions of up to 10% of the total consolidated annual turnover.

It is noted in the proposal that the sanction is applicable to, for instance, situations where the company has not set up an Audit Committee, the Audit Committee members do not have the appropriate qualifications or the company has changed the auditor. BUSINESSEUROPE finds the sanctions to be disproportional for an administrative failure. The questions are an issue for the owners, and in some companies the election of the Audit Committee is a decision taken by the shareholders. Further, in some Member States the supervisory body as such can take over the responsibilities of the Audit Committee. Finally, we cannot see why we need administrative sanctions on top of the normal court systems that ensures a separation between the authorities that issues and interprets the regulation and the enforcement of the same regulation.