

Draft Summary Report

MEETING OF THE AUDIT REGULATORY COMMITTEE

29th February 2008

Mr. Pierre Delsaux, Director in DG Internal Market and Services, chaired the first part of the meeting. Mr. Jürgen Tiedje, Head of Unit F4-Auditing, chaired the second part of the meeting.

The following items were discussed:

Agenda item I: approval of the agenda of the meeting and approval of the minutes of the meeting of 24th January 2008

The agenda was adopted. The minutes of the meeting of 24 January were approved after including the received remarks.

Agenda item II: PCAOB – Discussion draft comment letter

The Commission services presented to Member States a draft comment letter. Member States were invited to comment before Thursday, 6 March 2008.

Agenda item III: Third Countries – Discussion Commission Decision under Article 46

The Commission presented the second draft Commission decision concerning a transitional period for audit activities of certain third country auditors and audit entities and explained the amendments introduced compared with the first draft decision. Commission services also explained that the instrument used to grant this transitional period (Commission Decision) is a directly applicable instrument and consequently a formal transposition into national law is not needed.

Comments by Member States:

- One Member State considered the nature of the transitional period as "exceptional". Subsequently, it would prefer limiting the length of the transitional period to audit reports published before 31 December 2009. After this date, the situation might be reviewed and an extension of the transitional period might be granted. Four other Member States supported this point. The Member State would also prefer "Reciprocity" to be included in the draft decision. Furthermore, it would prefer a stricter review clause in Article 2 as it considers a public commitment from the concerned third countries insufficient. Finally, this Member State could agree to group II to be included under certain conditions but opposes including Group III. One Member State supported this point and added that a public commitment to set up a public oversight and quality assurance systems would be required for Group II and Group III before granting the transitional period to these countries.
- Another Member State supported the proposed draft decision and replied to the previous Member State's comments. Regarding the "exceptional" nature of the

transitional period, it recalled that the outcome of the public consultation on Articles 45-47 was that the transitional period should take place in order to get a pragmatic implementation of the Directive as well as attract third countries to independent public oversight system. It considered the length of the transitional period appropriate in order to give sufficient time to third countries to move towards independent public oversight systems. A transitional period for financial years at the beginning of 2008 does not give a fair chance to third countries to move towards independent public oversight systems. It considers including "reciprocity" in the draft decision as going beyond what is provided in the Directive. It considers Article 2 and its review clause as too strict and would prefer a clearer commitment towards Group II. It supports including Group III in the transitional period.

- One Member State agreed with the previous comments and highlighted the need of having a pragmatic approach toward third countries. It also indicated that reciprocity should be taken into account after the transitional period.
- Four Member States suggested adding to the information requirement of Article 1 (1) (e) the following sentence: "while observing the rules of confidentiality/professional secrecy". One of these Member States also enquired about the reference to "competent authorities of Member States referred to in Article 45 of the Directive"
- One Member State had concerns about Member States' powers with regard to audits carried out during the transitional period if registration of third country audit entities is not required.
- One Member State indicated that in recital 3 the difference between groups 2 and 3 needs to be clarified more.

The Commission ask MS to send their written comments by 7th March 2008.

The Commission also presented the **third draft of the Technical Statement** outlining the future work program to Member States and asked them for comments.

Comments by Member States:

- One Member State indicated that "public oversight body" in the second bullet point of principle 2 should be "public oversight system".
- Another Member State preferred a strong wording of the principles as it considers the present wording too open and unclear.

Member States were asked to send their written comments by 7th March 2008. A new document taking into account these comments to the extent possible will be circulated.

IV: Third Countries – Adequacy assessment of third countries

The Commission informed that a draft questionnaire regarding the transfer to third-country public oversight authorities of audit working papers held by European statutory auditors and audit entities has been prepared. This questionnaire will be sent to third countries that regulate European audit firms and will facilitate the knowledge of their confidentiality and professional secrecy rules for the purpose of taking appropriate implementing rules under Article 47. The Commission informed that the questionnaire was previously sent to EGAOB members and AuRC members for comments. No essential comments were made. The Commission ask for MS opinion on the questionnaire.

Comments by Member States:

- One Member State agreed with Commission's approach but pointed out that the Commission should reinforce the idea that MS are also subject to European data protection rules.
- Two Member States pointed out that the wording of the explanatory part 1. 2. c. does not correspond with the wording of Article 47 (2) (c) of the Directive.
- One observer pointed out that the third-country penalties and sanctions applicable to breaches of the disclosure ban should also include a mentioned to civil liability rules.

A new document taking into account the above mentioned comments will be circulated and Member States will be able to send their written comments by 4th March 2008.

V. Subprime market

The Commission informed Member States about the state of play of the ECOFIN roadmap and its impact on the role of the auditor.

One Member State drew the attention to a report on the enforcement regarding financial statements in Europe which states that there is a lack of disclosure in the financial statements regarding providing the methods used for valuations and assumptions. It would be important to assess what auditors have done in these cases.

VI ISA – Topics left open for discussion + ISQC1

a) Study on costs and benefits of introducing ISA

The contractor of Lot 1 of the ISA study, focusing on a cost-benefit analysis for the introduction of ISA, gave an overview of the set-up of the study.

The Commission asked the Member States whether the ISA subgroup in the EGAOB can be involved in the final review process. Member States agreed.

One Member State suggested that the experience of Member States that already adopted ISA could be interesting for the study. It enquired whether the contractor would make a distinction between Member States which already adopted ISA and Member States which did not yet adopt ISA.

b) Working document regarding cross cutting issues on ISA.

Comments by Member States on the scope of adoption of ISA:

- One Member State informed Member States that it has adopted ISQC 1 through its auditing standards. It considered both Article 26 and Article 29 of the Statutory Audit Directive as inappropriate to adopt ISQC 1.
- Another Member State preferred waiting with the adoption of ISQC 1 until the results of the technical cost-benefit analysis are available. It supported a non binding instrument like a recommendation for any possible adoption of ISQC 1. It supported restricting the scope of ISA to those relevant for statutory audits.

- One Member State supported including ISQC 1 in the cost-benefit study of the contractor of Lot 1 of the ISA study, though separated from the rest of the study. It was of the opinion that the adoption of ISQC 1 should be general and restricted to PIE.
- Another Member State informed that it has implemented ISQC 1 and that, especially regarding terminology, legislation is too vague as a means for introducing ISQC 1.
- One Member State informed it has not introduced ISA by law as such. ISQC 1 is not introduced as an ISA but as a reference point. However, it should not serve as the only benchmark for the organisation of internal controls.
- Another Member State has partially included ISQC 1 in its national legislation. It favoured Article 29 for introducing ISQC 1.
- One Member State would welcome regulation on internal controls in an audit firm. It has its own standard through a non-binding instrument.

The Commission concluded that ISQC 1 will be part of the study, though as a separate item.

Comments by Member States on the application material of ISA:

- 6 Member States preferred option 2 (= endorsement by the European Commission through non-binding instruments), as there are concerns regarding possible legal difficulties for option 1 (= adoption through binding EU legislations) and an absence of harmonisation in option 3 (= application material remaining outside scope of consideration by European Commission).
- Three Member States favoured options 2 and 3.
- One Member State favoured option 3. It is concerned about possible legal problems linked to option 1, for instance regarding the meaning of application material. Under option 2, a recommendation might lead to uncertainty regarding its binding nature.
- One participant informed the meeting that its system resembles option 2 and is functioning well. It therefore supports option 2.
- One Member State was tentative towards option 2 as it is concerned how legal problems would be addressed under option 1. It was also concerned how enforcement would be organised if there is no binding measure.
- Only one Member State favoured option 1.

The Commission concluded to focus on options 2 and 3. Member States agreed to a meeting to be set up by the Commission with experts designated by Member States to assess both the workload and the timing regarding the translation of ISA. The Commission emphasized that the purpose of this meeting would not be to take any decision.

Replies by Member States regarding management's responsibilities:

- Four Member States considered the shaping of management responsibilities the responsibility of national legislators and not the ISA. One of these Member States considered it important for the IAASB and regulators to bring along other stakeholders apart from auditors in an effective consultation leading to an effective dialogue in Europe.
- One Member State considered the ISA to leave sufficient leeway for national legislation to describe the system.

- One Member State considered this issue very sensitive and too complex to give a clear reply at this moment.

The Commission concluded it would not be possible to avoid dealing with internal controls under audit standards but that audit standards should not define management's responsibilities on internal controls.

In the light of replies by Member States on specific standards the Commission concluded that there is a need for national flexibility on the contents of audit reports. On external confirmations, Member States almost unanimously favoured not making them mandatory. On external experts, Member States favoured including experts in the audit engagement team and to extend the professional secrecy rules to the auditor's external experts through national law, but should remain careful when proceeding in this direction.

VII. Freedom to provide services in the field of statutory audits

DG Internal Market has presented a working document that proposes as tentative line that the freedom to provide services should be possible in the field of statutory audit.

- One Member State commented that when the directive on the recognition of professional qualifications was adopted, similar problems arose concerning the question whether cross border services were possible. Concerning the provision of services in the field of statutory audit, Article 14 of the Directive 2006/43 should apply. One question is still pending: in a case of a statutory auditor established in one Member State but providing statutory audit services in another one, which public oversight will supervise this person? Both public oversight?
- Five Member States expressed the view that the Services Directive was not applicable in the field of statutory audit. Concerning the analysis provided in the working paper presented by the Commission stating that the solution of the Ramrath case might not be valid any more, they have agreed that the situation have changed since the case was judged, given the adoption of the Statutory Audit Directive. Now there would be a co-operation between public oversight authorities allowing for supervision of the auditors providing services without being established in a given Member State. Nevertheless, the question of professional secrecy is not solved, the rules on professional secrecy are not harmonised. It is difficult to have confidential business documents circulating from one Member State to another. Therefore the solution of the Ramrath case could still be applicable. It should be possible for Member States to require establishment on their territory for statutory auditors. Concerning the professional title, the provider of services should have, in any case, the title of the host Member State.
- Two Member States agreed with the Commission working paper that the freedom to provide services should exist in the field of statutory audit. One of these Member States considered it necessary to establish a committee for co-operation between the different national authorities.
- Another participant expressed the view there would be also the necessity to make an analysis of the relationship of the Statutory Audit Directive with the Prospectus and the Transparency Directives.

VIII. Quality Assurance

The Commission presented the latest draft Commission recommendation on Quality Assurance. Member States were invited to comment.

- One Member State was worried, regarding point 16 in respect to the list of requirements for on-site inspections, that the inspectors are not liable for their work before the public oversight body.
- Another Member State was concerned that there was no definition of the term "investigation". It also missed a proper link between the point 6 and point 21 as well as relationship between the follow up of the recommendations and disciplinary systems.
- Two Member States did not agree with point 6(b), which may lead to an ambiguity on which body should then take the responsibility for inspection reports.
- Three Member States were concerned that point 21 did not properly address the possible issues to secure the confidentiality of information to be disclosed to the public and thus the name of the auditor/audit firm should not be public. One of these Member States underlined their current practice on not disclosing the names of individual auditors and audit firms.
- One Member State supported point 21 by stressing that it is well balanced and that investors, who sometimes seem to be forgotten, are properly and timely informed.
- Another Member State suggested making it clear that inspection work should not touch upon non-PIEs audits.
- One Member State informed of the possible cross-border issues due the fact that the PIE definition may not be the same in all MS. Regarding point 21, it was concerned about the fact that currently the publicity concerns not only the disciplinary measures, but also the disciplinary actions initiated. This may raise a legal difficulty as disciplinary actions may not lead to disciplinary measures/penalties against auditors. It requested that the wording should be clarified to avoid any misunderstanding.

The Commission informed that Article 34 of the Directive requires respect of home country regulation and oversight. The Commission informed that it belongs to MS to regulate the publicity of disciplinary actions and/or measures, but in any case if a disciplinary actions leads to disciplinary measures, such measures shall be public.

- One Member State raised concerns on an inadequate coverage of appointment of inspectors, their education, training and professional experience, such as a number of years required for inspectors.

The Commission mentioned that the Recommendation should be based on principles and these decisions should be left for MS.

- Another Member State considered point 14 a bit too strict in requiring inspectors (and experts) to be only directly remunerated by their employer. It also suggested that inspectors and experts should be banned to get remunerated by networks.
- One Member State stressed that we should not come back to the drafting stage in order to accommodate all national legislative particularities. The recommendation should stay principles-based.

The Commission concluded by offering to provide last comments on the draft by Tuesday 4 March 2008.

IX. Transposition of the Eight Company Law Directive – Scoreboard

As the deadline for transposing the Directive on Statutory Audit is getting closer (29 June 2008), the Commission services presented their plans for closely monitoring the transposition process and in particular the establishment of public oversight bodies in MS. In this respect, on the basis of information provided by MS, the Transposition Scoreboard will regularly be published on the DG MARKT website before the full transposition of the Directive.

- One Member State asked on how the information on the transposition would fit the general notification requirement on the transposition.
- Another Member State questioned the benefit of providing information on the basis of the existing laws since this information would soon become obsolete with the adoption of new legislation (expected date: June 15) fully transposing the Directive.
- One Member State asked for an agreement to be able to provide additional comments on answers to the questionnaire.

The Commission mentioned that Member States will be invited to provide the Commission with a list of national measures, including the specific provisions transposing the Directive. Further steps will be discussed at the Transposition Workshop scheduled for 24 April 2008.