



**Mr Klaus-Heiner Lehne**  
Member of the European Parliament  
European Parliament  
Rue Wiertz 60  
1047 Bruxelles

21 November 2013

Dear Member of the European Parliament,

I write to you regarding current discussions on the Audit Regulation and Directive.

BUSINESSEUROPE supports the efforts to adopt new rules which ensure that European companies have access to high quality audits and that auditors operate independently. Both the European Parliament and the Council have made significant progress on the dossier and we are pleased that you may soon be able to agree a final set of rules that is both practical and able to ensure confidence in the audit.

There are nevertheless a number of issues that could have undesirable consequences such as lowering the overall quality of audits or needlessly restricting companies' freedom to lay out their internal governance.

This is especially true for the proposed mandatory rotation of audit firms and the definition of non-audit services which creates the risk of being misaligned with current international definitions and practices, generating significant compliance challenges for businesses in an international context. We also have concerns about the wording and scope of the audit report which could also lead to conflicts with anticipated international practices.

We explain these issues in more detail in the appendix to this letter in which we also make some concrete suggestions. BUSINESSEUROPE hopes that you share its concerns and recommendations and remains at your disposal should you wish to discuss this subject further.

Yours sincerely,

Markus J. Beyrer



### EUROPEAN AUDIT REGULATION

#### **BUSINESSEUROPE'S COMMENTS ON KEY AREAS OF DISCREPANCY IN THE COMPROMISE PROPOSALS FROM THE EUROPEAN PARLIAMENT AND THE COUNCIL IN THE CONTEXT OF TRILOGUE NEGOTIATIONS.**

BUSINESSEUROPE has monitored developments and negotiations on the Audit Regulation and the Audit Directive. We believe that both the European Parliament and the Council have made significant progress on the dossiers in order to achieve a final set of regulations that is both practical and able to ensure enhanced confidence in the audit.

BUSINESSEUROPE welcomes a common approach to the composition of the audit committee by removing a requirement for having a member with specific knowledge in auditing on top of the current requirement of having an independent member with knowledge in auditing and/or accounting.

Having said this, the current proposals still raise three areas of concern:

- The principle of mandatory firm rotation generates practical concerns and problems;
- The definition of non-audit services creates the risk of being misaligned with current international definitions and practice and thus could lead to significant compliance challenges for businesses in an international context;
- The wording and scope of the audit report risks being misaligned with anticipated international practice.

#### **Mandatory Firm Rotation**

BUSINESSEUROPE firmly believes that the independence of the auditor is a key element for ensuring audit quality. However, the current regime enacted in 2008 with regular partner rotation and strong oversight by audit committees has proven to be efficient and is only now beginning to mature. It would therefore be untimely to put in place new measures before having evaluated existing measures.

Nevertheless, BUSINESSEUROPE has suggestions to make on the current proposals:

<b>Text reference</b>	<b>Council</b>	<b>Parliament</b>	<b>Suggestion by BUSINESSEUROPE</b>
Reg: Article 33			
Initial period (2 terms)	Up to 10 years (MS option)	Up to 14 years (MS option)	Up to 14 years (two times 7 years corresponding with the partner rotation), , provided regular audit

			committee assessments (at least every 7 years). No MS option in order to generate level playing field for MNE's/PIE's
MS option (3 <sup>rd</sup> term)	+ 5-10 years	+ 11 years	+ 7 years (third partner rotation). No MS option
Criteria for 3 <sup>rd</sup> term	Tender or joint audit during initial terms	Tender, Audit Committee Assessment or joint audit during initial terms	Regular audit committee assessment, public tender or joint audit. No MS option in order to generate level playing field for MNE's/PIE's
Cool-on (required period of independence prior to election) (Directive art 22 and Reg Art 10(1))	Independent from the financial year covered. Internal control design and implementation services prohibited in financial year prior to financial year covered	Independent from the financial year covered	Independent from the financial year covered
Cool-off period Reg. art 33 Reg. art 10	4 years - audit services 6 months – NAS	4 years	4 years provided they can provide any non-audit service in order to ensure competition on the non-audit service market segment

Our suggestion tries to align the overall rotation criteria with the partner rotation requirement. Furthermore, it is of utmost importance to generate a level playing field by setting a mandatory 14 years initial period in order to ensure that large MNEs with Public Interest Entities in more than one jurisdiction can establish a robust rotation plan both for the audit firm rotation and the partner rotation. It should also be noted that according to the International Standards on Auditing, group audits should be conducted by the same auditor(s) throughout the group.

Special attention should be given to the transition period in order for companies being able to adapt to the new regime. There should be substantive lead time to shift current and possible long non-audit services projects away from potential future auditors in order for the potential auditors to fulfill the cool-on requirements. This should also ensure that Europe does not face a disproportional number of audit tenders in the first 1-2 years.

**Non-Audit Services**

BUSINESSEUROPE also has suggestion on the proposals regarding non-audit services:

<b>Text reference</b>	<b>Council</b>	<b>Parliament</b>	<b>Suggestion by BUSINESSEUROPE</b>
Reg: Article 9+10			
Alignment of list with IESBA Code of Ethics	No Different phrasing: Art. 10(1)(b, c, d, l(i))	Yes	Follow JURI-proposal in order to achieve global comparability and ensure global compliance
Additional prohibited services	Tax compliance assistance (Art 10(1)(a))  Human resource services – cost control and structuring the organization (Art 10(1)(l(ii)+(iii)))	None	BUSINESSEUROPE does not support the extension. However, if further services are prohibited, then it is very important that it is clearly stated which services – on top of the Code of Ethics – are specifically prohibited in Europe in order to facilitate global compliance within a MNE-group
CAP (Regulation Art 9(2))	70 % of audit fee	None	BUSINESSEUROPE believes the blacklist is sufficient combined with Audit Committee approval and oversight

It is very important that the starting point for prohibiting non-audit services is the services that are already prohibited today by the IESBA Code of Ethics (Code). It is key that MNEs and especially the Audit Committees of the MNEs can effectively and efficiently monitor that no prohibited non-audit services are being provided. However, if the definitions in Europe are different from the globally accepted definitions currently in the Code, then it becomes very difficult to ensure compliance globally, especially in jurisdictions where they use the Code and they will have a different understanding compared with the European definition.

In order to resolve this, we suggest starting with the list and definitions that are currently in the Code of Ethics and then clearly indicate any changes/additions to this list. We hope that the additional items will be limited.

**Audit Report**

BUSINESSEUROPE has suggestions on the proposed changes to the Audit Report:

<b>Text reference</b>	<b>Council</b>	<b>Parliament</b>	<b>Suggestion by BUSINESSEUROPE</b>
Reg: Article 22 Directive: Article 28			
Going concern	Directive Art 28(1)(f1): Provide a statement on any material uncertainty(ies) related to events or conditions that may cast significant doubt about the entity's ability to continue as a going concern	Regulation Art 22(2)(l): Provide <ul style="list-style-type: none"> <li>• A conclusion on the appropriateness of the going concern assumption; and</li> <li>• A statement as to whether the auditor has identified any material uncertainty relating that may cast significant doubt about the going concern assumption</li> </ul>	The approach taken by Parliament is closest to the approach taken by IAASB. The parliament approach allows for a short and clear statement, which BUSINESSEUROPE finds most useful and more useful than the longer narrative in the IAASB proposal.
Information about "Risk of material misstatement"	Directive Art 28(1)(f2): Report if, in the course of conducting the audit, he/she/it has become aware of any key areas of risk of material misstatement of the annual or consolidated financial statements	Regulation Art 22(2)(fa): Provide <ol style="list-style-type: none"> <li>1. a description of the most important assessed risks of material misstatement;</li> <li>2. a summary of the auditor's response to those risks; and</li> <li>3. key observations arising from the audit work</li> <li>4. a clear</li> </ol>	BUSINESSEUROPE finds it important that any reporting is short, precise and company specific and does only focus on the audit. This section should not include new information on the financial statements. IAASB focuses in their current exposure draft on "areas identified as significant risks in accordance with the

		<p>reference to the relevant disclosures</p> <p>Matters to be disclosed should be discussed with the audit committee</p>	<p>relevant auditing standard and/or ability to obtain sufficient audit evidence.</p> <p>The information entitled "Key Audit Matters" is suggested to include</p> <ul style="list-style-type: none"> <li>• why the matter is important;</li> <li>• a reference to the relevant disclosure; and</li> <li>• The section should not contain conclusions.</li> </ul> <p>BUSINESSEUROPE strongly suggests to align the final text with the international initiative. To this extent BUSINESSEUROPE suggests to build on the Parliament proposal. We believe that point 3 in the Parliament proposal on Art 22(2)(fa) should be deleted, as this could blur the clarity of the section for the reader and very quickly generate hidden (or soft) qualifications leaving the reader more confused at the end of the day.</p>
Scope	All entities	PIE's	<p>BUSINESSEUROPE supports the line taken by IAASB in their exposure draft, implying that reporting on Going Concern should be included in all audit</p>

			reports and reporting on Key Audit Matters should only be included in reporting for listed (or in Europe PIE) entities.
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We noted the enhanced support for the International Standards on Auditing, including the alignment with the current IAASB-project on Auditor Reporting. In regard of the specific wording in Article 22 in the Regulation and article 28 in the Directive, we would like to draw attention to the current IAASB proposal on Auditor Reporting. According to our analysis, the current wording in the Parliament proposal seems to be closer aligned with the IAASB draft than the Council text both in scope and in content (wording). We suggest aligning the final text with the international initiative, especially as the differences are mostly in wording rather than in the intended content. To this extent, we believe that point 3 in the Parliament proposal on Art 22(2)(fa) should be deleted as this could blur the clarity of the section and lead to confusing hidden (or soft) qualifications.

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