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Subject:	Proposal for a Directive of the European Parliament and of the Council amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts Proposal for a Regulation of the European Parliament and of the Council on specific requirements regarding statutory audit of public-interest entities - Guidance for future work

I. INTRODUCTION

1. On 7 December 2011, the Commission submitted two proposals covering on the one hand a revision of the Audit Directive (Eighth Company Law Directive) (doc. 16971/11) and on the other a Regulation on specific requirements regarding statutory audit of public-interest entities (doc. 16972/11).

2. The proposals arose from the Commission Green Paper of October 2010, initiating a consultation on Audit Policy, in the aftermath of the global financial crisis and in the general context of financial market reform. The Green Paper opened a debate on the role and function of the auditor in the operating environment for auditors and the broader context of financial stability. The combined proposals for a Directive and a Regulation constitute a comprehensive approach to addressing issues across the audit spectrum.
3. These proposals have been discussed by the Council preparatory bodies under the Danish, Cyprus, Irish and Lithuanian Presidencies.
4. On 29 May 2013, the Competitiveness Council held an orientation debate on the three main outstanding issues: mandatory rotation of auditors and audit firms; restriction on the provision of related financial audit services and prohibition of non-audit services; and cooperation of national audit oversight bodies.
5. Taking into account the general orientation given by the Council, the Presidency presented compromise texts on the Directive and the Regulation which were discussed by the Company Law Working Party on 31 May, 14 June and 5 July and by the Company Law Attaches on 20-21 June and 11 July.
6. The objective of the present discussion is to provide guidance to the Working Party for the finalisation of the compromises on the three issues discussed at the Competitiveness Council with a view to facilitating a compromise on the whole texts of the Directive and the Regulation and thus the opening of negotiations with the European Parliament.
7. In order to structure the discussion, the Presidency has prepared the questions set out under point II of the present note.

II. QUESTIONS ON THE THREE OUTSTANDING ISSUES

1. Restriction on the provision of related financial audit services and Prohibition of non-audit services

At the Competitiveness Council, Ministers expressed broad support for having a black list of prohibited non-audit services, but asked for further work on the specific content of the black list. Ministers expressed concerns about the 70% “cap” for financial audit related services.

The Working Party had in-depth discussions on the services included on the black list on the basis of revised compromise texts prepared by the Presidency with a view to accommodating delegations' main concerns and to finding a balanced compromise solution.

The black list in the Presidency compromise (doc. 11908/13) follows the principle that all non-audit services, which could affect:

- the opening and closing balances of the audited financial statements,
- management or decision-making process;
- the processes of financial information generation and control

should not be permitted to be provided to the audited entity.

According to this compromise text the prohibition covers the period starting one year before the period audited and ending one year after the issuing of the audit report, as these periods are considered relevant for the independence of statutory auditor and audit firm.

As regards the cap, the Presidency tried to accommodate delegations concerns by excluding financial audit related services imposed not only by EU but also by national legislation therefore the scope of restricted services decreased.

Questions:

- 1) In the spirit of compromise can you agree to the principle that all non-audit services as proposed by the Presidency should be prohibited to be provided to the audited entity?**
- 2) Which periods should the prohibition cover to ensure the independence of statutory auditors and audit firms?**
- 3) Can you agree to 70 percent cap for financial audit related services excluding those imposed by EU and also by national legislation?**

2. Mandatory rotation of auditors and audit firms of Public Interest Entities

Having regard to the need to ensure the high quality of audit, including independence and objectivity of auditors in particular of Public Interest Entities, which is endangered by the prevalence of long audit tenure of statutory auditor firms/statutory auditors, and with regard to the societal role of audit in supporting the integrity of the economic system and facilitating well informed economic choices of investors, the Commission in the Regulation proposed provisions requiring the mandatory rotation of auditors and audit firms after a maximum period of 6 years which could, under certain exceptional circumstances, be extended to 8 years. The Commission also proposed that where a public-interest entity has appointed two or more statutory auditors or audit firms (joint audit), the maximum duration of the engagements will be 9 years and that on an exceptional basis, such duration may be extended to 12 years.

At the Competitiveness Council, the majority of Member States expressed favourable opinions on some form of mandatory rotation of statutory auditors and audit firms when statutory audit of public interest companies is conducted, but divergent opinions on the scope of mandatory rotation and on the length of the maximum period of engagement.

Divergent views have persisted in the discussions at Working Party level. These differences concern in particular the distinction between "systemic" and other Public Interest Entities, as well as the requirements which should be satisfied in order to allow a longer maximum period of engagement.

The Presidency has tried to reconcile those views in the following ways: by finding a middle ground between delegations positions as regards the maximum period of engagement, by introducing differentiations between "systemic" (credit institutions as defined in Article 4(1) of Directive 2006/48/EC, unless they fall under Article 2 of that Directive and insurance undertakings as defined in Article 2(1) of Council Directive 91/674/EEC) and other public interest entities and by introducing some flexibility for Member States to introduce stricter rules.

As a compromise, the Presidency text (doc. 11908/13) of 3 July provides for a maximum period of engagement of 10 years, that can be extended, subject to the satisfaction of certain criteria (tendering or joint audit), until

- (i) a maximum of 13 (tendering) or 16 (joint audit) years in case of statutory audit of the "systemic" Public Interest Entities, and
- (ii) a maximum of 16 years (tendering or joint audit) in case of other Public Interest Entities.

In addition, the Presidency compromise foresees that, on an exceptional basis, the Public Interest Entity may request the competent authority to grant another extension to re-appoint the statutory auditor or audit firm for a maximum of 2 further years (3 years for joint audit).

Questions:

Could you agree in a spirit of compromise to the distinction between "systemic" and other PIEs in terms of duration as proposed by the Presidency?

3. Cooperation of national audit oversight bodies

The Commission proposal on the Regulation envisages that EU-wide cooperation on auditor oversight between the national competent authorities takes place within the European Securities and Markets Authority (ESMA). The proposed committee would assume functions previously undertaken by the European Group of Auditors' Oversight Bodies (EGAOB), an expert group chaired by the Commission.

Delegations expressed broad support for the idea of continued cooperation between national audit oversight bodies at EU level, but were divided as regards the question as to which EU body the cooperation tasks should be assigned and on some of the additional tasks proposed.

At the Competitiveness Council, an important number of Member States expressed opposition to any involvement of ESMA in the coordination of public audit oversight many of them supporting an alternative coordination mechanism based on European Board of Auditors' Oversight Bodies (EBAOB). However, a small number of Member States were in favour of ESMA.

Based on the orientation debate at the Competitiveness Council, the Presidency developed a compromise solution without involvement of ESMA - the creation of Committee of European Auditors' Oversight Bodies (CEAOB). This alternative model was discussed in the Council Working party on 20-21 June and 5 July.

The discussions in the working group revealed the different positions of Member States regarding the governance of the CEOB, notably whether the Committee should be chaired by the Commission or by an official elected by the Members of the CEOB. The question of the provision of the secretariat, logistical and practical support of such committee also arose.

Questions:

1. The Presidency asks delegations to express their views on the principles of governance of the proposed Committee of European Auditing Oversight Bodies. More concretely, delegation are asked to express their views, which of the following alternatives they would support:
 - a) CEAOB chaired by an official elected by the Members of the CEAOB (the Vice Chair would be appointed by the Commission);
 - b) CEAOB chaired by the Commission (the Vice Chair would be elected by the Members of the CEAOB).
- 2) Do you agree that the Secretariat of CEAOB would be provided by the Commission and that the detailed rules about logistical and practical arrangements of the functioning of CEAOB be set in the rules of procedure of the CEAOB?

III. CONCLUSION

The Permanent Representatives Committee is invited to give guidance to the Company Law Working Party on the three main outstanding issues on the Audit proposals on the basis of the questions set out in point II.

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