



September 2012
AK Position Paper

AK position on the Karim report (JURI):
Commission Proposal for a Directive on
amending Directive 2006/43/EC on statutory
audits of annual accounts and consolidated
accounts and for a Regulation on specific
requirements regarding statutory audit of
public-interest entities

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

At the end of last year, Commissioner Barnier submitted a Commission proposal on amending the Audit Directive as well as a proposal especially for public-interest entities. Background of the revised regulations is the Green Paper on Audit Policy from 2011, which attracted harsh criticism, in particular with regard to the independence of auditors. The Commission is convinced that the financial crisis has brought to light massive deficiencies concerning the rules applying to statutory audits of annual accounts.

The draft of the Commission has been intensively discussed at national level in Austria within the scope of an expert group in the Federal Ministry of Justice. Representatives of auditors, science, Austrian social partners, the Austrian Financial Market Authority as well as the Ministries of Justice, of Finance and of Economy, Family and Youth have among other participated in these discussions. Particular intensive discussions took place with regard to separating consultation and audit as well as external rotation. From the point of view of the Austrian Federal Chamber of Labour, we would like to emphasise that these subjects have been controversially evaluated and that it has not been possible to find a unified opinion. However, the hostile attitude of business and auditor representatives is in contrast to the opinion of the BAK - supported in particular also by representatives of the Financial

Market Authority -, who are explicitly in favour of external rotation. The BAK also expects independence to be strengthened by a clearer separation of consultation and audit.

On June 22nd, the rapporteur of the Legal Committee of the European Parliament Sajjad Karim submitted a working document to the Committee, in which he in particular deals in more detail with "controversial" areas, concerning for example the audit committee, auditors' reports and the independence of auditors.

We would like to outline our positions on these subjects within the scope of this letter. From our point of view, an implementation of the key points of the Commission proposals is in particular important to set a clear sign towards strengthening the independence of corporate supervisory boards as well as their impact.

The AK position in detail

Principal issues on the differentiation between Directive and Regulation

In our opinion, the differentiation between Directive and Regulation has not been wholly successful. Many reform proposals were only included in the Regulation and would therefore only apply to public-interest entities, but not to all other corporations, such as (including major) companies that are not listed, limited companies with supervisory board or board etc. These points include for example the provisions in Chapter 1 of the Regulation with regard to separating consultation and audit, in Chapter IV the rules on the content of the audit report and of course in Chapter V the rules on the appointment of the statutory auditor. From the point of view of the BAK, these points should be included in the Directive and therefore apply to all entities. From our point of view it is difficult to understand why in case of these companies

- a concurrent consultation and audit of companies carried out by the same auditor should be less controversial in respect of independence;
- why the audit certificate shall be less detailed
- why the report of the auditor to the supervisory board shall be less detailed
- or why regular rotation should not benefit independence.

The BAK finds such a limited definition of the term "public-interest entities" difficult to understand. The definition should include all companies that have to set up an audit committee. These

include apart from capital market oriented companies all so-called XL companies as defined in § 271a öUGB [Austrian Commercial Code], i.e. when the company is the size defined by § 221 Paragraph 3 first sentence UGB and when it - in addition - exceeds the size criteria expressed in Euro by a factor of five. Article 2 d) Number 13 has to be expanded by XL companies. The Member States must at least have the option to expand the term "public-interest entities".

Pension or Severance Pay Funds must also be classified as public-interest entities.

Separation of consultation and audit

We reject the proposal of rapporteur Karim to provide the audit committee with greater competencies in respect of separating consultation and audit, for example with regard to certain non-audit services requiring prior approval by the audit committee. In Article 10 of the Regulation, the Commission proposal clearly prohibits the provision of non-audit services such as bookkeeping, valuation services, actuarial services etc., as these are completely incompatible with concurrent audit services. In contrast, the Commission proposal provides in exceptional cases prior approval by the audit committee concerning services, which might entail a conflict of interest, such as human resources services, preparing a comfort letter for investors and similar. From the point of view of the BAK, the ban on non-

audit services should under no circumstances be weakened; an approval by the audit committee can also not lessen the system's inherent dependencies, which arise in cases of concurrent audit and consultation. From the point of view of the BAK, the exceptional cases in the Commission proposal are appropriate.

Communication supervisory board/ audit committee with statutory auditors

The Green Paper on Audit Policy has repeatedly pointed out that often the communication between statutory auditors and supervisory boards is not optimal. The BAK shares this opinion. We therefore expressly welcome the measures provided for in the Regulation for example in respect of a more detailed report to the audit committee or a more detailed audit report. As already mentioned above, this improved form of reporting should be regulated for all companies and not only for public-interest entities. We therefore agree with rapporteur Karim, who voices his opinion on page 4 of his report, that "less is often more". The audit reports currently submitted to supervisory boards do hardly contain any details about procedure and results of the reporting activities. From our point of view, in future these must be depicted in the audit report in far more detail to give supervisory boards the opportunity of gaining a more differentiated picture of the audited company. The catalogue proposed in Article 23 of the Regulation must be appropriately revised.

External rotation

The external rotation is probably the most controversial point of the Commis-

sion proposals. It is firmly rejected by a part of auditors - in particular the Big 4 - and business organisations. However, in Austria it is expressly welcomed by representatives of supervisory authorities and the BAK. Rapporteur Karim recommends to discuss the issue further. From the point of view of the BAK, the fact that auditors without having the "economic pressure" not to lose the contract, can concentrate more on the audit itself, speaks for external rotation. The often voiced opinion that one had to expect a higher level of effort and lower auditing quality at the start of an audit, can be met by the proposal of the Commission draft that the minimum term of the appointment of an auditor shall be more than two years. Exceptions should only take place if a change of control takes place concerning the owner of the audited company. In addition, the optional proposed joint audits result in the fact that a second auditor is able to retain and apply the specific know how after the change. The forwarding of documents as well as the improved documentation of the audit proposed in the draft of the Commission also represent suitable countermeasures to the voiced criticism. The higher level of effort at the start of the auditing period is offset by the significant advantage that the auditor, when determining his audit results, is completely free of any economic interest; the term of the contract is clearly defined and limited. In addition, the existing auditor might also make a special effort as not to show any weakness or inferiority to the succeeding auditor during the legally subscribed change. A change of auditor is also associated with a change of method; hence with an increased chance to reveal any so far undiscovered weaknesses. At socio-psychological level, a regular change

of auditor is associated with a personal delimitation within the audit institution; any "confraternization", which is too close and might have a negative effect on the quality of the audit, can be reduced.

There are many studies concerning this subject, most of which emphasise the negative effects of a mandatory rotation; however, most of them are only of limited informative value, as they only reflect the opinion of questioned auditors and business representatives and on the whole focus on the quality of the audit as subject of the investigation. However, scientifically the latter is only very difficult to define so that the results of these studies are in most cases only able to comment on some aspects.

Restricting the audit to major capital companies

The Austrian Federal Chamber of Labour is strictly opposed to the attempt to free small and medium-sized enterprises from the audit obligation. The auditor fulfils the important reflection function in particular for the management of small and medium-sized enterprises, especially as many of these companies do not (yet) have a fully developed accounting system or where these for reasons of cost are only furnished with limited resources. In view of the increasingly more complex balance sheet regulations - in connection with national tax regulations - any exemption from the mandatory audit harbours the danger that deficiencies of the accounting systems in this sector increase, which might result in corporate crises or even insolvencies. However, more freedom with regard to balancing would also re-

sult in the fact that the trust of creditors in the figures submitted would be reduced, which might as a result increase borrowing costs.

Hence, from the point of view of the BAK, medium-sized companies - as provided in Article 34 of the EU Accounting Directive - should continue to be subject to an audit obligation. In addition, all "small" capital companies, which have a supervisory board or a board, should be subject to an audit of annual accounts.

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

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