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AK Position Paper

AK Position Paper on the Proposal concerning statutory audits (Directive and Regulation)

About us

The Federal Chamber of Labour is by law representing the interests of about 3.2 million employees and consumers in Austria. It acts for the interests of its members in fields of social-, educational-, economical-, and consumer issues both on the national and on the EU-level in Brussels. Furthermore the Austrian Federal Chamber of Labour is a part of the Austrian social partnership.

The AK EUROPA office in Brussels was established in 1991 to bring forward the interests of all its members directly vis-à-vis the European Institutions.

Organisation and Tasks of the Austrian Federal Chamber of Labour

The Austrian Federal Chamber of Labour is the umbrella organisation of the nine regional Chambers of Labour in Austria, which have together the statutory mandate to represent the interests of their members.

The Chambers of Labour provide their members a broad range of services, including for instance advice on matters of labour law, consumer rights, social insurance and educational matters.

More than three quarters of the 2 million member-consultations carried out each year concern labour-, social insurance- and insolvency law. Furthermore the Austrian Federal Chamber of Labour makes use of its vested right to state its opinion in the legislation process of the European Union and in Austria in order to shape the interests of the employees and consumers towards the legislator.

All Austrian employees are subject to compulsory membership. The member fee is determined by law and is amounting to 0.5% of the members' gross wages or salaries (up to the social security payroll tax cap maximum). 560.000 - amongst others unemployed, persons on maternity (paternity) leave, community- and military service - of the 3.2 million members are exempt from subscription payment, but are entitled to all services provided by the Austrian Federal Chambers of Labour.

Herbert Tumpel
President

Werner Muhm
Director

Executive Summary

The measures by the European Commission on restoring confidence in annual statutory audits include a proposal for a Directive of the European Parliament and the Council on amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts on the one hand, and a proposal for a Regulation of the European Parliament and the Council on specific requirements regarding statutory audit of public-interest entities on the other.

1. Statement on amending the Directive on statutory audits of annual accounts and consolidated accounts

The proposals for the Directive have to be analysed against the background of the recipients of annual statutory audits. The group of audited annual accounts is not only limited to investors, but includes also and in particular creditors, employees and other stakeholders that have to be protected by transparent, sound and reliable information. Hence, the measures provided within the scope of the planned Regulation to improve the information on the economic situation and to strengthen the independence of statutory audits should therefore not be limited to public-interest entities, but apply in general by being included in the Directive. In particular the external rotation of audit firms, the suggested improvements in respect of carrying out statutory audits, the extensions of the statutory auditor's report

as well as preventing conflicts of interest (separation of audit and non-audit services) should be included in the Directive.

2. Statement on the Proposal for a Regulation of the European Parliament and the Council on specific requirements regarding statutory audit of public-interest entities

From the point of view of the AK, in particular the proposals included in the planned Regulation represent an important step towards strengthening the independence of statutory audits. The Regulation proposals have to be mainly supported. In particular the mandatory external rotation of audit firms, the improvements in respect of carrying out statutory audits and preparing auditor's reports as well as the ban on audit firms providing non-audit services strengthen the independence and the quality of statutory audits and should therefore in general be included in the Directive.

The AK emphasises once again that the definition of the term "public-interest entities" has to include all undertakings that have to set up an audit committee.

The AK position in detail

1. Statement on amending the Directive on statutory audits of annual accounts and consolidated accounts

The proposals for the Directive have to be analysed against the background of the recipients of annual statutory audits. The group of audited annual accounts is not only limited to investors, but includes also and in particular creditors, employees and other stakeholders that have to be protected by transparent, sound and reliable information. Hence, the measures provided within the scope of the planned Regulation to improve the information on the economic situation and to strengthen the independence of statutory audits should therefore not be limited to public-interest entities, but apply in general by being included in the Directive. In particular the external rotation of audit firms, the suggested improvements in respect of carrying out statutory audits, the extensions of the statutory auditor's report as well as preventing conflicts of interest (separation of audit and non-audit services) should be included in the Directive.

On the individual proposals:

Article 2 a) (1)

We welcome the proposed definition in respect of statutory audits as it enables the Member States to require statutory audits also for smaller entities.

Article 2 d) (13)

This Article is of key significance as the measures laid down within the scope of the Regulation on strengthening the independence of statutory audits only apply to "public-interest entities". If the EU Commission had its way, only banks, insurance companies and listed companies are public-interest entities.

Large, non-listed corporations, which from a stakeholder point of view, due to their activities, their size or the number of their employees are also of public interest, are not included by the Regulation; hence, they are not affected by the increased requirements on statutory audits.

The AK regards such a limited definition of the term "public-interest entities" as not acceptable. Within the scope of the definition, all entities have to be included that have to set up an audit committee. These include, apart from

capital market oriented corporations, all so-called XL companies as defined in § 271a UGB [Austrian Commercial Code], if the corporation reaches the quantitative threshold pursuant to § 221(3) first sentence UGB and if it in addition exceeds the threshold expressed in Euro by fivefold. Thus, XL companies have to be included in Article 2 d) (13). The Member States must at least be given the option to extend the definition “public-interest entities”.

Article 3 and Article 22(2)

The AK is opposed to any liberalisation of the provisions in respect of ownership of audit firms. Any raising of capital from external sources (e.g. capital market) does promote large audit firms even more. Apart from that, external investors will require a rate of return, which may affect the independence of statutory audits. Independence could also be threatened by possible interests of companies to be audited in audit firms. In the end, the investors decide on the continued existence of the company, which means they have significant influence on the business policy. The AK is also critical of the fact that audit firms may be members of the administration or administrative body of the audit firm.

Article 3 a) and Article 3 b)

The proposals aim at opening the market for audit firms within the European Union. Statutory auditors and audit firms shall be able to expand their auditing activities within the Union and be given the option of also working in other Member States. However, the AK is doubtful whether this will change the competitive situation and that small or medium-sized audit firms will find it easier to access the market. On the contrary, the pressure on smaller providers on the national market will even intensify.

Carrying out a statutory audit requires comprehensive knowledge of various fields of law, which, depending on the Member State may be regulated very differently (e.g. tax law). There must not be any difference with regard to the required skills, whether cross-border auditing activities are only carried out on a temporary basis or occasionally or whether it is the aim to set up a permanent base in a host Member State. From the point of view of the AK, a combination of an adaptation period and a subsequent aptitude test should be requirements for all cross-border auditing activities. Only if the required linguistic and legal skills exist, it will be possible to provide proper cross-border statutory audit services.

Article 6, Article 14 and Article 26

Both training requirements and examination standards have to be harmonised within the Union to ensure that statutory audits in the Single Market are of equal quality. Thus, the AK welcomes the efforts of the Commission in respect of urging the competent authorities in the Member States to work more closely together.

Article 32 and Article 32 a)

The AK generally adopts a positive attitude towards the proposal of the Commission that in future a public authority will be responsible for accrediting and registering statutory auditors and audit firms as well as being in charge of quality assurance. However, the authority has to be adequately equipped with the relevant necessary personnel and financial resources.

However, if already the first proposal of the Commission states that the “new” authority will be able to delegate accrediting and registering responsibilities to other authorities and bodies, it is to be expected that professional organisations will continue to play a key role. Austria, for example has a two-stage quality control system. A working committee for external quality assessments - appointed by the auditors - that undertakes the actual quality control is acting at the operative level. The independent

public quality control authority, whose resources are extremely modest, acts in a second instance. It is not clear whether the provision in Article 32 (b) line 3 that “Practitioners shall not be allowed to be involved in the governance of the public oversight system”, also applies in case of delegating responsibilities in accordance with Article 32 a). It should be the aim that also with regard to delegating responsibilities strict independence rules will be enforced and that Article 32 applies. The BAK suggests to include the independence principles set out in Title VI, Article 36 of the Regulation in the Directive.

The AK welcomes the right of the competent authority in accordance with Article 32 d) (5) “where necessary, to initiate and conduct investigations in relation to statutory auditors and audit firms and the right to take appropriate action” as well as the obligation to provide the authority with adequate resources.

Article 43 a) and Article 43 b)

The AK rejects an adaptation of auditing standards to the scale of the business of the undertaking. Based on the reduced complexity of accounting relating to small and medium-sized enterprises, the audit effort is small in any case; therefore, we regard the additional softening of auditing standards as not being necessary. The legal pro-

visions in respect of supervisory bodies also do not include different control standards with regard to the scale of undertakings, as here too the control complexity of small and medium-sized enterprises is smaller in any case.

2. Statement on the Proposal for a Regulation of the European Parliament and the Council on specific requirements regarding statutory audit of public-interest entities

From the point of view of the AK, in particular the proposals included in the planned Regulation represent an important step towards strengthening the independence of statutory audits. The Regulation proposals have to be mainly supported. In particular the mandatory external rotation of audit firms, the improvements in respect of carrying out statutory audits and preparing auditor's reports as well as the ban on audit firms providing non-audit services strengthen the independence and the quality of statutory audits and should therefore in general be included in the Directive.

The AK emphasises once again that the definition of the term "public-interest entities" has to include all undertakings that have to set up an audit committee.

On the individual proposals:

Title II

Conditions for carrying out statutory audit of public-interest entities

Chapter I - Independence and avoidance of conflict of interest

Article 7 and Article 8

Clear incompatibility rules should apply to statutory auditors and audit firms relating to statutory audits of public-interest entities and the until recently large discretionary powers of the Member States should be restricted. The AK supports the measures suggested in the Regulation and regards it, within the meaning of independence, as proper that auditors are not permitted to carry out transactions with financial instruments, which are issued, guaranteed or secured by an audited undertaking.

The "cooling-off period" laid down in Article 8, according to which "a statutory auditor or a key audit partner who carries out a statutory audit of a public-interest entity on behalf of an audit firm shall not, before a period of at least two years has elapsed since he or she resigned" take up a key management

position or a become a member of the audit committee of the audited entity, is also regarded by the AK as a sensible strengthening of independence. However, this regulation only refers to the audited entity. In order to prevent attempts to bypass this rule, we suggest to extend the two-year “cooling-off period” also to the affiliated companies of the audited entity.

We also suggest to apply the independence standards proposed in the Regulation to all statutory audits, thereby regulating them in the Directive. The special aim of the statutory audit is to protect creditors; hence, it is difficult to understand why the independence standards should only apply partially.

Article 9

The definitions and requirements on audit fees specified in Article 9 are also an important step towards strengthening the independence of statutory audits. From the point of view of the AK, the relevant measures in case the fee limits have been exceeded - disclosure and approval by the audit committee or the supervisory authority - are adequate.

However, it has to be noted that the audit committee is only authorized to take decisions if the supervisory body in its entirety grants decision-making competencies to the audit committee. The Regulation should take the general

principle of corporate governance into consideration and therefore name the supervisory body as a whole or the administrative body as the primarily competent organ for making decisions.

Article 10

The Regulation makes it clear that non-audit services are in general incompatible with the independent function of statutory audits, which are in the public interest and that for this reason they may not be provided by the statutory auditor. This ban, which is to be supported in general, is immediately undermined by that fact that certain non-audit services may after all be provided by the audit firm, provided the audit committee (relating to expert services and bookkeeping) or the competent authority (in case of ICS measures, valuation services) gives its prior approval.

Taking into consideration that the prospect of profitable consultancy contracts could affect the objectivity of the audit result, the AK has always demanded a stricter separation of audit and consultancy. The submitted draft of the Commission is in accordance with the demands of the AK, and has its support in spite of the restrictions referred to.

The comments on Article 9, second paragraph, according to which the supervisory body in its entirety is the primarily competent decision-making body, also apply here.

Article 11

The AK regards the stronger integration of the audit committee with regard to assessing the independence of the auditor as sensible. However, it must be made clear that the audit committee is responsible to the supervisory body as a whole or the administrative body and is only able to take decisions to the extent it has been authorised by the supervisory body or administrative body. The overall responsibility of the supervisory body in respect of the annual statutory audits also remains if an audit committee has been set up.

As the audit committee is always exclusively made up of members of the supervisory body or the administrative body, only the supervisory body or the administrative body are able to assume the functions of the audit committee if the latter does not exist.

Chapter II - Confidentiality and professional secrecy

No comments

Chapter III - Performance of the statutory audit

Article 14

Of course the future is uncertain and annual statutory audits can only provide a limited assessment on the future viability of a corporation. However - as outlined in (2) - the auditor may not be fully relieved of all responsibility regarding the future viability of the corporation. In accordance with Article 22 (l) the auditor has to "provide a statement on the situation of the audited entity or, in case of the statutory audit of consolidated financial statements, of the parent undertaking and the group especially an assessment of the entity's or the parent undertaking's and group's ability to meet its/their obligation in the foreseeable future and therefore continue as a going concern." However, the auditor provides an assessment on the future viability of the audited corporation, for which he assumes responsibility. In the event that the development of the audited company contradicts the auditor's assessment it has to be examined whether and to which extent the auditor should have foreseen this development.

Articles 15 to 20

These concern the rules relating to the performance of the statutory audit. The provisions contained in the draft Regulation are necessary to ensure uniform standards in the Union.

Chapter IV - Audit reporting

Article 22

So far, one of the greatest problems of statutory audits has been the negative perception of a “restricted” auditor’s report. Over the years, this has led to an “all or nothing” mentality, with the consequence that in practice restrictions or omissions in the auditor’s report are the absolute exception. The unrestricted or positive auditor’s report only provides information specifying that the annual account is a true and fair view of the actual circumstances; it does not provide a differentiated explanation on the quality of the annual account or even less on the financial soundness of the undertaking. The AK expressly welcomes the proposal of the Commission to supplement the auditor’s report accordingly. All items of the auditor’s report referred to improve both transparency and significance of the audited annual account. We would like to point out again that the aimed at improvements of the auditor’s report would be important for all statutory audits - and not only for statutory audits of public-interest entities.

Article 23

The contents of the additional report to the audit committee provided for in Article 23 are also sensible in principle from the point of view of the AK. However, it must also be mandatory to submit this report to the supervisory body as a whole as the supervisory body as a whole of a public limited company is responsible for the observation of the audited annual account.

We suggest including the additional reporting points in the Directive as they are relevant to all audited entities.

Article 24

It is of particular importance that the audit committee comprehensively reports to the supervisory or administrative body on its activity and integration with the scope of statutory audits. The audit committee may not be allowed to separate from the supervisory body as a whole. Committees and thereby also the audit committee have the primary purpose of preparing negotiations and decisions for the supervisory or administrative body or to supervise the decisions of supervisory or administrative bodies.

Chapter V - Transparency reporting by statutory auditors and audit firms and record keeping

Articles 26 to 30

Statutory auditors and audit firms have - as outlined in the introductory remarks of the Regulation - an important social function. Creditors, employees, shareholders and the public sector rely on the statements of statutory auditors and audit firms in respect of the actual circumstances in audited entities. It is therefore justified that statutory auditors and audit firms have to demonstrate their independence to the outside by strengthened transparency provisions. Hence, the AK welcomes Articles 26 - 30 of the Regulation proposal.

Title III

The appointment of statutory auditors or audit firms by public-interest entities

Article 31 and Article 32

Due to EU regulations, the Member States already have clear legal provisions in place with regard to the composition of the audit committee and the appointment of statutory auditors and audit firms. The creation of new provisions by way of Regulation seems to be excessive. In addition, the tender procedure in respect of appointing statutory auditors as outlined

in the proposal does not represent a substantial development, as it is more a request to submit an offer rather than open tendering. Open and transparent tendering only exists if the invitation to tender is published.

Article 33

The AK welcomes the introduction of the external rotation of statutory auditors and audit firms. External rotation is an essential measure to promote the independence of statutory audits and also to boost competition between statutory auditors and audit firms. However, the duration of the engagement when exhausting the extension of up to 12 years is clearly too long and counteracts the intention. From the point of view of the AK, a mandatory change should take place after a maximum duration of six years, independent of the fact whether one or two statutory auditors or audit firms have been appointed. Any additional extension has to be rejected.

Article 34

As already pointed out several times, the corporate governance of the Member States should remain unaffected. Only the supervisory body and not the audit committee should be able to "inform the competent authority concerning the dismissal or resignation of the statutory auditor or audit firm" [...] and "give an adequate explanation of the reasons thereof".

Title IV

Surveillance of the activities of auditors and audit firms carrying out statutory audit of public-interest entities

The AK supports strengthening the authority within the scope of surveillance. However, it is not clear why the surveillance structure for public-interest entities in relation to other entities is regulated separately. It is not comprehensible that the independence standards set out in Article 36, the confidentiality in Article 37 or the powers of the competent authorities in Article 38 should only apply to those persons who are responsible for surveilling public-interest entities within the authority. It will have to be assumed that in practice only one authority competent for surveillance will exist at national level. Hence, the standards of the Regulation concerning the surveillance should therefore be uniformly defined in the Directive and apply to all statutory audits. A differentiation in accordance with recipients of audited annual accounts only makes sense in Article 40. Statutory auditors of public-interest entities pursuant to paragraph 2 should be subject to quality assurance reviews carried out by the authority in three-year intervals; in respect of statutory auditors of remaining entities, a quality assurance review in six-year intervals should be adequate.

Should you have any further questions
please do not hesitate to contact

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