

Summary Report

MEETING OF THE AUDIT REGULATORY COMMITTEE

17 July 2007

Mr. Jürgen Tiedje, Head of Unit F4-Auditing in DG Internal Market and Services, European Commission, chaired the meeting.

The following points were discussed:

Agenda item I: Approval of the agenda of the meeting and approval of the minutes of the meeting of 3 May 2007

The agenda was adopted. The minutes of the meeting of 3 May 2007 after including the additional remarks from a Member State were approved.

Agenda item II: Co-operation between Member States and third countries

1. The Commission informed the Member States that a summary of the public consultation on art. 46 has been published on the website of DG Internal Market (http://ec.europa.eu/internal_market/auditing/relations/index_en.htm). Chairman asked for Member States provisional position on setting equivalence criteria.

Member States' comments on equivalence:

- One Member State agreed with the principle based approach on equivalence but had two questions: (i) can the country reports with information supplied by the third countries serve as basis for assessing equivalence and (ii) which assessment process will be used. This Member State remarked that a clear idea on how to apply the principles is needed.
- Two other Member States remarked that the working document does not mention reciprocity as a criterion for equivalence. This is however an unavoidable requirement in the equivalence process.
- Another Member State asked whether the Commission envisages implementing the principles in legislation or in an informal agreement. It agreed with principles but agreed with the first Member State that a workable approach to do an assessment is needed and that it is important to define the process to make the equivalence assessment. It also commented that reciprocity should not be part of the article 46 equivalence assessment.
- Another Member State agreed with the principles, but remarked that the difficulty is setting the criteria for the principles. It asked how the evolution of third countries would be evaluated. Regarding independence of third country inspections (principle Nr.1), it stated it should generally be considered within the boundaries allowed under the Statutory Audit Directive (double mechanism of either independent inspectors or monitored peer review).

2. The Commission presented possible ideas for a possible transitional regime, more specifically on setting conditions for the audit firms in question and the length of the transitional period. Chairman asked Member States input on (i) possible conditions for audit firms in question and (ii) possible length of the transitional period.

Comments of Member States on transitional regime:

- One Member State had doubts on the practical implementation of the possible conditions. On the length of the transitional period, it expressed the opinion that the amount of work Europe expects to happen in a third country should determine the length of the transitional period. To restrict the transitional period until 2009 is considered as ambitious, even unrealistic.
- Another Member State opposed a transitional period for countries without public oversight.
- One Member State would only like countries out of category one to be admitted to a transitional period, that can be no longer than June 2009. It stated that priority has to be given to the protection of shareholders and third parties.
- Another Member State agreed with the previous Member State on a restricted period for the transitional period and considered a total transitional period up to 2012 as too long as this would take away the incentive to produce an equivalent system. Monitoring the deadline should be used as a means of pressure. Regarding the conditions, It stated that the criteria should be looked at from a legal point of view.
- Another Member State also stated that a pragmatic approach is needed. It considered strict criteria not to be possible; the elements of articles 29, 30 and 32 of the Directive that are already present in a third country should help in deciding on a transitional period.
- A Member State stated that the length of the transitional period should depend on the situation in the third country concerned.

Replies of the Commission to Member States comments on transitional regime:

- The Commission clarified that the suggested conditions are tentative ideas and do not reflect the position of the Commission. Regarding the audit opinion stating that the auditor comes from a non equivalent country, the Commission explained that this is a concern of investors who desire to know whether a third country is equivalent or not. The suggested conditions are the result of proposals of stakeholders.
- On setting national conditions for audit firms by the Member States, the Commission informed the Member States that the markets are not in favour of this. On disclosures for investors, the Commission informed the Member States that investors would like to be informed.
- The Commission asked the Member States two further questions: (i) do Member States agree with a disclosure for investors and (ii) do Member States agree to any transitional period until June 2009.

3. The Commission informed the Member States on the classification of third countries into categories, depending on the public oversight present in those countries. The Commission stressed that this document is confidential and needs to remain confidential for the time being.

The Commission felt that in this stage a transitional period for the countries in categories one and two is clearly justifiable, but is willing to discuss the countries in categories three and four. The Commission asked the Member States for their input on two specific questions: (i) which countries are granted a transitional period and (ii) how should countries be encouraged to improve on public oversight and regulation.

Comments by the Member States:

- One Member State stated a transitional period needs to be open to countries in all four categories so that all of them would be given the same opportunities.
- Another Member State agreed with this Member State. It asked where countries with peer review systems would be situated.
- Another Member State favoured a short transitional period only for countries in category 1 (with public oversight bodies).
- A Member State remarked that it is difficult to assess which countries should be given a transitional period as the Member States do not dispose of all the information. It favoured having different transposition periods for the different categories, depending on the work to be done by those countries.
- Another Member State agreed with the first two Member States. Regarding the transitional period, it stated it is important to motivate those countries to move forward.

Replies by the Commission to Member States comments:

- The Commission clarified that peer review systems are positioned in category two, independent supervision in category one.

Agenda item III: International Standards on Auditing

III.1. The Commission informed Member States on a study to be launched begin August. The subjects of this study would be a cost/benefit analysis of introducing ISA and a study on the differences between the clarified ISA and PCAOB standards.

Member States' comments on study:

- One Member State agreed with the reasons for the study. It stated that the study on the differences between ISA and PCAOB is the most important part of the study. It asked the reaction of IAASB.

Commission replies to Member States' comments:

The Commission replied that IAASB is willing to cooperate with the Commission once there is a contractor in this regard.

III.2. The Chairman explained a letter the Commission services received from the IAASB, where they outline their future possible actions (3 options) regarding the definition of material weakness in the context of auditors' reporting about internal controls in companies. The Commission invited Member States for their comments.

Comments by Member States:

- Two Member States raised doubts on option 1 (aligning with the US definition). Option 2 (common definition, which would be different from US one) would be a more preferred option for them. For the latter no international standard at all would be the best solution.
- One Member State did not support neither option 1, nor option 2.
- Another Member State did not accept that option 2 implied additional work for auditors as auditors already do this.
- Three Member States supported option 3 (leaving to Member States to finally decide).
- Another Member State did not see any of those options to improve the current situation where the definition of the material weakness as currently defined in ISAs is used.

The Chairman suggested that the IAASB should not take any action regarding the definition of the material weakness by 2009 until the Clarity project is finished, but leave this to the work program later on. The Member States accepted this proposal.

Agenda item IV: Quality Assurance

After having consulted the EU audit regulators and the audit profession, the Commission services presented the next steps taken regarding the possible Commission Recommendation on external quality assurance of statutory auditors and audit firms and explained key sensitive points of the contents of the possible Recommendation. Member States were invited to discuss the document distributed by the Commission services.

Member States comments regarding the scope of the possible Recommendation:

- One Member State expressed the view that there must be good reasons to exclude other Public Interest Entities (PIE) like banks or insurance companies from the scope of this Recommendation. It also mentioned that the state-owned company could also be designated by the its Ministry of Finance as a PIE.
- Three Member States supported the view the first Member State whereas another Member State is opposed. The first Member States delegate also mentioned that the state-owned company could also be designated by the its Ministry of Finance as a PIE.
- Three Member States suggested that the Recommendation similarly as the Statutory Audit Directive, deals with all statutory auditors and audit firms, not only those auditing PIEs.

The Chairman explained that PIEs are most relevant for international co-operation. He also mentioned the Recommendation was likely to be issued still this year.

Comments by Member States related to professional associations:

- One Member State raised a question on what the differences was between a quality assurance review and an inspection and suggested to have clear definitions for those terms.

- Another Member State informed that regarding its future quality assurance system, professional associations would have a role, but ultimate responsibility would lie with the public oversight authorities.
- A Member State mentioned that a new quality assurance system is being looked at in this Member State. It wonders whether under option 2 (certain delegation to the professional association subject to the public oversight) presented in the paper, it would make sense for the public oversight authority to approve an individual inspection report.
- Another Member State sees the role of the professional associations related to registration of individual auditors. The professional associations can have a role in the quality assurance system of audit firms, but the responsibility lies with the public oversight authority.
- Two Member States expressed a preference for option 2.
- O responded that in 2003 it decided not to involve professional associations in the daily operation of the quality assurance system as it would have raised independence concerns. That is why its public oversight authority directly hires practicing auditors to perform quality assurance inspections.
- Another Member State preferred option 1 (public oversight authority performs inspections; no contracting out neither to professional associations, nor practicing auditors). However, both option 1 and option 2 could be acceptable.

Member States comments on the possible involvement of practicing auditors in performing inspections:

- One Member State underlined that their quality assurance system is not a "peer review system". The delegation admitted that its current system should be a bit tightened up, but so far during the last 4 years it has worked well. The public oversight authority receives draft reports, can access working documents of the inspectors. It did not believe that full time inspectors employed by the public oversight authority would be possible due to cost constraints and difficulties to find appropriate people. It has 30 audit firms auditing listed companies.
- Another Member State suggested that the possible Recommendation should deal with training and qualifications as this subject is already touched in Art. 29 par 1(d) of the Statutory Audit Directive.

The Chairman emphasized that the possible Recommendation would identify the best international practices rather than all kind of options allowed under the Statutory Audit Directive.

- One Member State responded that it was difficult to look for best practices. It had had a "monitored peer review" system. Since 1/09/2007, the final responsibility would lie within the public oversight authority. It hinted that the experience and maintaining an up-to-date knowledge of inspectors is essential. It informed the meeting that they understood from PCAOB during their congress in May 2007 that monitored peer review would be acceptable if certain conditions were fulfilled like independent funding, the power of the public oversight system to do on his own initiative inspections and a full control on the executed peer reviews and the system and rules of control.

- Another Member State responded that complete reliance on practicing auditors was not workable solution. It believed that the best system is a mixed one where the profession was present.
- A Member State responded that if professionals were involved then there would be an independence problem.
- Another Member State suggested the definitions for an appropriate professional training and experience required from the inspectors who are not practising auditors.
- A Member State shared practical experience of getting their inspectors trained another Member State.

- On the point of group audits, the Chairman stressed the importance for a group auditor to have access to the working documents of the subsidiary auditor. One Member State reacted that Article 27 of the Statutory Audit Directive already clearly allowed this.

Member States comments regarding the publication of the individual inspection reports:

- Three Member States expressed doubts.
- One Member State also raised cautiousness over this subject.
- Another Member State wondered what the final public benefits would be. It emphasized that the inspected audit firm might however publish an individual inspection report if they wanted to. A Member State explained that there might be also additional costs, for example due to two inspection reports, rather than just one.

The Chairman suggested coming back on the subject of transparency in September.

Agenda item V: Transposition

The Commission informed the Member States of concerns of the audit profession whether Member States will comply in time. In future transposition workshops, the Commission will play a more proactive part and ask questions to the Member States. The Commission informed Member States that the textual comparison between the Audit Directive and the national legislation will be carried out through a transposition table and suggests to already start working on a partial table and to have already bilateral meetings.

Agenda item VI: Auditors' liability and audit markets

VI.1. The Commission informed the Member States that the summary report of the public consultation on auditors' liability is published on its website.

VI.2. The Commission informed the Member States on the Oxera study on ownership rules applying to audit firms and their consequences on audit market concentration. The final version is expected for September 2007.

During the next AuRC meeting of September, Member States will be invited to give an overview about the legal situation in their countries concerning auditors' liability as in some Member States there seem to have taken place changes to the law in this field.

Agenda item VII: Other Business

The Chairman informed the Member States of the next meeting dates foreseen in 2007:

14th September 2007; 17th October 2007; 14th November 2007 and 12th December 2007.