DIRECTORATE GENERAL FOR
INTERNAL MARKET AND SERVICES

CONSULTATION ON IMPLEMENTATION OF ARTICLES 45-47 OF THE DIRECTIVE ON STATUTORY AUDIT (2006/43/EC)

COOPERATION WITH NON-EU JURISDICTIONS ON AUDITOR OVERSIGHT

SUMMARY REPORT

EXECUTIVE SUMMARY

1. 41 replies were received in response to the public consultation on the Commission's possible future strategy and priorities on statutory audit in relation to non-EU countries. The contributions were submitted by a wide variety of stakeholders from across the EU and from non-EU countries.

Support for the objective

2. In its consultation paper, DG Internal Market and Services set out the following objective for its strategy: Encouraging the development of regulation and public oversight for the audit profession in third countries whilst minimising disruption on European markets. All respondents to the public consultation supported this policy objective.

Support for the approach that the Commission assesses and decides on equivalence of third countries

3. The respondents welcomed the approach that DG Internal Market and Services would take the initiative to assess equivalence of third country's public oversight systems. Support was expressed that principles-based criteria would be applied for such an assessment. Some respondents recommended that education and training systems of the oversight regimes should be taken into account in this assessment.

Support for a possible initiative on transitional measures under Article 46

4. Strong support was expressed for introducing transitional measures to offer time for developing effective public oversight for auditors in third countries. The majority of respondents agreed with the Commission's proposal to assess the existing third country systems and determine whether there is a willingness and realistic possibility of moving towards public oversight within a reasonable time frame. Several respondents, in particular investors, recommended that transitional measures should be subject to conditions.

Support for the prioritisation of third countries for an equivalence assessment

5. The respondents agreed with the methodology of DG Internal Market and Services to prioritise third countries for equivalence assessment by three criteria "number of third country issuers concerned", "advanced oversight structures" and "major world economies". Several respondents recommended that additional criteria could be used; among them being "size of the companies" and "the issuers' volume of trading on EU regulated markets". Moreover, respondents, particularly stock exchanges, asked to include further countries in the list of countries DG Internal Market and Services selected for initial assessment.

Caution against different registration systems in EU Member States

6. The respondents expressed the opinion that differing registration requirements across the EU are undesirable and should be avoided. Several respondents, notably from the audit profession, asked the Commission to actively discourage EU Member States to introduce differing registration requirements for third country audit firms.

The need for EU Member State authorities to co-operate on registration

7. General support was expressed for developing a system of co-operation in registration procedures between authorities in EU Member States. In respect to the various possibilities of such a system of co-operation, the comments of respondents offered various options for such a system ranging from the concept of an EU-passport to be recognized across Member States to the concept of co-ordination of registration procedures among Member States.

8. Strong support was expressed for the idea that the European Group of Auditors Oversight Bodies (EGAOB) could be the appropriate forum in which co-operation on third country auditors' registration should be further developed.

Support for the use of auditing standards reflecting international practice

9. The majority of respondents are opposed to a situation in which third country audit firms would be forced to use auditing standards of the Member State where they should register in accordance with the Directive.

10. Respondents recommended therefore that third country auditors should be allowed to use ISAs and/or US PCAOB standards for registration purposes during a transitional period. Several respondents also recommended that third country auditors should be permitted – in addition to the use of ISAs and US standard – to use other auditing standards if they are equivalent to ISAs (e.g. Japanese or Canadian auditing standards).

Independence rules – support for the IFAC Code of Ethics

11. The great majority of respondents supported the suggestion of DG Internal Market and Services that third country audit entities be permitted to use the IFAC Code of Ethics if deemed equivalent to the requirements set out in the Directive of Statutory Audit. There has been only limited support for starting equivalence assessments of the independence requirements in individual third countries.

Importance of co-operation between oversight bodies of EU Member States and third countries on the transfer of audit working papers emphasised

12. The majority of respondents underlined the importance of close co-operation between the oversight bodies of EU Member States and third countries. Within this co-operation various issues related to the transfer of documents should be differentiated and agreed on.

Support for the conditions established in the adequacy test

13. The respondents, in principle, agreed with the conditions established for the adequacy test. Most frequently emphasised was the importance that authorities of third countries must, under all circumstances, be prohibited from using transmitted audit working documents for purposes other than public oversight or making them available to other authorities.

Circumstances that justify, in exceptional cases, direct transfer of audit working papers

14. The general view of respondents was that exceptional cases which justify a direct transfer of audit working papers by the audit firm to the third country authority could only be cases of urgency, such as major corporate scandals. Many respondents argued that exceptional cases should be restricted to cases in which a formal investigation has been instigated as opposed to routine inspections.

1.- INTRODUCTION

This report provides a summary of the comments received in response to a public consultation issued by the European Commission services on 11th January 2007 on its future strategy and priorities on statutory audit in relation to non-EU countries.

The new Directive on Statutory Audit (2006/43/EC) grants the European Commission the right to introduce implementing measures under the comitology procedure. The possible implementing measures concern regulation and oversight of non-EU country auditors and audit entities (Article 45 and 46 of the Directive) as well as co-operation with competent authorities from non-EU countries (Article 47 of the Directive):

The Directive requires non-EU country auditors and auditor entities, that conduct a statutory audit on companies incorporated outside the EU whose securities are admitted to trading on an EU regulated market, to register with a competent authority in each EU Member State in which their clients' securities are admitted to trading and to be subject to that EU Member State's oversight and sanctions (Article 45 of the Directive). A Member State may exempt such auditors and audit entities in whole or in part from these requirements on the basis of reciprocity provided that the auditor/ audit entity of a non-EU country issuer is subject to an oversight system which the European Commission has recognised as equivalent (Article 46 of the Directive). The consultation document invited interested parties to express their views on:

- the possible approach to the assessment of equivalence of a non-EU country's public oversight regimes (question 1);
- possible transitional measures in cases in which the public oversight regime of a non-EU country cannot be recognised as being equivalent (question 2);
- possible criteria for prioritising equivalence assessment of public oversight regimes of non-EU countries (question 3);
- the possible scenario of fundamentally differing registration requirements across the European Union due to Member States exercising their right to modify registration requirements (question 4);
- possible co-operation of EU Member States in registration procedures and the role of the European Group of Auditors Oversight Bodies (EGAOB) in this context (question 5).

According to the Directive, a Member State may only register non-EU country auditors/ audit entities that audit the accounts of companies incorporated outside the EU whose securities are traded on an EU regulated market if audits are carried out in accordance with International Standards on Auditing (ISA) as adopted by the European Commission and independence requirements stipulated in the Directive or with auditing standards and independence requirements which the European Commission has recognised as being equivalent (Article 45 of the Directive). In this regard stakeholders were invited to articulate their point of view on:

- any transitional measures until the European Commission has adopted ISAs (question 6);
- the possible approach to the assessment of equivalence of a non-EU country's independence rules (question 7).

Pursuant to the Directive, a Member State may permit the transfer of audit working papers or other documents held by statutory auditors or audit firms to the competent authorities in non-EU countries provided that, inter alia, such authorities meet requirements which the European Commission has recognised as adequate (Article 47 of the Directive). In exceptional cases, which the European Commission may specify, a Member State may also allow statutory auditors and audit firms to transfer audit working papers or other documents directly to the competent non-EU country authority. The consultation document invited interested parties to comment on:

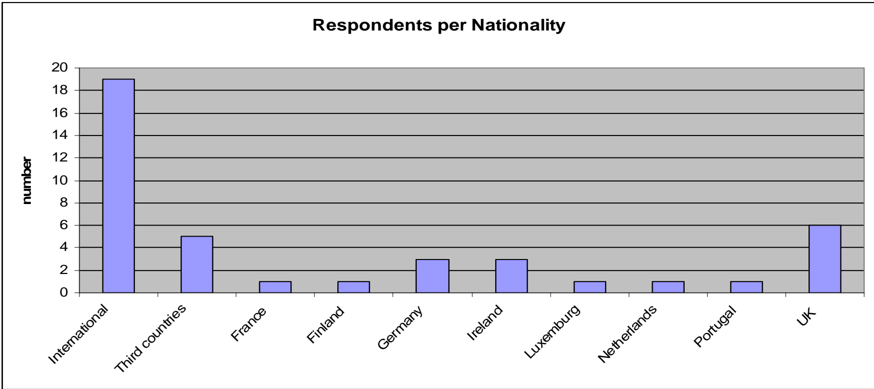
- the content of the "adequacy test" to be conducted by the European Commission (question 8);
- the possible scope for co-operation on the exchange of audit working papers or other documents between the authorities of an EU Member State and a non-EU country (question 9);
- the circumstances to be considered exceptional so as to allow direct transfer of audit working papers (question 10).

The report reflects those views that have been repeatedly expressed by respondents as well as any opposite opinions, even if they were only advanced in a single reply. In drawing up the report in this way it was intended to emphasise whether and in respect to which issues the respondents took up different positions. Where relevant and feasible the presentation will also include histograms.

The report will follow the structure of the consultation document. It will start with a general presentation of all the replies received. Subsequently, it will outline the comments received on the questions raised in the consultation.

2.- THE RESPONDENTS

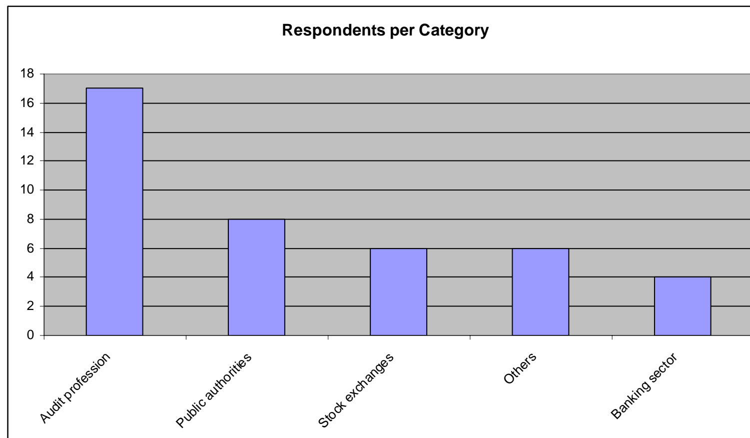
41 contributions were received in response to the consultation on co-operation with non-EU jurisdictions on auditor oversight. The geographic coverage was very wide with contributions coming from countries within the EU, such as France, Finland, Germany, Ireland, Luxembourg, the Netherlands, Portugal and the United Kingdom, as well as from non-EU countries such as the Cayman Islands, Japan and South Africa. A significant number of replies were received from international networks and associations.



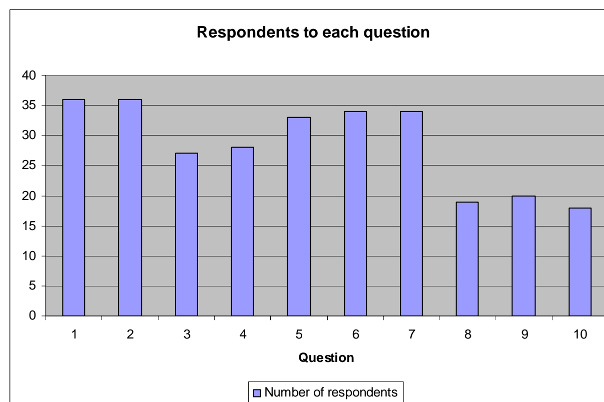
NB: "Third Countries" stands for non-EU countries; "International" stands for international networks and associations.

The following stakeholders were represented in the contributions received:

Respondents per Category	
Category (in alphabetical order)	*Number of replies received (percentage)*
Audit profession (networks and audit institutes)	17 (41, 46%)
Banking sector (Banking federations and associations)	4 (9, 76%)
Public authorities (regulators, oversight bodies)	8 (19, 52%)
Stock exchanges	6 (14, 63%)
Others (insurers, law firms, business associations etc.))	6 (14, 63%)



A minority of respondents responded to every question. Respondents predominantly concentrated on questions of particular interest to their activities.



A detailed analysis of the respondents' repartition by category will be provided for each question in the following part of the presentation.

3.- THE RESULT OF THE PUBLIC CONSULTATION

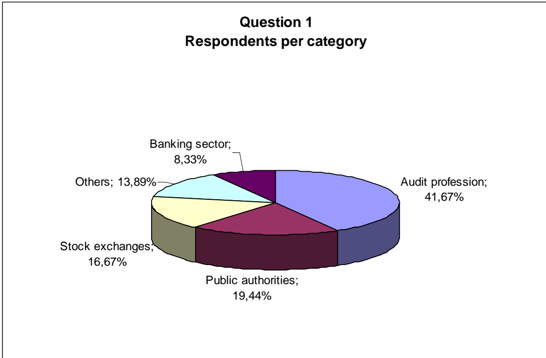
3.1- SUPPORT FOR COMMISSION ACTION

Overall support was expressed for a possible Commission initiative to implement the Directive of Statutory Audit and to improve its transposition so that its new requirements will be brought into effect in a way which encourages the development of effective systems of audit regulation and which does not damage EU capital markets. The concepts presented by DG Internal Market and Services to achieve these objectives were widely appreciated.

3.2- ASSESSMENT AND DECISION ON EQUIVALENCE OF THIRD COUNTRIES (ARTICLE 46)

Question 1:
Do you have further comments, or concerns to share, on equivalence?

36 of all respondents to the public consultation addressed the first question.



The vast majority of the respondents explicitly welcomed the approach that the Commission might take the initiative to assess and decide on equivalence of third country's public oversight systems. An EU-wide decision on equivalence is seen as being more reliable, more consistent and more cost effective than assessment of the third countries' oversight regimes by individual EU Member States. A majority of respondents also emphasised that they agree with the approach to apply principles-based criteria for the equivalence assessment rather than rules. Such approach would take into account that oversight regimes in different countries could not be identical as the law, culture and customs differ from country to country.

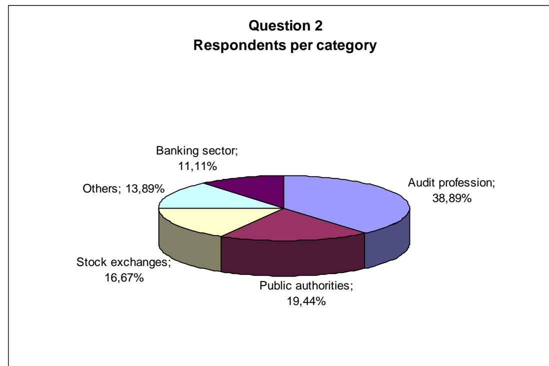
Regarding the horizontal criteria to be set for the equivalence assessment, some respondents recommended that the education and training systems of the oversight regimes should also be taken into account; those being fundamental to the development of audit infrastructures. Furthermore, one respondent proposed to pay attention to the liability regime of a third country. This might have an essential impact on the audit quality in third countries as well as on its comparability to European audits. Respondents from the audit profession remarked that the requirement of an oversight system being independent from the audit profession should not preclude some involvement of the audit profession. An effective oversight system could include the involvement of a minority of practitioners, the use of independent personnel from the audit profession to perform inspections under the control of the oversight body and some funding provided by registered audit firms.

Eventually, several respondents - particularly from the audit profession - addressed the issue of reciprocity which, according to the Directive, is, in addition to equivalence, a pre-condition for EU Member States to exempt third country audit entities from registration. The respondents emphasised that reciprocity should be an important factor in the decision on equivalence. The majority of those respondents, however, favour a flexible interpretation, recommending that it suffices if the third country oversight bodies show a willingness to co-operate with EU-oversight systems.

3.3- TRANSITIONAL SOLUTIONS UNDER ARTICLE 46

Question 2:
Do you have comments on the need for transitional measures?

36 of all respondents expressed their view on the second question.



The great majority of the respondents explicitly emphasized the need for introducing transitional measures to foster the development of effective regulatory systems of public oversight in third countries. Moreover, several respondents underlined that transitional measures should apply to a broad range of third countries.

The vast majority of respondents supported the Commission's proposal to assess the existing third country systems as to whether there is a willingness and a realistic possibility of moving towards public oversight within a reasonable time frame. They agreed that such an approach may reduce administrative costs and provide an incentive for third countries to install a principles-based effective public oversight regime. Two respondents also pointed out that an indiscriminate imposition of interim registration could lead to similar requirements by other jurisdictions being imposed on EU audit entities.

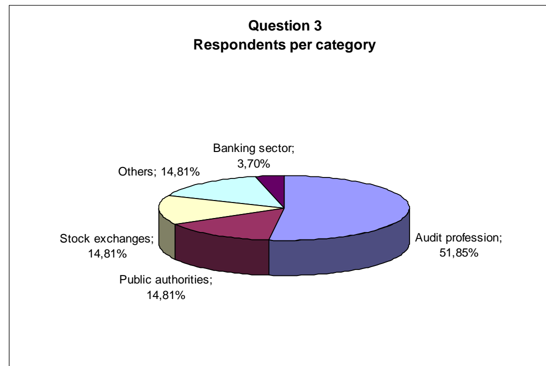
With respect to the length of the transitional period the views of the respondents varied. Several respondents requested a well defined ultimate time line between 3 and 5 years. Others expressed the view that the transitional period should provide for sufficient time for effective oversight systems to develop. According to their view a time limit should be fixed for each country on an individual basis taking into account the respective stage of development of the oversight system. If necessary, the time limit should be extended beyond the one which was initially envisaged. Such a time limit should be up to 4 – 5 years or, as two respondents suggested, at least 5 years.

Several respondents recommended that transitional measures should be subject to conditions. It was, for example, suggested that roadmaps should be agreed upon with the third country in question in which a time table and targeted measures should be fixed. Several respondents suggested that convergence should be assessed periodically and that transitional measures should only be extended if satisfactory progress could be determined.

3.4- PRIORITIES FOR THE ASSESSMENT OF THIRD COUNTRIES

Question 3: Do you have any comments or observations on the above list of third countries? Do you have specific information on those third countries which you would like to share with the European Commission services and if so, which?

27 of all respondents to the public consultation commented on question 3.



The majority of the respondents explicitly stated that they are supportive of the approach to prioritise third countries for equivalence assessment on the criteria "number of companies concerned", "advanced oversight structures in place" and "major world economies".

Several respondents commented further on the approach to prioritise third countries for equivalence assessment suggesting additional criteria:

One respondent recommended the application of a risk-based approach. Third countries which would be likely to give rise to the greatest risk to EU investors if their oversight regimes were not aligned and provide the greatest benefit if they were, taking into account of the likelihood and value of success in agreeing acceptable standards, should be prioritised for equivalence assessment.

Moreover, several respondents suggested the following additional criteria for prioritising third countries for equivalence assessment:

- size of the companies,
- nature of the activity of the companies,
- the issuers' volume of trading on EU regulated markets and
- a long-established relationship with EU Member States.

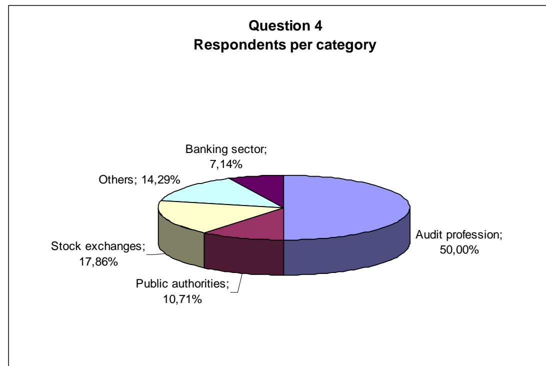
The great majority of respondents agreed with the countries the Commission selected for initial assessments. Beyond that the respondents, particularly stock exchanges, asked to include the following countries in the list: Chile, Columbia, Georgia, the Gulf countries, Marshall Islands, Macedonia, Mauritius, Netherlands Antilles, Nigeria, Pakistan, Peru, Ukraine and Zambia.

Widespread support was expressed with respect to the approach to use for equivalence assessment inter alia external surveys and reports. Several respondents did, however, express concerns; the reports might be outdated and aims do not necessarily coincide. Several respondents indicated that the reports of the IFAC compliance programme contain additional information for the assessment. One respondent suggested additional information should be obtained directly from the third country public oversight bodies.

3.5- POSSIBLE (ADDITIONAL) WORKSTREAM ON THE BASIS OF ARTICLE 45

Question 4: Do you have any comments or observations that you wish to bring to the European Commission's attention as regards the explanation of the possible development of different registration systems in the EU Member States?

28 of all respondents expressed their view on question 4.



All the respondents agreed with the analysis on the case scenarios that may arise under Article 45 and Article 46 of the Directive of Statutory Audit, depending on the way EU Member States exercise registration options. The great majority of respondents explicitly stated that differing registration requirements across the EU are undesirable and should be avoided. Such scenario would lead to the fragmentation of capital markets, increase costs for audit firms, companies and capital markets and entail uncertainties of audit quality. Against this background, several respondents expressed the wish that further work should be devoted to the interaction of registrations' systems in EU Member States and a system of co-operation respectively.

Beyond expressing general views, respondents, particularly from the audit profession, made specific remarks with respect to the individual case scenarios outlined in the consultation document.

Those respondents considered scenarios, in which third countries do not qualify for an equivalence decision under Article 46 and EU Member States require audit entities to register with the competent authority in the respective EU Member State and be subject to its public oversight, as the scenario which will most likely occur. In this respect it was pointed out that registration should only require information which was strictly necessary.

With respect to scenarios, in which public oversight systems in a third country are considered to be equivalent and EU Member States use the option under Article 46 to modify registration requirements, the great majority of respondents cautioned that EU Member States should abstain from modifying registration requirements but exempt audit entities from registration. Several respondents asked the Commission to actively discourage EU Member States to modify registration requirements. On the other hand one respondent pointed out that modification of registration requirements would be appropriate where it serves to ensure a level playing field with audit firms domiciled in the national jurisdiction concerned.

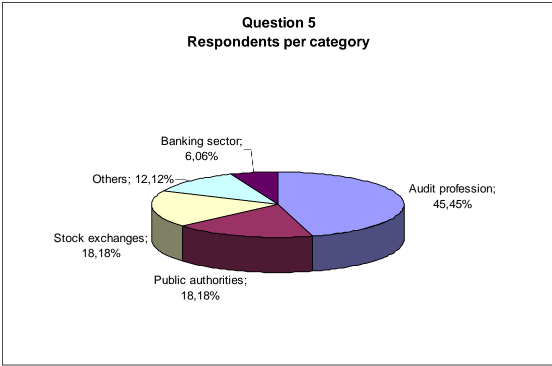
Regarding scenarios, in which audit entities from third countries fall under transitional arrangements, several respondents emphasised that EU Member States should not apply their national registration and oversight requirements under Article 45 of the Directive. One respondent suggested in cases in which audit firms profit from transitional measures the Commission and EU Member States should collaborate. The registration process should be postponed until the end of the transitional period and constitute part of the Commission assessment process. On the other hand, one respondent emphasised that EU Member State authorities may, for information purposes, wish to require some form of registration.

Several respondents from the audit profession identified the likelihood of a scenario in which a third country oversight regime is considered to be equivalent but reciprocal arrangements have not yet evolved. In this respect respondents encouraged the Commission to expedite the agreement and implementation of reciprocity to avoid individual EU Member States seeking to register and supervise audit entities from those countries. Moreover, it was requested that EU Member States maintain consistency in how they handle registration of third country audit entities.

3.6- POSSIBLE ROLE OF THE EUROPEAN GROUP OF AUDITORS OVERSIGHT BODIES

Question 5:
Do you have comments on a concept for co-operation in registration procedures that would aim at reducing administrative burdens and cost?

33 of all respondents to the consultation addressed question 5.



General support was expressed for developing a system of co-operation in registration procedures between the authorities of the EU Member States. The respondents agreed that co-operation in registration would be essential to reduce the administrative burden imposed on audit entities that are subject to multiple registrations.

With respect to the various possibilities of co-operation on third country auditors' registration the comments of the respondents show a multilayered picture.

Some respondents, particularly from the audit profession, recommended introducing an "EU audit passport". A third country audit entity should only be subject to one registration procedure in an EU Member State. Once registered in an EU Member State, other Member States should fully rely on the other Member State's registration and abandon any further registration.

The other respondents' proposals are based on the concept of multiple registrations:

A few respondents from the audit profession proposed to introduce a system of co-operation in which an audit entity, once registered in an EU Member State, will automatically be registered in other EU Member States.

Other respondents - also from the audit profession - favoured a system in which an audit entity is subject to one extensive registration procedure and other EU Member States would subsequently apply simplified procedures taking account of the initial registration procedure of the "lead" Member State.

Finally, one respondent proposed introducing a "registration light model". Under such concept each EU Member State should keep its responsibilities and maintain own registers for third country auditors. Yet, to facilitate registration, standardised forms should be used by the registering authorities. Alongside, a timely exchange of any changes of the entries between competent authorities in the EU Member States should be established.

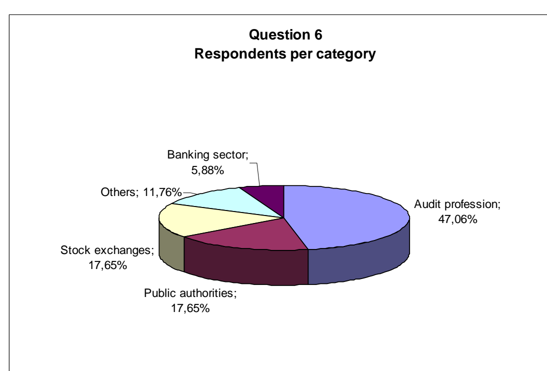
Many stock exchanges suggested that a system of co-operation should not be limited to registration. It should extend to continuous monitoring and oversight functions which should only be performed by one oversight body and be relied on by other EU Member State authorities.

General support was expressed that the EGAOB would be the appropriate forum in which co-operation on third country auditors' registration could be agreed on.

3.7- AUDITING STANDARDS

Question 6:
Do you have comments on the use of International Standards on auditing and US auditing standards by third country audit firm for registration purposes for a limited transitional period?

34 of all respondents replied to question 6.



Overwhelming support was expressed for the view that third country audit entities should not be required to apply the national GAAS of the respective EU Member State. Such a requirement would burden audit entities with increased costs and might have a detrimental effect on the attractiveness of a listing on EU capital markets. Accordingly, the respondents support the introduction of transitional measures until the Commission adopts International Auditing Standards (ISAs).

The great majority of respondents recommended that third country auditors should be permitted to use ISAs <u>and</u> US GAAS for registration purposes for a limited transitional period. Several respondents supported the use of ISAs <u>or</u> US GAAS as a transitional measure.

Several respondents from the audit profession expressed the view that the use of US GAAS should only be considered in case of reciprocal acceptance of ISAs for use in the United States. By contrast other respondents favoured an unconditional use of US GAAS; such standards being widely used and respected. Moreover, failure to allow the use of US GAAS would cause unnecessary costs and difficulties for third country auditors. Eventually, several respondents from the audit profession asked for a clarification on whether the reference in the consultation document to US GAAS is to:

- US auditing standards as established by the US Accounting Standards Board (US ASB) for non-SEC registrant companies,
- US auditing standards issued by the PCAOB (PCAOB GAAS) which are applicable to SEC registrants,
- both sets of standards.

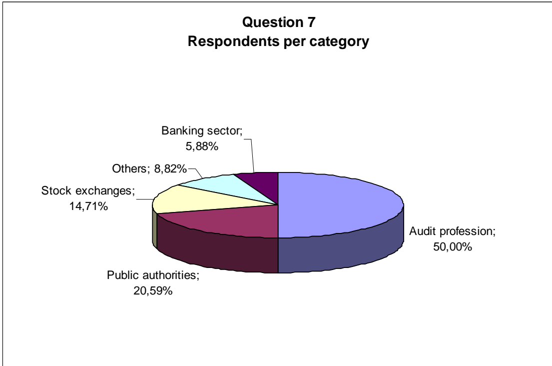
Some respondents recommended permitting third country auditors - in addition to the use of ISAs and US GAAS - the use of other auditing standards, particularly Japanese GAAS and Canadian GAAS. Pre-emptive actions which exclude the use of other GAAS could incur serious unintended impacts on markets. Other respondents recommended that the Commission should in any case assess the third country GAAS on whether they are equivalent to ISAs. In this case third country auditors should be allowed to use them as well.

Several respondents from the audit profession recommended, in the long term (national) auditing standards should be brought into line with a single set of international auditing standards. One reason given was that the users of financial statements in global capital markets deserve consistency in reporting and auditing.

3.8- INDEPENDENCE RULES

Question 7:
Do you have any comments on independence issues under Article 45?

34 of all respondents expressed their view on question 7.



The great majority of the respondents supported the idea to permit third country audit entities the use of the IFAC Code of Ethics if deemed equivalent to the requirements set out in the Directive of Statutory Audit. Such an approach would be pragmatic and entail lower costs than assessing the equivalence of individual third countries' independence rules. Moreover, it would create a consistent understanding of auditor independence and be supported by the EU Recommendation on Independence (2003). In light of the recognition of the IFAC Code of Ethics one respondent remarked that differences between any EU Member State's independence rules and those in the IFAC Code of Ethics must be minimal. To the extent that Member States adopt more stringent rules these should not be applied on an extraterritorial basis. Beyond that many respondents - particularly from the audit profession - recommended the adoption of a single set of independence rules by all Member States which could preferably be based on the IFAC Code of Ethics. A common set of standards would reduce compliance costs and complexity and be beneficial to all stakeholders.

Several respondents argued for a combination of the proposals submitted by the Commission services:

Some respondents supported the option to permit third country auditors the use of the IFAC Code of Ethics if deemed equivalent. Yet, in addition, the independence rules of those third countries which have not endorsed the IFAC Code of Ethics should be assessed and, if deemed equivalent, their use should be allowed as well.

A minority of respondents from the category of public authorities recommended that the Commission should conduct an equivalence assessment of the individual third countries' independence rules as long as the IFAC Code of Ethics is not revised. Such an approach would be necessary to ensure equivalent independence rules. As soon as the revised IFAC Code of Ethics has been recognised as being equivalent, the use of its independence standards should be allowed.

The great majority of respondents rejected the option to exclusively assess the individual third countries' independence rules and if deemed equivalent to allow third country audit entities the use of home country rules. Such an approach would be costly, inefficient and require establishing a system to monitor changes in each country's rules to ensure that changes have not created unacceptable differences. Only a very few respondents favoured the option to assess exclusively the third country's independence rules. One reason given was that otherwise the IFAC Code of Ethics would receive special status.

Eventually, two respondents from the category of public authorities rejected either proposal submitted by the Commission and recommended the introduction of a more unified independence rule. The option to permit the use of the IFAC Code of Ethics if deemed equivalent might discriminate against third country auditors in cases in which the auditors of EU Member States were to be allowed to

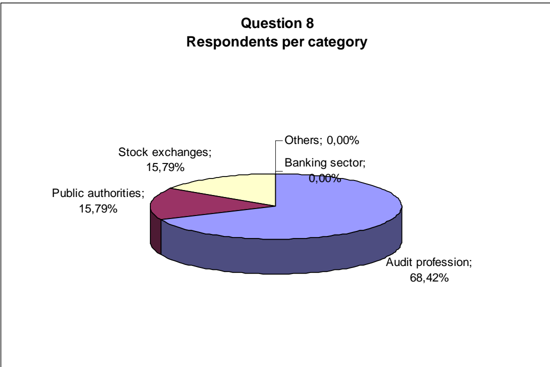
operate under significantly less stringent rules than the IFAC Code of Ethics imposes. The option to perform equivalence assessment of individual third countries' independence rules was rejected on the grounds that such approach would not promote uniformity.

3.9- CO-OPERATION REGARDING ARTICLE 47

3.9.1- GENERAL CONTEXT

Question 8:
Do you have any concerns which you would like to make European Commission services aware of?

19 of all respondents to the public consultation addressed question 8.



Respondents commented on the transfer of audit working papers by EU Member States' authorities to the competent authorities of third countries in general and addressed the adequacy test in particular.

The majority of respondents underlined the importance of a close co-operation between the oversight bodies of EU Member States and third countries. Within this co-operation various issues of transfer of audit working papers should be differentiated and agreed on. In this respect several respondents raised their concern that the laws of EU Member States and third countries concerning the transfer of information might differ – a problem which should be addressed.

Several respondents emphasised that the terms "audit working paper" and "other documents" as used in the Directive should be clearly defined so as to create legal certainty. One respondent recommended a more descriptive definition of both terms.

Some respondents, in particular from the audit profession, suggested that the transfer of audit working papers should be restricted to cases of formal investigation and should only in exceptional cases apply to quality assurance reviews. Such interpretation would be in line with Article 47. Its structure would imply that "transfer" is considered to be an exception. Moreover, the transfer of working papers would constitute an unacceptable impediment to the work of an audit firm.

Two respondents required that the transfer of audit working papers should be subject to the consent of the respective EU company who mandated the auditor. Accordingly, one respondent expressed the opinion that there should be the possibility of a full appeals' process before any transfer may take place.

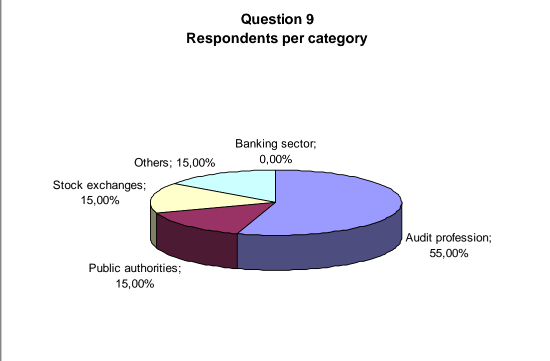
With respect to determining the criteria for the adequacy test, several respondents explicitly emphasised that those be considered and handled very carefully, particularly as the sensitive issues of professional secrecy and confidentiality of business data are concerned. Many respondents recommended involving the audit profession and audit clients in the discussion for developing criteria for the test; those being directly concerned if audit working papers are transferred to competent authorities of third countries.

Many respondents from the audit profession emphasised that there should be a clear distinction between data protection legislation and issues of client confidentiality and professional secrecy. Those subjects would be clearly distinct and should be considered separately in the context of the adequacy test. Moreover, several respondents remarked that data protection is not identified by the Directive of Statutory Audit as part of the oversight system for assessment purpose.

3.9.2- POSSIBLE SCOPE FOR CO-OPERATION

Question 9:
Do you have any comments on the conditions set up in the adequacy test?

20 of all respondents replied to question 9.



Several respondents explicitly expressed agreement in principle with the conditions established in the adequacy test. The majority, however, directly commented on the proposed conditions of the adequacy test.

With respect to the Commission's proposal to draw up a non-exhaustive list of documents that can be transferred, two respondents remarked that the list established by the Commission services could lead to confusion: The group auditor's review of the audit working papers of auditors of subsidiaries would already form part of the audit working papers of the group auditor. One respondent from the category of public authorities suggested that instead of drawing up a non-exhaustive list of documents which can be transferred it might be easier to draw up a "black list". This list should specify documents or most sensitive information and data where aspects of confidentiality and data protection must be assessed carefully by the competent authorities in the EU Member States. Such a "black list" should be supplemented by clear principles of the assessment.

Several respondents from the audit profession highlighted again the importance of a clear definition of the term "audit working papers". A definition would be necessary to create legal certainty with respect to which documents are actually subject to potential exchange. It was also emphasised that the definition should not be too broad. Otherwise regulators would be in a position to ask for virtually any kind of information.

Only a few respondents explicitly addressed the second condition of the proposed adequacy test, namely that documents which the European public oversight bodies do not consider necessary for an investigation or inspection by the competent authorities of a third country cannot be transferred. Those respondents considered the condition as an important safeguard to ensure that third country oversight bodies cannot request documents on grounds of the probability they might unveil something of interest.

With respect to the third condition proposed for the adequacy test, providing that transmitted documents shall be covered by the obligation of professional secrecy, two stock exchanges suggested to distinguish between three categories of documents:

- documents obtained from the company,
- documents resulting from the carrying out of audit procedures and
- correspondence between the company and its directors.

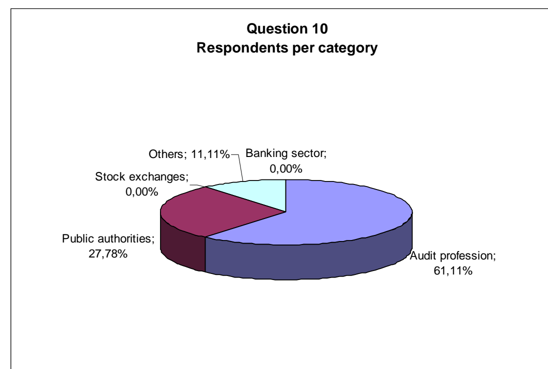
Such a distinction would be useful when considering confidentiality and professional secrecy. One respondent from the audit profession emphasised the importance that the criteria of data privacy and of confidentiality are discussed in the context of the adequacy test. The focus should be on the right to have access to data transferred, storage, confidentiality and its enforcement and destruction requirements.

Most frequently addressed was the fourth condition proposed for the adequacy test. The respondents emphasised the importance that authorities of third countries must, under all circumstances, be prohibited from using transmitted audit working documents for purposes other than public oversight, quality assurance and investigations or making them available to other authorities, such as tax authorities or competition authorities.

3.9.3- DIRECT TRANSFER FROM AUDIT FIRMS

Question 10:
Which circumstances could, in your view, be considered as exceptional?

18 of all respondents expressed their view on question 10.



The general view of respondents was that exceptional cases which justify a direct transfer of audit working papers by the audit firm to the third country authority could only be cases of urgency. Several respondents emphasised that such exceptional cases may only arise where the EU Member State in question could not engage in the matter itself. This would be the case if, for example, an investigation by the competent EU Member State could not be performed in time. Accordingly, many respondents argued that exceptional cases should be restricted to cases in which a formal investigation has been instigated as opposed to routine inspections. The latter would require less time and resources.

Against the background that the Directive requires a direct transfer of audit working papers where investigations have been initiated by the competent authorities of a third country, other respondents from the audit profession concluded that a specification of exceptional cases which justify the direct transfer of audit working papers by an audit firm to third country authorities would not be necessary. The strict criteria stipulated in Article 47 (4) of the Directive would be such that any circumstances meeting the criteria would, by definition, be exceptional.

One respondent from the audit profession expressed the view that direct transfer of audit working papers should be allowed in cases in which it is necessary to safeguard the audit firm's legitimate interests. The transfer should, however, be quantitatively and qualitatively limited to what is necessary and proportionate. In line with that approach it was argued that direct transfer should be allowed in cases in which the audit firm faces legal sanctions if it does not transfer the requested documents.

One respondent did not take the audit firm's legitimate interests in a direct transfer of audit working papers as starting point to define exceptional cases, but the interests of the investors. Exceptional cases would require special grounds for suspecting, or evidence of, wrongdoing such as fraud, professional misconduct, or professional failings likely to have led to substantial losses for investors. Another respondent, similarly, expressed the opinion that an eminent collapse of a multi-national firm would be an exceptional case justifying direct transfer of audit working papers.

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