

# AmCham EU supports proportionate reforms of the audit profession

27 February 2012

As representatives of business with significant investments in the European Union, employing hundreds of thousands of its citizens, we have a strong interest in a vibrant, high-quality audit profession which is vital to the effective functioning of EU capital markets.

Accordingly, the American Chamber of Commerce to the European Union (AmCham EU) supports proportionate reforms of the EU audit profession that will promote audit quality and reinforce investor confidence in financial reporting. However, these reforms need to be seen in a global context. Many of the proposed measures do not consider properly the transatlantic market place and will have an extra-territorial impact that will increase both cost and complexity with little apparent benefit.

In this regard we have a number of concerns. We have provided additional narrative on each of the in the paper that follows and have suggested a number of more effective and proportionate alternatives. However, in summary:

1. We support the goal of strengthening the role of the audit committee as an integral element of the corporate governance environment. As such, we do not support the requirement in Article 9(2) of the Regulation to impose a 10% cap on the provision of “related financial audit services” by a statutory auditor to a public interest entity. It should be the responsibility of the audit committee to decide whether such services should be limited or not.
2. We agree that auditor independence is a key ingredient for maintaining trust and confidence in the EU capital markets. However, we do not support a number of the prohibitions set out in Article 10(3) of the Regulation that prevent a statutory auditor from providing non-audit services to a public interest entity. All such prohibitions should be fully aligned with International Codes of Ethics. This will safeguard auditor independence whilst at the same time reducing divergence between the EU and third countries.
3. The requirements in Article 22 of the Regulation that govern the content of the Audit Report are unnecessarily prescriptive and inappropriate. As an

American Chamber of Commerce to the European Union  
Avenue des Arts/Kunstlaan 53, 1000 Brussels, Belgium  
Telephone 32-2-513 68 92 Fax 32-2-513 79 28  
Email: [info@amchameu.eu](mailto:info@amchameu.eu)

Secretariat Point of Contact: Emanuele Degortes, [Emanuele.degortes@amchameu.eu](mailto:Emanuele.degortes@amchameu.eu); 02 289 1036

## AmCham EU's position on Audit Reforms

---

alternative, we support the consistent application of the requirements of International Standards on Auditing in this regard which will ensure a level playing-field between the EU and third countries.

4. The requirement in Article 31(1) of the Regulation to increase the number of members of the audit committee who should have competence in auditing and accounting, is unnecessary. We support the existing requirements of Article 41(1) of Directive 2006/43/EC which require a minimum of at least one such individual.
5. We do not support the requirement in Article 33(2) of the Regulation that forces a public interest entity to rotate its statutory auditor after a pre-defined period. This will increase costs for companies whilst undermining audit quality, especially for multinationals operating across multiple jurisdictions. It should be for the audit committee and those charged with governance to decide whether or not to re-appoint the incumbent auditor.
6. We do not support the regime for Administrative Sanctions set out in Title V of the Regulation and the accompanying Annex in so far as they apply to public interest entities. This should be a matter for the Member States to decide.

### **1 - Article 9(2) and caps on the provision of “Related Financial Audit services”**

There are two related concerns - firstly, the introduction of a new definition of “Related Financial Audit services”; secondly, and more importantly, a cap on these services equal to 10% of the statutory audit fee.

Article 10(2) identifies the services that fall within the new definition. These are broadly equivalent to the types of service that fall within the existing definitions of Audit Related services or Other Assurance services. There is no need for this additional definition which **adds complexity with little obvious benefit** other than to facilitate the proposed cap.

A number of the services covered by the definition (e.g., the audit of interim financial statements as covered by Article 10(2)(a)) are those that are **customarily performed** by the statutory auditor as an integral part of the audit role. Others are those which **can only be performed** by a statutory auditor and are required by national law (e.g., the certification on compliance with tax requirements as covered by Article 10(2)(e) reflects an existing obligation under Greek Law).

AmCham EU's position on Audit Reforms

---

By definition, the provision of such services **does not constitute a threat to independence**. Accordingly, there is no reason for these services to be capped.

It should be for audit committees to monitor and review the services provided by the statutory auditor. All such fees should continue to be disclosed in a company's financial statements as required by existing EU legislation.

## **2 - Article 10(3) and the prohibition of non-audit services**

The proposed Regulation introduces new levels of prohibitions with regard to the provision of non-audit services to companies that are public interest entities. We are not aware of any evidence to show that the provision of non-audit services by statutory auditors to public interest entities was a factor that contributed to the financial crisis.

We believe that the provision of non-audit services by a statutory auditor to the company being audited, subject to appropriate safeguards, does help auditor's to obtain a deeper understanding of the company's business, thereby supporting audit quality. This is particularly relevant for larger companies that are public interest entities given the geographical scale and increasing complexity of their activities.

There are also potential efficiencies and cost advantages for companies when using a statutory auditor to perform certain non-audit services. In the current economic climate, we do not support measures that will increase costs to the companies we represent.

The proposed adoption of stricter non-audit service prohibitions at EU level will create complexity, increase costs to EU businesses and undermine the goal of greater regulatory compatibility at the global level. Accordingly, we support the consistent application of credible International Codes of Ethics such as those developed by the International Ethical Standards Board for Accountants (IESBA). The IESBA Code provides for the application of safeguards to potential threats to independence, periodic rotation of key audit partners and restrictions on personal and business relationships between an individual auditor and the company being audited.

The Audit Committee should be responsible for monitoring, reviewing and approving all services provided by a statutory auditor to the company.

## **3 - Article 22 and the Audit Report**

We fully support proposals which are aimed at a more informative audit report and we also support the proposal for a new report from the statutory auditor to

## AmCham EU's position on Audit Reforms

the audit committee. However, the detailed proposals set out in Article 22 of the Regulation surrounding the audit report are of concern.

We do not support the detailed and overly prescriptive contents of some of the current proposals which are neither useful nor do they provide understandable information for most users of financial statements. Limiting the length of the audit report to “10,000 characters without spaces” (Article 22(4)) is one example of over prescription. The identification of “each member of the engagement team” (Article 22(2)(q)) will provide no value to shareholders. For the largest companies such a listing would easily exceed the proposed 10,000 character threshold.

However, the greater concern is the proposed departure from International Standards on Auditing promulgated by the IAASB which currently govern the form and content of the audit report. Such a move will undermine international convergence and promote confusion in the international marketplace. Whilst we agree that there is scope for audit reports to be more informative and useful to shareholders and the wider stakeholder community, any such changes need to be coordinated at an international level as part of the ongoing IAASB work programme.

### **4 - Article 31(1) and the composition of the audit committee**

Audit committees (and other equivalent bodies) fulfil a vital corporate governance role. As such, specialised skills are a desirable attribute for at least some audit committee members in order to maximise their overall effectiveness.

Article 41(1) of the Statutory Audit Directive 2006/43/EC introduced a legal requirement for all public interest entities to establish an audit committee. It also required at least one member of the audit committee to be independent and to have competence in accounting and/or auditing. This Directive was due to be implemented by June 2008 (at the heart of the financial and economic crisis) although many Member States did not meet that deadline.

The Commission proposals in Article 31 of the draft Regulation seek to expand these requirements to include one member of the audit committee with competence in auditing **and another member** with competence in accounting and/or auditing.

Given the expanded scope of the proposed definition of Public Interest Entity, many more companies will be required to establish an audit committee. At the same time, the pool of individuals with the necessary skills in accounting and auditing is limited.

Whilst these skill sets are important, there are many other skills of equal if not greater importance that should form part of an audit committee's overall suite of skills.

Accordingly, we believe the existing requirement in Article 41(1) should be retained. Companies should be free to expand these requirements to suit their own circumstances.

### **5 - Article 33(2) and mandatory rotation of the statutory auditor**

We do not support mandatory rotation of the statutory auditor. We believe that audit firm rotation **will increase costs** to the companies we represent. Such an approach cannot be justified in general and in particular at a time of economic recession.

At the same time, we believe that audit firm rotation **will undermine audit quality**, especially in the early years of a new relationship between the auditor and the company being audited.

Some commentators have suggested that audit firm rotation could help open up the audit market and provide greater opportunities for smaller audit firms. However, research performed for the European Commission which, inter alia, analysed the Italian audit market where rotation has been in their law since the 1970s, has clearly demonstrated that the Italian audit market is one of the most concentrated in the EU. Accordingly, we believe that audit firm rotation **will increase audit market concentration**, not reduce it.

We believe to impose audit firm rotation on the EU PIE audit market will **undermine the important oversight role** of the audit committee and remove the shareholders' right to appoint or re-appoint the audit firm that is best suited to a company's particular circumstances.

Adoption of audit firm rotation in the EU would also have **significant implications for the transatlantic market place**. Many multinational companies operate through a network of subsidiaries across the globe. Adoption of audit firm rotation in EU legislation would represent not only an additional regulatory burden for EU companies but also a potential barrier to trade given its extraterritorial effect.

Whilst the independence of a statutory auditor is an essential prerequisite for an objective opinion on a company's financial statements, we believe there are **more effective alternatives** to preserve auditor independence such as rotation of key audit partners, a strengthened role for audit committees, greater transparency around the process for appointing or re-appointing the statutory auditor and independent inspection of audit firms by the competent authorities.

We support these alternatives and believe that audit committees should be encouraged to perform a periodic review of auditor quality, independence and effectiveness. Where a statutory auditor is re-appointed, the reasons for that decision should be clearly articulated.

### **6 - Administrative Sanctions**

The proposed Regulation contains an obligation for Member States to establish rules on administrative sanctions that will apply in cases where the requirements



## AmCham EU's position on Audit Reforms

of the Regulation have been breached. An Annex to the proposed Regulation contains 29 specific breaches, some of which apply to public interest entities as opposed to their statutory auditor.

The proposed Regulation also contains very detailed and prescriptive requirements for the sanctions that should apply.

We do not support the inclusion of these rules and sanctions in the proposed Regulation. These are matters that should be left to the individual Member States and not legislated at EU level.

\*\*\*

*AmCham EU speaks for American companies committed to Europe on trade, investment and competitiveness issues. It aims to ensure a growth-orientated business and investment climate in Europe. AmCham EU facilitates the resolution of transatlantic issues that impact business and plays a role in creating better understanding of EU and US positions on business matters. Aggregate U.S. investment in Europe totaled €1.7 trillion in 2010 and directly supports more than 4.2 million jobs in Europe.*

\*\*\*