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NOTE

From:	General Secretariat
To:	Working Party on Company Law
On:	15 May 2013
No. Cion prop.:	16972/11 DRS 122 CODEC 2040
Subject:	Proposal for a Regulation of the European Parliament and of the Council on specific requirements regarding statutory audit of public-interest entities - Presidency compromise text

Delegations will find attached a steering note and an overall Presidency compromise text. Changes to the previous compromise texts are underlined.

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Presidency Steering Note - Regulation

Article 3 Definitions

The Presidency proposes deleting the reference to the definition of "audit report" in this Article in view of the proposed amendment to the definition of "audit report" in Article 2(9) of the Directive.

Article 4 Large public interest entities

In line with Member States' suggestions, the Presidency proposes deleting this Article.

Article 5 Independence and Objectivity

Moved to the Directive as Article 22(5).

Article 6 Internal organisation of auditors and audit firms

Moved to the Directive as Article 22a.

Article 7 Independence from the audited entity

Moved to the Directive as Article 22b.

Article 8 Employment by public-interest entities of former statutory auditors or of employees of statutory auditors or audit firms

Moved to the Directive as Article 22c.

Article 9 Audit Fees

The Presidency is proposing to increase the threshold at Article 9(2). It is likely that this will form an element of the audit dossier to be submitted to the COMPET Council for consideration at its meeting on 29 May. The Presidency does not propose to provide for an exchange on the Article at working party prior to this.

Article 10 Prohibition of the provision of non-audit services

This text is unchanged. The views of Member States will be invited on the present draft.

Article 11 Preparation for the statutory audit and assessment of threats to independence

Moved to the Directive as Article 22d.

Article 12 Confidentiality and professional secrecy

No change.

Article 13 Disclosure to third-country auditors and to third country authorities

Transferred to the Directive as Article 23(5).

Article 14 Scope of the statutory audit

In order to ensure consistency with the provisions agreed under the Accounting Directive, no change is proposed to the text.

Article 15 Professional scepticism

Moved to the Directive as Article 22e.

Article 16 Organisation of the work

Moved to the Directive as Article 22f.

Article 17 Incidents and Irregularities (formerly Market integrity)

Various Member States drafting suggestions have been included in the text.

Article 18 Audit of consolidated financial statements

Moved to the Directive and merged with Article 27 there.

Article 19 Internal quality control review

Following comments from Member State, point (b) has been deleted from paragraph 3.

In paragraph 4(b) and (c), Member State drafting suggestions have been taken up. It has also been revised as regards comments made about taking account of audits of PIEs undertaken by sole practitioners.

Article 20 Use of international standards on auditing

Arising from proposed changes proposed to Article 26 of the Directive, the Presidency considers that this Article can be deleted.

Article 21 Results of the statutory audit

No change.

Article 22 Audit report

The cross reference to article 28 of the Directive has been relocated from paragraph 1 to paragraph 2 for purposes of clarity and in acknowledgement of some Member States comments.

The amendments at 22.2(c) are for clarity of scope as discussed at the Working Party meeting.

Paragraph (e) has been reinstated in the audit report following comments raised by Member States at Working Party meeting.

The changes at 22.2 (f) are in response to concerns raised by Member States.

The renumbering of the references at 22.2 (h) to (j) clarify where these new paragraphs are now located.
The changes at 22.2(k) are intended to address the concerns raised by Member States that the responsibility for the identification of key areas of risk lies with management.

The changes at 22.2(l) are in response to MS comments relating to responsibility for going concern and include a MS drafting suggestion.

22.2(o) has been moved to article 28 of the Directive in line with discussion at the Working Party meeting.

The changes at 22.2(q) are suggestions from Member States.

22.2(u) and 22.2(v) are proposed to be deleted as these should now be covered at Article 28.1 of the Directive.
22.2(w) has been reinstated in the audit report at the request of Member States.

The changes at line 1 of paragraph 3 are to clarify this paragraph relates to joint audits.

The deletion of the last sentence in paragraph 3 is intended to address Member States concerns that one audit opinion would take precedence in the event of a disagreement between joint auditors/firms.

The proposed changes at paragraph 4 are for reasons of clarity.

Article 23 Additional report to the audit committee
The changes at paragraph 1 sub para 3 are aimed at providing greater clarity on foot of comments from Member States.

Paragraph 1 sub para 4 has been deleted as discussed at Working Party meeting.

The deletion within paragraph 2 sub paragraph 1 responds to Member States observations as to the redundancy of the wording in question.

23.2(aa) has been relocated back to the Audit Report provision at 22.2(e) at the request of Member States.

The changes at 23.2(a) address Member States' concerns at the proposed requirement that each member of the audit team be named.

The changes at 23.2(e) are in the interests of greater clarity.

The changes at 23.2(ea) include the merging of (ea) and (eb) as discussed at the Working Party meeting and reflect the comments of Member States at that meeting.

The changes at 23.2(ec) are intended to reflect Member States comments on qualitative and qualitative relevance of materiality.
The changes at 23.2(f) include the merger of (f) and (j) as discussed at Working Party meeting and are intended to reflect Member States views.

23.2(g) is deleted in line with Member States suggestions.

The changes to 23.2(ga) are intended to address Member States concerns.

The changes at 23.2(h) are intended to address Member States concerns raised at Working Party meetings.

The changes at 23.2(k) are intended to give this paragraph substance and significance to cater for comments by Member States.

The changes at 23.2(l) are intended to address Member States concerns relating to the earlier draft of this paragraph.

Paragraph 23.2(m) does not apply to all audits and the changes are intended to reflect this.

Paragraph 23.2(na) has been moved back to the audit report provision at Article 22 at the request of Member States.
The intention of the changes proposed at paragraph 3 is to clarify that this paragraph only applies to joint audits.

The changes at paragraph 4 are those that arise from discussion at the Working Party meeting.

The changes made at paragraph 5 are to avoid conflict between this paragraph and national laws.

Article 24 Monitoring of the statutory audit by the audit committee

The change in the title is intended to better reflect the provisions of this article.

The Presidency proposed amendments to subparagraph 1 to respond to the call from a number of Member States for the reinstatement of the original wording.
Some Member States called for clarification to be provided as to the term 'parties' referred to at subparagraph 2. The changes are intended to address this request.

The changes made at subparagraph 3 are designed to avoid any conflict with 31(2) and (3).

The changes in the final sub paragraph are for clarity.

Article 25 Report to Supervisors of public interest entities

The changes at the first subparagraph of 25.1 are at the request of Member States.

The changes at 25.1(a) to (c) are drafting suggestions from Member States and for clarity.

The changes in the final subparagraph of 25.1 are those discussed at the Working Party meeting.

Paragraph 3 changes are drafting suggestions from Member States.

Article 26 Disclosure of financial information

The Presidency has attempted to take account of comments by Member States about calibrating these provisions to take account of smaller audit firms/sole practitioners.

Article 27 Transparency Report

Some minor drafting changes have been introduced here.

Article 28 Corporate governance statement

Deleted consequent upon the deletion of "large public interest entities".

Article 29 Information to competent authorities

No change.

Article 30 Record keeping

References to the various Articles to be further changed in course of the discussions.

The period of five years to be changed to "at least five years".

Article 31 Audit Committee

Some Member States asked for this article to be moved to the Directive. The Presidency intends to put the question to Member States as to their preference for retaining the article in the regulation or moving it to the Directive, but with application to PIEs alone.

The changes at paragraph 1 first subparagraph are to facilitate those Member States with particular corporate structures.

The changes at 1(a) and (b) are the thresholds used at article 3.3(a) of the proposed Accounting Directive.

Paragraph 1 final paragraph is an attempt to address Member States questions relating to independence.

The changes at paragraphs 2 and 3 are intended to address Member States concerns.

Paragraphs 4 and 5 were deemed as no longer required in the light of the earlier proposed changes to this article.

Article 32 Appointment of the statutory auditors or audit firms

At paragraph 2 and at paragraph 3 first sub paragraph, the changes are for the purpose of alignment with changes proposed at article 33.

At paragraph 3(a) the deletion proposed reflects the proposed changes at Article 4.
The changes at Article 7 are a drafting suggestion from a Member State.

The deletion of paragraph 10 reflects discussions at the Working Party meetings.

Article 33 Duration of the audit engagement

The changes at paragraph 1 sub paragraph 1 and 2 arise from Member States' preference for a reduction of the initial minimum appointment to a period of 1 year.

Following the WP meetings and after reviewing the written Member States' comments, the Presidency is proposing amendments at Paragraph 1 subparagraphs 3 and 4 and at paragraph 3 which would permit an initial continuous engagement of up to 7 years (8 for joint audit) which would be renewable for a maximum of 7 further years (8 for joint audit). On an exceptional basis the Public Interest Entity may request the competent authority to grant an extension to re-appoint the statutory auditor or audit firm for an additional engagement. In case of appointment of more than one statutory auditor or audit firm, this third engagement is for a maximum of three years, while for a single statutory auditor or audit firm, this third engagement is for a maximum of two years.

The original paragraph 3 has been renumbered 3a for sequencing purposes and the changes serve to update cross references arising from earlier changes.

Paragraph 4 increases the Key audit partner's audit tenure from 5 to 7 years to reflect the revised Presidency approach to these provisions
As it is likely that this issue will be presented to Ministers for discussion at the COMPET Council on 29 May, it is not proposed to consider it at the next WP meeting.

Article 33a

No change.

Article 34 Dismissal and resignation of the statutory auditors or audit firms

No change.

Article 35 Designation of competent authorities

In summary, the amendments proposed here are in facilitation of requests from several MS, for flexibility as regards designated competent authorities.

This is achieved by the inclusion of "amongst" at Paragraph 1, and the insertion of "at least" at paragraph 2 ,with the list of competent authorities listed there at (a) to (h)has the effect of ensuring that this list is no longer exhaustive.

On paragraph 6, in response to requests from a number of MS, only the Commission is required to be notified with the relevant information and it has the function of compiling this and make it public.

Article 36 Conditions of independence

As an attempt to accommodate representations from several MS,a new provision is now proposed for inclusion here permitting the competent authority to consult with and be assisted by experts for the carrying out of specific tasks, with the proviso that these experts cannot be involved in any decision-making of the Competent Authority.

MS may wish to indicate whether they consider that this addressesthe considerations articulated by them at the WP. This also parallels the situation at Article 32 of the Directive.

Article 37 Professional secrecy

There are minor changes to the title, in addition to the extension of secrecy obligations to independent contractors. It is also specified that persons involved in the governance of competent authorities are also subject to these provisions.

Article 38 Powers of competent authorities

Under the revised Presidency draft, the power at paragraph 3 for competent authorities to access documents has been restricted to "documents related to the statutory audit or other documents held by statutory auditors or audit firms" – 3(a) and (d).

In qualification of the powers being provided at paragraph 3, which were the subject of extensive MS comment, paragraph 4 now specifies restraints on the exercise of these powers and requires that the exercise of the more significant of these require prior intervention of a judicial authority.

On paragraph 5, in order to address concerns expressed by some MS, a special regime for cooperatives and saving banks is proposed to be introduced.

Article 39 Cooperation with other competent authorities at national level

No changes.

Article 40 Quality assurance

Reference in this provision to competent authorities "designated under Article 35.1" has been included at the request of several MS.

At paragraph 6 some drafting suggestions by a MS have been included.

Article 41 Investigation

In line with MS comments, "correcting" has been replaced with "examining" at subparagraph 1. At the suggestion of one MS, relating to the term "experts", a reference to the compliance requirements provided for in Article 40(4) has been added.

Article 42 Market monitoring

Arising from MS comments, "competition authorities in the Member States" are alternatively nominated to undertake these tasks.

Article 43 Contingency planning

In consideration of MS comments, the Presidency suggests deletion of this provision.

Article 44 Transparency of Competent Authorities

Following MS comments, reference to the protection of business secrets have been added at point (d).

Article 45 Obligation to cooperate

No change.

Article 46 ESMA

The text of the latest Presidency compromise on Article 46(1) is reproduced here.
As it is likely that this issue will be presented to Ministers for discussion at the COMPET Council on 29 May, it is not proposed to consider it at the next WP meeting.

Article 47 Home Member State principle

No change.

Article 48 Exchange of Information

This is being transferred to the Directive as Article 49.

Article 49 Cooperation with regard to quality assurance reviews

Insofar as the proposed coordination role of ESMA regarding quality assurance reviews, is concerned, the Presidency compromise clarifies that this is only an option for the competent authorities of the Member States concerned. A joint request by the Member States concerned is required to trigger this. In addition, the obligatory notification of ESMA has been deleted.

Articles 50 and 52 European Quality Certificate/Cooperation with regard to contingency planning

These Articles are proposed for deletion.

Article 51 Cooperation with regard to investigations or on-site inspections

As regards investigations and on-site inspections and the the coordination role previously foreseen for ESMA, the Presidency compromise is that should merely be an option for the competent authorities of the Member States concerned. A joint request by the Member States concerned is now required to trigger this coordination by ESMA. In addition, the obligatory notification of ESMA has been deleted.

Article 53 Colleges of competent authorities

The Presidency compromise now provides for a flexible approach whereby the establishment of colleges, whether by the competent authorities or by ESMA, is voluntary.

Article 54 Delegation of tasks

No change.

Article 55 Confidentiality and professional secrecy in relation to ESMA

The Presidency compromise attempts to address the concerns expressed by some Member States by restricting the exemption on confidentiality to cases where the disclosure of information is required as a matter of law.

Article 56 Protection of personal data

No change.

Article 57 Agreement on exchange of information

Following comments by MS, ESMAs involvement is proposed only in cases where there is a request by a competent authority.

Drafting suggestion by a MS has been taken on-board for the second subparagraph of paragraph 1.

Article 58 Disclosure of information received from third countries

No change.

Article 59 Disclosure of information transferred to third countries

No change.

Article 60 Cooperation with international organisation and bodies

Following drafting suggestion by several MS, "elaborating" has been replaced with "issuing".

Articles 61 – 67 Administrative sanctions and measures

Other than the second part of Article 61 -moved to the Directive as 30A-30G

Articles 68 – 72 Delegated acts, reporting and transitional and final provisions

The issue of Delegated v Implementing Acts is a horizontal one and the Council Legal Services will be invited to make a presentation to the WP in the matter.

In the event the specific Articles of the Regulation referred to in Article 68, i.e. (2), (3) and (5) have been deleted. Nonetheless the issue of Delegated v Implementing Acts arises in the overall context of these Audit proposals.

ANNEX II

2011/0359 (COD)

Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

on specific requirements regarding statutory audit of public-interest entities

(Text with EEA relevance)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 114 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national Parliaments,

Having regard to the opinion of the European Economic and Social Committee[1],

After consulting the European Data Protection Supervisor[2],

Acting in accordance with the ordinary legislative procedure,

Whereas:

(1) Statutory auditors and audit firms are entrusted by law to conduct statutory audits of public-interest entities with a view to enhancing the degree of confidence of the public in the annual and consolidated financial statements of such entities. The public-interest function of statutory audit means that a broad community of people and institutions rely on the quality of a statutory auditor's work. Good audit quality contributes to the orderly functioning of markets by enhancing the integrity and efficiency of financial statements. Thereby, auditors fulfil a particularly important societal role.

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1 OJ C , , p. .

2 Date of the opinion of the EDPS

(2) Union legislation requires that the financial stements, comprising annual accounts or consolidated accounts, of credit institutions, insurance undertakings, issuers of securities admitted to trading on a regulated market, payment institutions, UCITS, electronic money institutions and alternative investment funds be audited by one or more persons entitled to carry out such audits in accordance with Union law, namely: Article 1(1) of Council Directive 86/635/EEC of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions[3], Article 1(1) of Council Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertankings[4], Article 4(4) of Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC[5], Article 15(2) of Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC[6], Article 73 of Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)[7], Article 3(1) of Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48EC and repealing Directive 2000/46/EC[8], and Article 22(3) of Directive 2011/61/EC of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010[9]. Moreover, Article 4(1)(1) of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive

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3 OJ L 372, 31.12.1986, p. 1.
4 OJ L 374, 31.12.1991, p. 7.
5 OJ L 390, 31.12.2004, p. 38.
6 OJ L 319, 5.12.2007, p. 1.
7 OJ L 302, 17.11.2009, p. 32.
8 OJ L 267, 10.10.2009, p. 7.
9 OJ L 174, 1.7.2011, p.1.

93/22/EEC[10] also requires that the annual financial statements of investment firms be audited when the Fourth Council Directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies[11] or the Seventh Council Directive 83/349/EEC of 13 June 1983 on consolidated accounts[12] are not appplicable.

(3) The conditions for the approval of the persons responsible for carrying out the statutory audit as well as the minimum requirements for carrying out such statutory audit are laid down in Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC[13].

(4) During the recent financial crisis, numerous banks revealed huge losses from 2007 to 2009 on the position they had held both on and off balance sheet. This raised not only the question of how auditors could give unqualified audit reports to their clients for those periods but also about the suitability and adequacy of the current legislative framework. The Commission published on 13 October 2010 a Green Paper on Audit Policy: Lessons from the Crisis[14], which launched a wide public consultation, in the general context of financial market regulatory reform, on the role and scope of audit and how the audit function could be enhanced in order to contribute to increased financial stability. It resulted from the public consultation that the rules of Directive 2006/43/EC regarding the carrying out of the statutory audit of annual and consolidated accounts of public-interest entities could be substantially improved. The European Parliament issued an own initiative report on the Green Paper on 13 September 2011. The European Economic and Social Committee also adopted a report on that Green Paper on 16 June 2011.

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10 OJ L 145, 30.4.2004, p. 1.
11 OJ L 222, 14.8.1978, p.11.
12 OJ L 193, 18.7.1983, p. 1.
13 OJ L 157, 9.6.2006, p.87.
14 COM(2010)561 final.

(5) It is important to lay down detailed rules with a view to ensuring that the statutory audits of public-interest entities are of adequate quality and are carried out by statutory auditors and audit firms subject to stringent requirements. A common regulatory approach should enhance the integrity, independence, objectivity, responsibility, transparency and reliability of statutory auditors and audit firms carrying out statutory audit of public-interest entities, contributing to the quality of statutory audit in the Union, thereby contributing to smooth functioning of the internal market, while achieving a high level of consumer and investor protection. The development of a separate act for public-interest entities should also ensure consistent harmonisation and uniform application and thus contribute to a more effective functioning of the internal market.

(6) The financial sector is evolving and new categories of financial institutions are created by Union law. The importance of new entities and activities outside the regular banking system is growing and their impact on financial stability has become greater. Therefore, it is appropriate that the definition of public-interest entity also encompasses other financial institutions and entities such as investment firms, payment institutions, undertakings for collective investments in transferable securities (UCITS), electronic money institutions and alternative investment funds.

(7) Audit of annual and consolidated financial statements is intended as a statutory safeguard for investors, lenders and business counterparties who have a stake or a business interest in public-interest entities. Hence, statutory auditors and audit firms should be completely independent when carrying out statutory audits of such entities and conflicts of interest should be avoided. In order to determine the independence of auditors and audit firms, the concept of network in which auditors and firms operate has to be taken into account.

(8) Adequate internal organisation of statutory auditors and audit firms should contribute to preventing any threats to their independence. Thus, owners or shareholders of an audit firm, as well as those managing it, should not intervene in the carrying out of a statutory audit in any way which jeopardises the independence and objectivity of the statutory auditor who carries out the statutory audit on behalf of the audit firm. Additionally, statutory auditors and audit firms should establish appropriate internal policies and procedures in relation to employees and other persons involved in the statutory audit activity within their organisations in order to ensure compliance with their statutory obligations.

Those policies and procedures should in particular seek to prevent and address any threats to independence and ensure the quality, integrity and thoroughness of the statutory audit. Those policies and procedures should be proportionate in view of the scale and complexity of the business of the statutory auditor or audit firm.

(9) Auditors, audit firms and their employees should in particular refrain from carrying out the statutory audit of an entity if they have a business interest or financial interest in it and from engaging on trading in financial instruments issued, guaranteed or otherwise supported by an audited entity, other than holdings in diversified collective investment schemes. The statutory auditor or audit firm should abstain from the internal decision-making processes of the audited entity. Statutory auditors or their employees should be prevented from taking up duties in the audited entity at managerial or board level until an appropriate period has elapsed since the end of the audit engagement.

(10) The level of fees received from one audited entity and the structure of fees can also threaten the independence of a statutory auditor or audit firm. Thus, it is important to ensure that audit fees are not based on any form of contingency and that, when the audit fees from a single client are significant, a specific procedure is established to secure the quality of the audit. If the dependence on a single client is excessive, the statutory auditor or the audit firm should refrain from undertaking the statutory audit in question.

(11) The provision of services other than statutory audit to audited entities by statutory auditors, audit firms or members of their networks may compromise their independence. Therefore, it is appropriate to require the statutory auditor, the audit firm and the members of their network not to provide non-audit services to their audited entities. The provision of non-audit services by an audit firm to a company would prevent that audit firm from carrying out statutory audit of that company, thus resulting in a reduction of the audit firms available to provide statutory audit, in particular with regard to the audit of large public-interest entities where the market is concentrated. As a result, in order to secure that a minimum number of audit firms is able to provide audit services to large public-interest entities, it is appropriate to request that audit firms of significant dimension focus their professional activity on the carrying out of statutory audit and are not allowed to undertake other services unconnected to their statutory audit function such as consultancy or advisory services.

(12) With a view to avoiding conflicts of interest it is important that the statutory auditor or the audit firm, before accepting or continuing an engagement for a statutory audit of a public-interest entity, assesses whether the independence requirements are met, and in particular whether any threats to independence arise as a result of the relationship with that entity. In order to maintain this independence, it is also important that they keep records of all threats to their independence and that of their employeess and other persons involved in the statutory audit process, as well as the safeguards applied to mitigate those threats. Moreover, where the threats to their indepedence, even after having applied safeguards to mitigate those threats, are too significant, they should resign or abstain from the audit engagement. The statutory auditor or the audit firm should confirm annually to the audit committee of the audited entity their independence and discuss with such committee any threat to their independence as well as the safeguards applied to mitigate those threats.

(13) Directive 95/46 of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data[15] govern the processing of personal data carried our in the Member States in the context of this Regulation and under the supervision of the Member States competent authorities, in particular the public independent authorities designated by the Member States. Regulation (EU) No 45/2001 of the European Parliament and of the Council of 18 December 2000 on the protection of individuals with regard to the processing of personal data by the EU institutions and bodies and on the free movement of such data[16], governs the processing of personal data carried out by ESMA within the framework of this Regulation and under the supervision of the European Data Protection Supervisor. Any exchange or transmission of information by competent authorities should be in accordance with the rules on the transfer of personal data as laid down in Directive 95/46/EC and any exchange or transmission of information by ESMA should be in accordance with the rules on the transfer of personal data as laid down in Regulation (EC) No 45/2001.

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15 OJ L 281, 23.11.1995, p. 31.
16 OJ L 8, 12.1.2001, p. 1.

(14) It is important that statutory auditors and audit firms respect the rights to private life and data protection of of their clients. They should therefore be bound by strict rules on confidentiality and professional secrecy which, however, should not impede the proper enforcement of this Regulation or the cooperation with the group auditor during the performance of the audit of consolidated financial statements when the parent undertaking is in a third country, provided that Directive 95/46/EC is complied with. However, such rules would not allow a statutory auditor or audit firm to cooperate with third country authorities outside the cooperation channels foreseen in Chapter XI of Directive 2006/43/EC. Those confidentiality rules should also apply to any statutory auditor or audit firm which has ceased to be involved in a specific audit task.

(15) The statutory audit results in an opinion on the truth and fairness of the financial statements of the audited entities. Stakeholders, however, might to be unaware of the limitations of an audit (materiality, sampling techniques, role of the auditor in the detection of fraud and the responsibility of managers), which can lead to an expectation gap. In order to reduce such gap, it is important to provide more clarity on what the scope of the statutory audit is.

(16) Whilst the primary responsibility for delivering financial information should rest with the management of the audited entities, auditors play a role by actively challenging management from a user's perspective. In order to improve audit quality, it is therefore important that the professional scepticism exercised by auditors vis-à-vis the audited entity is reinforced. Auditors should recognise the possibility that a material misstatment due to fraud or error could exist, notwithstanding the auditor's past experience of the honesty and integrity of the audited entity's management. Securing audit quality should be the main criterion to organise the audit work and to allocate the necessary resources to the tasks. The integrity of the statutory auditor, audit firm and their staff is essential to ensure the public confidence in statutory audits and financial markets. Therefore, any incident that may have serious consequences for the integrity of the statutory audit activities should be appropriately managed. The statutory auditor or the audit firm should appropriately document the audit work.

(17) In the case of consolidated financial statements, it is important that there is a clear definition of responsibilities of the statutory auditors who audit different entities of the group. For this purpose, the group auditor should bear full responsibility for the audit report.

(18) A sound internal quality control review of the work carried out in each statutory audit engagement should be conducive to high audit quality. Therefore, the statutory auditor or the audit firm should not issue his, her or its audit report until such an internal quality control review has been completed.

(19) The results of the statutory audit should be presented to the stakeholders in the audit report. In order to increase the confidence of stakeholders in the financial statements of the audited entity, it is particularly important that the audit report is well-founded and solidly substantiated and its content expanded to include additional information specific to the audit carried out. The audit report should in particular include sufficient information on the methodology used in the audit, especially how much of the balance sheet has been directly verified and how much has been based on system and compliance testing, on the levels of materiality applied to perform the audit, on the key areas of risk of material misstatements of the annual and consolidated financial statements, on whether the statutory audit was designed to detect fraud and, in the event of a qualified or adverse opinion or a disclaimer of opinion, on the reasons for such decision.

(20) The value of statutory audit for the audited entity would be particularly enhanced if the communication between the statutory auditor or the audit firm, on the one hand, and the audit committee, on the other hand, was reinforced. Further to the regular dialogue during the carrying out of the statutory audit, it is important that the statutory auditor or the audit firm submits to the audit committee an additional and more detailed report on the results of the statutory audit. It should be possible to make such additional detailed reports available to the supervisors of public-interest entities, but not to the public.

(21) Statutory auditors or audit firms already provide supervisors of public-interest entities with information on facts or decisions which could constitute a breach of the rules governing the activities of the audited entity or the impairment of the continuous functioning of the audited entity. Supervisory tasks would also be facilitated if supervisors of credit and financial institutions were required to establish a regular dialogue with their statutory auditors and audit firms.

(22) In order to increase the confidence in and the liability of the statutory auditors and audit firms carrying out the statutory audit of public-interest entities, it is important that the transparency reporting by statutory auditors and audit firms is increased. Therefore, statutory auditors and audit firms should be required to disclose audited financial information, showing in particular their total turnover divided into audit fees paid by public-interest entities, audit fees paid by other entities and fees for other services. They should also disclose financial information at the level of the network to which they belong. The transparency reports of audit firms should be completed by a statement on corporate governance with a view to showing whether the audit firm maintains arrangements for sound corporate governance. Additional supplementary information on audit fees should be provided to competent authorities with a view to facilitating their supervisory tasks.

(23) Audit committees, or bodies performing an equivalent function within the audited entity, have a decisive role in contributing to high-quality statutory audit. It is particularly important to reinforce the independence and technical competence of the audit committee by requiring that a majority of its members is independent and that at least one member of the committee has competence in auditing and another one in auditing and/or accounting. The Commission Recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board[17] sets out how audit committees should be established and function. Considering, however, the dimension of boards in companies with reduced market capitalisation and in small and medium-sized public-interest entities, it would be appropriate that the functions assigned to the audit committee for those entities, or to a body performing equivalent functions within the audited entity, may be performed by the administrative or supervisory body as a whole. Public-interest entities which are UCITS or alternative investment funds should also be exempted

[17] OJ L 52, 25.2.2005, p. 51.

from the obligation to have an audit committee. This exemption takes into account the fact that where those funds function merely for the purpose of pooling assets, the employment of an audit committee is not appropriate. UCITS and alternative investments funds, as well as their management companies, operate in a strictly defined regulatory environment and are subject to specific governance mechanisms such as controls exercised by their depositary.

(24) It is also important that the role of the audit committee in the selection of a new statutory auditor or audit firm be reinforced, for the benefit of a more informed decision of the general meeting of shareholders or members of the audited entity. Hence, when making a proposal to the general meeting, the board should explain whether it follows the recommendation of the audit committee and, if not, why. The recommendation of the audit committee should include at least two possible choices for the audit engagement and a duly justified preference for one of them, so that the general meeting can make a real choice. In order to provide a fair and proper justification in its recommendation, the audit committee should use the results of a mandatory selection procedure organised by the audited entity, under the responsibility of the audit committee. In such selection procedure, the audited entity should invite statutory auditors or audit firms, including smaller ones, to present proposals for the audit engagement. Tender documents should contain transparent and non-discriminatory selection criteria to be used for the evaluation of proposals. Considering, however, that this selection procedure could entail disproportionate costs for companies with reduced market capitalisation or small and medium-sized public-interest entities having regard to their dimension, it is appropriate to relieve such entities from this obligation.

(25) The right of the general meeting of shareholders or members of the audited entity to choose the statutory auditor or the audit firm would be of no value if the audited entity were to enter into a contract with a third party providing for a restriction of such choice. Therefore any contractual clause entered into by the audited entity with a third party regarding the appointment or restricting the choice of a particular auditor or audit firm should be considered null and void.

(26) The appointment of more than one statutory auditor or audit firm by the public-interest entities would reinforce the professional scepticism and contribute to increasing audit quality. Also, this measure combined with the presence of smaller audit firms would facilitate the development of the capacity of such firms, thus contributing to increasing the

choice of statutory auditors and audit firms for public-interest entities. Therefore, the latter should be encouraged and incentivised to appoint more than one statutory auditor or audit firm to carry out the statutory audit.

(27) In order to address the familiarity threat and therefore reinforce the independence of auditors and audit firms, it is important to establish a maximum duration of the audit engagement of a statutory auditor or audit firm in a particular audited entity. An appropriate gradual rotation mechanism should also be established with regard to the most senior personnel involved in the statutory audit, including the key audit partners carrying out the statutory audit on behalf of the audit firm. It is also important to provide for an appropriate period within which such statutory auditor or audit firm may not carry out the statutory audit of the same entity. In order to ensure a smooth transition, the former auditor should transfer a handover file with relevant information to the incoming auditor.

(28) In order to protect the independence of the auditor, it is important that dismissal should be possible only where there are proper grounds and if those grounds are communicated to the authority or authorities responsible for supervision. Where there are proper grounds, but the audited entity does not act, the audit committee, the shareholders, the competent authorities responsible for the supervision of auditors and audit firms or the competent authorities responsible for the supervision of the public-interest entity should be empowered to bring a case before a national court on the dismissal of the auditor.

(29) In order to ensure a high level of investor and consumer confidence in the internal market by avoiding conflicts of interests, statutory auditors and audit firms should be subject to appropriate supervision by competent authorities which are independent from the audit profession and which have adequate capacity, expertise and resources. The national competent authorities should have the necessary powers to undertake their supervisory tasks, including the capacity to access documents, demand information from any person and carry out inspections. They should specialize in the supervision of financial markets, of compliance with financial reporting obligations or in statutory audit oversight. However, it should be possible that the supervision of the compliance with the obligations set on public-interest entities is carried out by the competent authorities responsible for the supervision of those entities. The funding of the competent authorities should be free from any possible undue influence by statutory auditors or audit firms.

(30) The quality of supervision should improve if there is effective cooperation between authorities charged with different tasks at national level. Therefore, the authorities competent to supervise compliance with the obligations on statutory audit of public-interest entities should cooperate with the authorities responsible for the approval and registration of statutory auditors and audit firms, with those supervising public-interest entities and with the Financial Intelligence Units referred to in Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2006 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing[18].

(31) External quality assurance for the statutory audit is fundamental for high quality audit. It adds credibility to published financial information and provides better protection of shareholders, investors, creditors and other interested parties. Statutory auditors and audit firms should therefore be subject to a system of quality assurance under the responsibility of the competent authorities, thus ensuring objectivity and independence from the audit profession. Quality assurance reviews should be organised in such a manner that each statutory auditor or each audit firm undertaking audits of public-interest entities is subject to a quality assurance review at least every three years. The Commission Recommendation of 6 May 2008 on external quality assurance for statutory auditors and audit firms auditing public interest entities[19] provides information on how inspections should be undertaken. Quality assurance reviews should be proportionate in view of the scale and complexity of the business of the reviewed audit firm or statutory auditor.

(32) Investigations help to detect, prevent and correct inadequate carrying out of the statutory audit of public-interest entities. Therefore, competent authorities should be empowered to undertake investigations of statutory auditors and audit firms.

(33) The market for the provision of statutory audit services to public-interest entities evolves over time. It is therefore necessary that competent authorities monitor the developments in the market, particularly as regards possible limited choice of auditor and the risks that arise from high market concentration.

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18 OJ L 309, 25.11.2005, p. 15.
19 OJ L 120, 7.5.2008, p.20.

(34) The demise of important audit firms may disrupt the provision of audit services in the market and could result in further structural accumulation of risk in the market. Therefore, competent authorities should, as a preventive action, request the largest audit firms in each Member State to establish contingency plans addressing a possible event threatening the continuity of operations of the concerned firm. Such plans may identify measures to prepare an orderly failure of the firm concerned.

(35) The transparency of the activities of competent authorities should contribute to increase the confidence of investors and consumers in the internal market. Therefore, competent authorities should be required to regularly report on their activities and to publish individual inspections reports.

(36) The cooperation between the competent authorities of the Member States can make an important contribution to ensuring consistently high quality in the statutory audit in the Union. Therefore, the competent authorities of the Member States should cooperate with each other, where necessary, for the purpose of carrying out their supervisory duties regarding statutory audits. They should respect the principle of home-country regulation and oversight by the Member State in which the statutory auditor or audit firm is approved and the audited entity has its registered office. The cooperation between competent authorities would be particularly enhanced if organised within the framework of the Joint Committee of European Supervisory Authorities (ESA), under the leadership of the European Securities and Markets Authority (ESMA) set up by Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities Market Authority)[20]. ESMA, with the assistance of the European Banking Authority (EBA) set up by Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority)[21] and the European Insurance and Occupational Pensions Authority (EIOPA) set up by Regulation (EU) No 1094/2010 of the European Parliament and of the

[20] OJ L 331, 15.12.2010, p.84.
[21] OJ L 331, 15.12.2010, p.12.

Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority)[22], should contribute to that cooperation by providing advice and guidelines to national competent authorities.

(36a) In order to ensure effective and efficient cooperation amongst national competent authorities and to carry out the tasks conferred on ESMA according to this Regulation, ESMA shall create a permanent internal committee, CEAOB, pursuant to Article 41 of Regulation (EU) No 1095/2010 which shall be composed of the national competent authorities in charge of audit, which constitute the European Group of Audit Oversight Bodies (EGAOB) created by Decision 2005/909/EC. Article 41(1) of Regulation (EU) No 1095/2010 provides for the possibility to delegate certain clearly defined tasks and decisions to internal committees. This Regulation provides that the Board of Supervisors of ESMA delegates tasks and decisions related to audit issues to the CEOAB which would allow competent authorities in the field of audit to take decisions in this regard.

(37) The scope of cooperation between the competent authorities of Member States should include exchange of information, cooperation with regard to quality assurance assurance reviews, assistance to investigations related to the carrying out of statutory audits of public-interest entities, including in cases where the conduct under investigation does not constitute an infringment of any legislative or regulatory provision in force in the Member States concerned and contingency planning. The modalities of cooperation between the competent authorities of the Member States may include the creation of colleges of competent authorities and the delegation of tasks among themselves. The concept of network in which auditors and firms operate should be taken into account in such cooperation. Competent authorities and the European Supervisory Authorities should respect appropriate confidentiality and professional secrecy rules.

(38) Recognition of the aptitude of statutory auditors and audit firms to perform statutory audits of public-interest entities should faciliate the access of auditors and firms to other clients. Therefore, it is important to provide for a Quality Certificate of European dimension which should be developed by ESMA. National competent authorities should be involved in the examination of the applications for the certificate.

[22] OJ L 331, 15.12.2010, p.48.

(39) The interrelation of capital markets calls for empowering national competent authorities and the European Supervisory Authorities to cooperate with supervisory authorities and bodies of third countries regarding the exchange of information or quality assurance reviews. However, where the cooperation with third country authorities is related to audit working papers or other documents held by statutory auditors or audit firms, the procedures of Directive 2006/43/EC should apply.

(40) Sustainable audit capacity and a competitive market for statutory audit services in which there is a sufficient choice of audit firms capable of carrying out statutory audits of public-interest entities are required in order to ensure a smooth functioning of capital markets. ESMA should report on the changes brought in the audit market structure by this Regulation. When carrying such analysis, ESMA should take into account the impact of the national civil liability rules for statutory auditors on the structure of the audit market. Based on such report and other appropriate evidence, the Commission should present a report on the impact of the national liability rules for statutory auditors on the audit market structure and should take the steps it considers appropriate as a result of its findings.

(41) In order to improve compliance with the requirements of this Regulation and following the Commission Communication of 9 December 2010 entitled 'Reinforcing sanctioning regimes in the financial sector'[23], the power to adopt supervisory measures and the sanctioning powers of competent authorities should be enhanced. Administrative pecuniary sanctions on statutory auditors, audit firms and public-interest entities for identified violations should be foreseen. The competent authorities should be transparent about the sanctions and measures they apply. The adoption and publication of sanctions should respect fundamental rights as laid down in the Charter of Fundamental Rights of the European Union, in particular the right to respect for private and family life (Article 7), the right to the protection of personal data (Article 8) and the right to an effective remedy and to a fair trial (Article 47).

[23] COM(2010)716 final.

(42) Whistleblowers can bring new information to the attention of competent authorities which assists them in detecting and sanctioning irregularities, including fraud. However, whistleblowers may be deterred from doing so for fear of retaliation, or may lack incentives to do so. Member States should therefore ensure that adequate arrangements are in place to encourage whistleblowers to alert them to possible breaches of this Regulation and to protect them from retaliation. Member States may also provide them with incentives for doing so; however, whistleblowers should only be eligible for such incentives where they bring to light new information which they are not already legally obliged to notify and where this information results in a sanction for a breach of this Regulation. Member States should also ensure that whistleblowing schemes they implement include mechanisms that provide appropriate protection of a reported person, particularly with regard the right to the protection of his personal data and procedures to ensure the right of the reported person of defence and to be heard before the adoption of a decision concerning him as well as the right to seek effective remedy before a tribunal against a decision concerning him.

(43) In order to take account of developments in auditing and the audit market, the Commission should be empowered to specify technical requirements on the content of the handover file that the new statutory auditor or audit firm should receive and on the establishment of a European quality certificate for statutory auditors and audit firms carrying out statutory audits of public-interest entities.

(44) In order to take account of the technical developments in the financial markets, in auditing and the audit profession and to specify the requirements laid down in this Regulation, the Commission should be empowered to adopt delegated acts in accordance with Article 290 of the Treaty on the Functioning of the European Union. In particular, the use of delegated acts is necessary to adapt the list of related audit services and of non-audit services as well as to set out the level of fees that ESMA could charge for delivering the European Quality Certificate to statutory auditors and audit firms. It is of particular importance that the Commission carries out appropriate consultations during its preparatory work, including at expert level. The Commission, when preparing and drawing up delegated acts, should ensure a simultaneous, timely and appropriate transmission of relevant documents to the European Parliament and to the Council.

(45) In order to ensure legal certainty and the smooth transition to the regime introduced by this Regulation, it is important to introduce a transitional regime regarding the entry into force of the obligation to rotate audit firms, the obligation to organise a selection procedure for the choice of audit firm and the conversion of audit firms into firms that only provide audit services.

(46) Since the objectives of this Regulation, namely clarifying and better defining the role of statutory audit regarding public-interest entities, improving the information that the statutory auditor or audit firm provides to the audited entity, investors and other stakeholers, improving the communication channels between auditors and supervisors of public-interest entities, preventing any conflict of interest arising from the provision of non-audit services to public-interest entities, mitigating the risk of any potential conflict of interest due to existing system of "auditee selects and pays the auditor" or to familiarity threat, facilitating the switching of statutory auditor or audit firm and the choice of an audit provider to public-interest entities, increasing the choice of audit providers to public-interest entities and improving the effectiveness, independence and consistency of the regulation and supervison of statutory auditors and audit firms providing statutory audits to public interest entities including as regards cooperation at Union level, cannot be sufficiently achieved by the Member States and can, therefore, by reason of their scale, be better achieved at Union level, the Union may adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty on European Union. In accordance with the principle of proportionality, as set out in that Article, this Regulatoin does not go beyond what is necessary in order to achieve those objectives.

(47) This Regulation respects the fundamental rights and observes the principles recognised in particular by the Charter of Fundamental Rights of the European Union, notably the right to respect for private and family life (Article 7), the right to the protection of personal data (Article 8), the freedom to conduct a business (Article 16), the right to an effective remedy and to a fair trial (Article 47), the presumption of innocence and right of defence (Article 48), the principles of legality and proportionality of criminal offences and penalties (Article 49), the right not to be tried or punished twice for the same offence (Article 50), and has to be applied in accordance with those rights and principles,

HAVE ADOPTED THIS REGULATION:

TITLE I

SUBJECT MATTER, SCOPE AND DEFINITIONS

Article 1

Subject matter

This Regulation lays down requirements for the carrying out statutory audit of annual and consolidated financial statements of public-interest entities, rules on the organisation and selection of statutory auditors and audit firms by public-interest entities to promote their independence and the avoidance of conflicts of interest and rules on the supervision of compliance by statutory auditors and audit firms with those requirements.

Article 2
Scope

1. This Regulation applies to the following:

   (a) statutory auditors and audit firms who carry out statutory audits of public-interest entities;

   (b) public-interest entities.

2. This Regulation applies without prejudice to Directive 2006/43/EC.

Article 3
Definitions

For the purposes of this Regulation, the definitions laid down in Article 2 of Directive 2006/43/EC shall apply, except for the definition of 'competent authority'.

Article 4
Large public interest entities

[…]

TITLE II

CONDITIONS FOR CARRYING OUT STATUTORY AUDIT OF PUBLIC-INTEREST ENTITIES

CHAPTER I

INDEPENDENCE AND AVOIDANCE OF CONFLICTS OF INTEREST

Article 5
Independence and objectivity
[transferred to the Directive, Article 22(5)]

Article 6
Internal organisation of auditors and audit firms
[transferred to Directive, Article 22a]

Article 7

Independence from the audited entity

[transferred to Directive, Article 22b]

Article 8
Employment by public-interest entities of former statutory auditors or of employees of statutory auditors or audit firms

[transferred to Directive, Article 22c]

Article 9

Audit fees

1. Fees for the provision of statutory audits to public-interest entities shall not be contingent fees.

   For the purposes of the first subparagraph, contingent fees means fees for audit engagements calculated on a predetermined basis relating to the outcome or result of a transaction or the result of the work performed. Fees shall not be regarded as being contingent if a court or a competent authority has established them.

2. When the statutory auditor or audit firm provides to the audited entity services other than the ones referred to in Article 10(1), the fees for such services shall be limited to no more than <u>70%</u> of the fees paid in any three year period by the audited entity for the statutory audit.

   For the purposes of the limits specified in the first subparagraph, services related to audit work imposed by Union legislation shall be excluded.

3. When the total fees received from a public-interest entity subject to the statutory audit represent either more than 20% or, for three consecutive years, more than 15% of the of the total annual fees received by the statutory auditor or audit firm carrying out the statutory audit, such auditor or firm shall disclose to the audit committee the fact that the total of such fees represents more than 20% or 15%, as appropriate, of the total fees received by the firm and the discussions referred to in Article 11(4)(d) shall be undertaken. The audit committee shall consider whether the audit engagement shall be subject to a quality control review by another statutory auditor or audit firm prior to the issuance of the audit report.

When the total fees received from a public-interest entity subject to the statutory audit represent, for three consecutive years, more than 15% of the total annual fees received by the statutory auditor or audit firm carrying out the statutory audit, the auditor or firm shall inform the competent authority referred to in Article 35(1) of such situation. The competent authority referred to in Article 35(1) shall decide on the basis of objective grounds provided by the statutory auditor or the audit firm whether the statutory auditor or audit firm of such entity may continue to carry out the statutory for an additional period which in any case shall not be longer than two years.

Where the audited entity is exempted from the obligation to have an audit committee, the audited entity shall decide which body or organ of the entity shall engage with the statutory auditor or audit firm for the purposes of the obligations set out in this paragraph

Article 10
Prohibition of the provision of non-audit services

1. A statutory auditor or an audit firm carrying out statutory audit of public-interest entities shall not directly or indirectly provide to the audited entity, to its parent undertaking and to its controlled undertakings non-audit services.

Where the statutory auditor belongs to a network, no member of such network shall provide to the audited entity, to its parent undertaking and to its controlled undertakings within the Union any non-audit services.

For the purposes of this Article, non-audit services shall mean:

(i) expert services unrelated to the audit, tax consultancy, general management and other advisory services;

(ii) bookkeeping and preparing accounting records and financial statements;

(iii) designing and implementing internal control or risk management procedure related to the preparation and/or control of financing information included in the financial statements and advice on risk;

(iv) valuation services, providing fairness opinions or contribution-in-kind reports;

(v) actuarial and legal services, including the resolution of litigation;

(vi) designing and implementing financial information technology systems for public-interest entities as referred to in Article 2(13)(b) to (j) of Directive 2006/43/EC;

(vii) participating in the audit client's internal audit and the provision of services related to the internal audit function;

(viii) broker or dealer, investment adviser, or investment banking services.

(ix) human resources services, including recruiting senior management;

(x) designing and implementing financial information technology systems for public-interest entities as referred to in Article 2(13)(a) of Directive 2006/43/EC.

2. A statutory auditor or an audit firm carrying out statutory audit of public-interest entities may provide to the audited entity, to its parent undertaking or its controlled undertakings statutory audit services and services other than the non-audit services referred to in paragraph 1 subject to the approval of the audit committee after having properly assessed threats and potential safeguards to independence in accordance with Article 11.

   Where the statutory auditor belongs to a network, any member of such network may provide to the audited entity, to its parent undertaking and to its controlled undertakings within the Union statutory audit services or services other than the non-audit services referred to in paragraph 1 subject to the approval of the audit committee and after having properly assessed threats and potential safeguards to independence in accordance with Article 11.

3. When a member of the network to which the statutory auditor or the audit firm carrying out statutory audit of a public-interest entity belongs provides non-audit services to an undertaking incorporated in a third country controlled by the audited public-interest entity, the statutory auditor or the audit firm concerned shall assess whether his, her or its independence would be compromised by such provision of services by the member of the network. If his, her or its independence is affected, the statutory auditor or the audit firm shall apply safeguards in order to mitigate the threats caused by such provision of services in a third country. The statutory auditor or the audit firm may continue to carry out the statutory audit of the public-interest entity only if he, she or it can justify, in accordance with Article 11,

that such provision of services does not affect his, her or its professional judgement and the audit report.

Being involved in the decision-taking of the audited entity and the provision of the services referred to in points (ii) and (iii) of paragraph 1 shall be considered as affecting such independence in all cases.

The provision of the services referred to in points (i) and (iv) to (viii) of paragraph 1 shall be presumed to affect such independence.

The statutory auditor or the audit firm may consult the competent authority for an opinion on this issue.

4. […]

5. The Commission shall be empowered to adopt delegated acts in accordance with Article 68 for the purpose of adapting the list of non-audit services referred to in paragraph 1 of this Article. When using such powers, the Commission shall take into account developments in auditing and the audit profession.

Article 11

Preparation for the statutory audit and assessment of threats to independence
[transferred to Directive, Article 22d]

CHAPTER II

CONFIDENTIALITY AND PROFESSIONAL SECRECY

Article 12

Confidentiality and professional secrecy

Statutory auditors or audit firms, including those who have ceased to be engaged in a particular audit assignment and former statutory auditors or audit firms, shall not invoke the rules on confidentiality and professional secrecy referred to in Article 23(1) and 23(4) of Directive 2006/43/EC to prevent the application of the provisions of this Regulation.

Article 13
Disclosure to third country auditors and to third country authorities

[transferred to Directive, Article 23(5)]

CHAPTER III

PERFORMANCE OF THE STATUTORY AUDIT

Article 14

Scope of the statutory audit

1. When carrying out the statutory audit of a public-interest entity, the statutory auditor or audit firm shall take the necessary steps with a view to forming an opinion as to whether the annual or consolidated financial statements of the public-interest entity give a true and fair view in accordance with the relevant financial reporting framework and, where appropriate, whether such annual or consolidated financial statements comply with statutory requirements.

   Such steps shall include at least the requirements set out in Articles 15 to 19.

The opinion of the statutory auditor or audit firm shall be expressed in accordance with Articles 21 to 25.

2. Without prejudice to the reporting requirements as referred to in Articles 22 and 23, the scope of statutory audit shall not include the assurance on the future viability of the audited entity nor the efficiency or effectiveness with which the management or administrative body has conducted or will conduct the affairs of the entity.

Article 15
Professional scepticism
[transferred to the Directive, Article 22e]

Article 16
Organisation of the work
[Transferred to the Directive, Article 22f]

Article 17

Incidents and Irregularities

1. Where the statutory auditor or an audit firm becomes aware of any development which is likely to have material consequences <u>for the outcome of</u> the statutory audit, the statutory auditor or the audit firm shall:

(a) keep a record of the development;

(b) take appropriate measures in response to the event or development;

(c) inform the relevant competent authority of the event or development forthwith if, having taken appropriate measures, the auditor continues to believe that the event or development is likely to have material consequences for the audit opinion.

The record referred in point (a) of the first subparagraph shall include the facts and circumstances of the development, information about the person or persons involved and details of the measures that have been taken pursuant to point (b) of that subparagraph.

2. Without prejudice to Directive 2005/60/EC, when a statutory auditor or an audit firm carrying out the statutory audit of a public-interest entity suspects or has reasonable grounds to suspect that irregularities with regard to the financial statements of the audited entity is being or has been committed or attempted, he, she or it shall inform the audited entity and invite it to investigate the matter and take appropriate measures to deal with such irregularities and to prevent any recurrence of such irregularities in the future.
Where the audited entity does not investigate the matter, […] the statutory auditor or audit firm shall inform the competent authorities supervising public-interest entities of such irregularities.

The disclosure in good faith to the competent authorities, by the statutory auditor or audit firm, of any <u>irregularities</u> referred to in the first subparagraph shall not constitute a breach of any contractual or legal restriction on disclosure of information and shall not involve such persons in <u>legal</u> liability.

Article 18

Audit of consolidated financial statements

[transferred to the Directive, Article 27]

Article 19

<u>Independent</u> quality control review

1. Before the reports referred to in Articles 22 and 23 are issued, an <u>independent</u> quality control review shall be performed to assess whether the statutory auditor or the key audit partner could reasonably have come to the opinion and conclusions expressed in the draft of these reports.

2. <u>Where the statutory audit is carried out by an audit firm, t</u>he <u>independent</u> quality control review shall be performed by an internal quality control reviewer. Such reviewer shall be a statutory auditor who is not involved in the performance of the statutory audit to which the <u>independent</u> quality review relates.

2a Where the statutory audit is carried out by a statutory auditor:

(a) if the statutory auditor is carrying out the statutory audit in an individual capacity but is a member of an audit firm, the independent quality control review may be performed by a statutory auditor who is also a member of the firm and who is not involved in the performance of the statutory audit.

(b) if the statutory auditor is not a member of an audit firm, he or she shall arrange that another statutory auditor, who may be a member of an audit firm, shall perform an independent quality control review. The disclosure of documents or information to the independent reviewer for the purposes of this Article shall not constitute a breach of professional secrecy. Documents or information disclosed to the independent reviewer for the purposes of this Article shall be subject to professional secrecy.

3. When conducting the independent review, the reviewer shall record at least the following:

(a) the oral and written information provided by the statutory auditor or key audit partner to support the main findings of the audit procedures carried out and the conclusions drawn from those findings, whether or not at the request of the independent quality control reviewer;

[…]

(c) the main findings of the audit procedures carried out and the conclusions drawn from those findings;

(d) the opinions of the statutory auditor or key audit partner, as expressed in the draft of the reports referred to in Articles 22 and 23;

4. The independent quality control review shall at least assess the following elements:

(a) the independence of the statutory auditor or audit firm with from the audited entity;

(b) the significant risks which are relevant to the statutory audit and that the statutory auditor or key audit partner has identified during the performance of the statutory audit and the measures that he or she has taken to adequately manage those risks;

(c) the reasoning of the statutory auditor or key audit partner, in particular with regard to the level of materiality and the significant risks referred to in point (b);

(d) any request for advice made to external experts and the implementation of such advice;

(e) the nature and scope of the corrected and uncorrected misstatements in the financial statements that were identified during the performance of the audit;

(f) the subjects discussed with the audit committee and the management and/or supervisory bodies of the audited entity;

(g) any subjects discussed with competent authorities and, if applicable, with other third parties;

(h) whether the documents and information selected from the file satisfactorily reflect the positions taken by the employees involved in the audit, and whether such documents and information support the opinion of the statutory auditor or key audit partner as expressed in the draft of the reports referred to in Articles 22 and 23.

5. The independent quality control reviewer shall discuss the results of the independent quality control review with the statutory auditor or the key audit partner. […] The audit firm shall establish procedures for determining the manner in which any disagreement between the key audit partner and the independent reviewer are to be resolved. Where paragraph 2a applies, the statutory auditor and the independent reviewer shall establish equivalent procedures, which may include submitting the specific issues to a third independent statutory auditor. The procedures shall provide for the documentation of decisions reached and the reasons for them.

6. The […] audit firm, and where paragraph 2a applies, the statutory auditor and the independent reviewer, shall keep a record of the results of the independent quality control review, together with the considerations underlying those results.

Art 20

Use of international standards on auditing

[deleted]

CHAPTER IV

AUDIT REPORTING

Article 21

Results of the statutory audit

The statutory auditor or the audit firm shall present the results of the statutory audit in the following reports:

– an audit report in accordance with Article 22;

– an additional report to the audit committee in accordance with Article 23.

The statutory auditor or the audit firm shall present the results of the statutory audit to the audit committee of the audited entity in accordance with Article 24 and to supervisors of public-interest entities in accordance with Article 25.

Article 22

Audit Report

1. The statutory auditor<u>(s)</u> or the audit firm<u>(s)</u> shall present the results of the statutory audit of the public-interest entity in an audit report.
2. The audit report <u>shall be prepared in accordance with the provisions of Article 28 of Directive 2006/43/EC and additionally</u> shall at least:
   (a) *[transferred to Article 28(1)(a) of the Directive]*
   (b) *[transferred to Article 28(1)(a) of the Directive]*
   (c) explain, where additional reports, <u>as required by the national law of the Member State,</u> have been reviewed and/or audited, the scope of such review/audit;
   (d) *[deleted]*
   (e) <u>indicate the date of the appointment and the period of total uninterrupted engagement including previous renewals and reappointments</u>

(f) <u>confirm whether</u> the statutory audit was conducted in accordance with the international standards on auditing as referred to in Article 26 of the Directive;

(g) [transferred to Article 28(1)(a) of the Directive]

(h) [transferred to Article 2<u>3</u>(2)(ea)]

(i) [transferred to Article 2<u>3</u>(2)(eb)]

(j) [transferred to Article 2<u>3</u>(2)(ec)]

(k) <u>state whether he/she/it has become aware of any</u> key areas of risk of material misstatement of the annual or consolidated financial statements <u>which have not been referred to</u> in the management report;

(l) <u>provide an opinion on the appropriateness of management's use of the going concern assumption in the preparation of the financial statements in accordance with the applicable financial reporting framework, and a statement as to whether, based on the audit, the auditor(s) or audit firm(s) has identified any material uncertainty(ies) related to events or conditions that may cast significant doubt about the entity's ability to continue as a going concern that the auditor(s) or audit firm(s) believes needs to be disclosed in accordance with the applicable financial reporting framework; […]</u>

(m) [transferred to Article 23(2)(ga)]

(n) explain to what extent the statutory audit was considered capable of detecting irregularities, including fraud;

(o) <u>[…]</u>

(p) confirm that the audit opinion is consistent with the additional report to the audit committee referred to in Article 23;

(q) declare that the non-audit services referred to in Article 10(1) were not provided and that the statutory auditor(s) or the audit firm(s) remained independent <u>of the audited entity</u> in conducting the audit.; *[Second sentence transferred to Article 23(2)(a)]*

(r) [deleted]

(s) [deleted]

(t) [Deleted except the final sentence transferred to 28(1)(f) of the Directive]

(u) <u>[…]</u>

(v) <u>[…]</u>

(w) <u>identify where the statutory auditor(s) or audit firm(s) is established.</u>

3. <u>In the case of joint audits the</u> statutory auditor<u>(s)</u> or audit firm<u>(s)</u> shall agree on the results of the statutory audit and submit a joint report and opinion. In case of disagreement, each statutory auditor or audit firm shall submit his, her or its opinion in separate <u>audit reports</u>. <u>[…]</u>

4. <u>Except as required at paragraph 2(p) above t</u>he audit report shall not contain any cross-references to the additional report to the audit committee referred to in Article 23 and shall be in clear and unambiguous language.

5. [Included in Article 28(2) of the Directive]

6. [deleted]

7. The statutory auditor or audit firm shall not use the name of any competent authority in such a way that would indicate or suggest endorsement or approval by that authority of the audit report.

Article 23

Additional report to the audit committee

1. The statutory auditor(s) or the audit firm(s) carrying out statutory audit of public interest entities shall submit an additional report to the audit committee of the audited entity.

If the audited entity does not have an audit committee, the additional report shall be submitted to the body performing equivalent functions within the audited entity.

The <u>statutory</u> auditor<u>(s) or audit firm(s) shall give the opportunity to comment on</u> the additional report to the management, administrative or supervisory body of the audited entity.

<u>[…]</u>

2. The additional report to the audit committee shall be in writing. It shall explain the results of the statutory audit carried out and shall at least:

(aa) <u>[…]</u>

(a) include a declaration of independence as provided for in point (q) of Article 22(2). Where the statutory audit was carried out by an audit firm, the report shall identify each <u>key audit partner who was engaged in the audit</u> and shall state that all members <u>of the audit engagement team</u> remained independent <u>of</u> the audited entity;

(b) identify the dates of the meetings with the audit committee or the body performing equivalent functions within the audited entity;

(c) identify the dates of the meetings, if any, with the management, administrative or supervisory body of the audited entity;

(d) *[deleted]*

(e) where two or more auditor(s) or audit firms have been appointed describe the distribution of tasks among the statutory auditor(s)s and/or the audit firm(s);

(ea) describe the methodology used, including which categories of the balance sheet have been directly verified and which have been based on system and compliance testing, including an explanation of any substantial variation in the weighting of substantive and compliance testing when compared to the previous year, even if the previous year's statutory audit had been conducted by another statutory auditor(s) or audit firm(s);

(eb) […]

(ec) lay out the details of the quantitative level of materiality applied to perform the statutory audit and of the qualitative factors which were considered when setting the level of materiality;

(f) indicate and explain judgments about material uncertainty that may cast significant doubt about the entity's ability to continue as a going concern and provide details of all guarantees, comfort letters, undertakings of public intervention and other support measures that have been relied upon when making a going concern assessment

(g) […]

(ga) report on the entity's or, in case of consolidated financial statements, the parent undertaking's internal financial control system, including significant internal financial control deficiencies identified during the statutory audit, as well as the accounting system;

(h) indicate and explain all instances of non-compliance with laws and regulations which the statutory auditor(s) or audit firm(s) consider may be important to the audit committee in order to fulfil its tasks;

(i) assess the valuation methods applied to the various items in the annual or consolidated financial statements including any impact of changes of such methods;

(j) […]

(k) if applicable where stock takes or physical verifications have taken place, confirm any attendance at stocktakes as well as the other instances of physical verification and indicate how much of the total stock or other assets were physically verified by the auditor(s) or audit firm(s);

(l) indicate and explain the scope of consolidation in and the exclusion criteria applied to the de-consolidated entities in the case of a statutory audit of consolidated financial statements;

(m) where applicable indicate which audit work is performed by third-country auditor(s), statutory auditor(s), third- country audit entity(ies) or audit firm(s) in case of a statutory audit of consolidated financial statements;

(n) indicate whether all requested explanations and documents were provided by the audited entity.

(na) […]

3. In the case of joint audits and in the case of a disagreement between the appointed statutory auditors or audit firms on auditing procedures, accounting rules or any other issue regarding the conduct of the statutory audit, the reasons for such disagreement shall be explained in the additional report to the audit committee.

4. The additional report to the audit committee shall be signed and dated. Where an audit firm carries out the statutory audit, the additional report to the audit committee shall be signed by at least the statutory auditor(s) carrying out the statutory audit on behalf of the audit firm.

5. Upon request, and in accordance with national law, the statutory auditor(s) or the audit firm(s) shall make available without delay the additional report to the competent authorities within the meaning of article 35(2) of Directive 2006/43/EC.

Article 24

Monitoring of the statutory audit by the audit committee

The audit committee, on behalf of the administrative or supervisory body of the public-interest entity, shall monitor the work of the statutory auditor(s) or audit firm(s) carrying out the statutory audit. […]

The statutory auditor(s) or audit firm(s) shall report to the audit committee on key matters arising from the statutory audit, and in particular on material weaknesses in internal control in relation to the financial reporting process. Upon request of a statutory auditor, an audit firm or the audit committee, the statutory auditor(s) or audit firm(s) shall discuss these matters with the audit committee.

Where an audited entity has an audit committee, the audit committee shall inform the administrative or supervisory body of the audited entity of the outcome of the statutory audit. The audit committee shall explain how the statutory audit contributed to the integrity of financial reporting and what its role was in this process.

Where the audited entity is exempted from the obligation to have an audit committee, the audited entity shall decide which body or organ of the entity shall engage with the statutory auditor(s) or audit firm(s) for the purposes of the obligations set out in this Article.

Article 25
Report to supervisors of public-interest entities

1. Without prejudice to Article 55 of Directive 2004/39/EC, Article 53 of Directive 2006/48/EC of the European Parliament and of the Council[24], Article 15(4) of Directive 2007/64/EC, Article 106 of Directive 2009/65/EC, the first paragraph of Article 3 of Directive 2009/110/EC and Article 72 of Directive 2009/138/EC of the European Parliament and of the Council[25], the statutory auditor or audit firm carrying out the statutory audit of a public-interest entity shall have a duty to report promptly to the competent authorities supervising the public-interest entity and, where relevant to the competent authority supervising the auditor or audit firm, any information concerning that public-interest entity of which he, she or it has become aware while carrying out that statutory audit and which has brought about or has the potential to bring about any of the following:
   (a) a material breach of the laws, regulations or administrative provisions which lay down, where appropriate, the conditions governing authorisation or which specifically govern the activities of such public-interest entity;
   (b) a material threat or doubt concerning the continuous functioning of the public-interest entity;
   (c) a refusal to issue an audit opinion on the financial statements or the issuing of an adverse or qualified opinion .

   The statutory auditor(s) or the audit firm(s) shall also have a duty to report any information referred to in paragraph 1 (a) (b) or (c) above of which he, she or it becomes aware in the course of carrying out the statutory audit of an undertaking having close links with the public-interest entity for which he, she or it is also carrying out the statutory audit. In this article, close links shall have the meaning assigned to it in article 46 of Directive 2006/48/EC. […]

24 OJ L 177, 30.6.2006, p.1.
25 OJ L 335, 17.12.2009, p.1.

2. Competent authorities supervising credit institutions and insurance undertakings shall establish a regular dialogue with the statutory auditor(s) and audit firm(s) carrying out the statutory audit of those institutions and undertakings.

In order to facilitate the exercise of the tasks referred to in the first subparagraph, EBA and EIOPA shall issue guidelines addressed to the competent authorities supervising credit institutions and insurance undertakings, in accordance with Article 16 of Regulation (EU) No 1093/2010 and of Regulation (EU) No 1094/2010, respectively.

3. The disclosure in good faith to the competent authorities, by the statutory auditor or audit firm, of any fact information or opinion referred to in paragraph 1 or of any fact information or opinion emerging during the dialogue provided for in paragraph 2 shall not constitute a breach of any contractual or legal restriction on disclosure of information and shall not involve such persons in liability of any kind.

CHAPTER V

TRANSPARENCY REPORTING BY STATUTORY AUDITORS AND AUDIT FIRMS AND RECORD KEEPING

Article 26

Disclosure of financial information

1. An audit firm that carries out statutory audits of public-interest entities shall make public its annual financial report within the meaning of Article 4(2) of Directive 2004/109/EC at the latest four months after the end of each financial year.

Statutory auditors who carry out statutory audits of public-interest entities shall publish their annual income statement.

2. The annual financial report and the annual income statement shall show the total turnover divided into fees from the statutory audit of annual and consolidated financial statements of public-interest entities and entities belonging to a group of undertakings whose parent undertaking is a public-interest entity, fees from the statutory audit of annual and consolidated financial statements of other entities and fees charged for related financial audit services.

The annual financial report or the annual income statement shall be audited. […]

3. Where the statutory auditor or the audit firm belongs to a network, the statutory auditor or the audit firm shall provide the following additional information in the annual financial report or as an annex to the annual income statement or in the Transparency Report:

   (a) the name of each statutory auditor or audit firm, based in the EU, belonging to the network;

   (b) the country(ies) in which each statutory auditor or audit firm belonging to the network is qualified as statutory auditor or has his, her or its registered office, central administration or principal place of business;

   (c) the total turnover generated in the European Union by the statutory auditors and audit firms belonging to the network, resulting from the statutory audit of annual and consolidated financial statements;

   By derogation from the first subparagraph, the statutory auditor or the audit firm may not provide the additional information where it is disclosed by the legal entity governing the network or another representative of the network. In this case, the statutory auditor or the audit firm shall indicate in the annex to the annual income statement or to the annual financial report where that information is accessible.

4. The annual financial report or annual income statement shall be published on the website of the statutory auditor or the audit firm and shall remain available on that website for at least five years.

   Statutory auditors and audit firms shall communicate to the competent authorities that the annual income statement or to the annual financial report have been published on the websites of the statutory auditor or the audit firm.

Article 27

Transparency Report

1. A statutory auditor or an audit firm that carries out statutory audit(s) of public-interest entities shall make public an annual transparency report at the latest three months after the end of each financial year. The annual transparency report shall be published on the website of the statutory auditor or audit firm and shall remain available on that website for at least five years.

   A statutory auditor or audit firm shall be allowed to update its published annual transparency report. In such a case, the auditor or firm indicate that it is an updated version of the report and the original version of the report shall continue to remain available on the website.

   Statutory auditors and audit firms shall communicate to ESMA and to the competent authorities that the transparency report has been published on the website of the statutory auditor or audit firm or, as appropriate, that it has been updated.

2. The annual transparency report shall include at least the following:

   (a) a description of the legal structure and ownership of the audit firm;

   (b) where the statutory auditor or audit firm belongs to a network, a description of the network and the legal and structural arrangements in the network;

   (c) a description of the governance structure of the audit firm;

   (d) a description of the internal quality control system of the audit firm and a statement by the administrative or management body on the effectiveness of its functioning;

   (e) an indication of when the last quality assurance review referred to in Article 40 was carried out;

   (f) a list of public-interest entities for which the statutory auditor or audit firm has carried out statutory audits during the preceding financial year and a list of all entities from which the statutory auditor or audit firm receives more than 5% of its annual revenue;

   (g) a statement concerning the statutory auditor's or audit firm's independence practices which also confirms that an internal review of independence compliance has been conducted;

(h) a statement on the policy followed by the statutory auditor or audit firm concerning the continuing education of statutory auditors referred to in Article 13 of Directive 2006/43/EC;

(i) information concerning the basis for the partners' remuneration in audit firms;

(j) a description of its policy concerning the rotation of key audit partners and staff in accordance with Article 33(4);

(k) […]

The statutory auditor or audit firm may, in exceptional circumstances, decide not to disclose the information required in point (f) of the first subparagraph to the extent necessary to mitigate an imminent and significant threat to the personal security of any person. The statutory auditor or audit firm shall be able to demonstrate to the competent authority the existence of such threat.

3. The transparency report shall be signed by the statutory auditor or audit firm.

Article 28

Corporate governance statement

[deleted]

Article 29

Information to competent authorities

A statutory auditor or audit firm shall provide annually to his, her or its competent authority a list of the audited public-interest entities by revenue generated from them.

Article 30

Record keeping

Statutory auditors and audit firms shall keep the documents and information referred to in [Article 6(1), Article 9(3), Article 11(3) and (4), Article 16(2) to (6), Article 17(1) and (2), Article 18(1) and (3), Article 19(3) to (6), Articles 22, 23 and 24, Article 25(1) and (2), Article 29, Article 32(2), (3), (5) and (6), Article 33(6) and Article 43(4)] for a period of <u>at least</u> five years following the production of such documents or information.
Member States may require statutory auditors and audit firms to keep the documents and information referred to in the first subparagraph for a longer period in accordance with their rules on personal data protection and administrative and judicial proceedings.

TITLE III

THE APPOINTMENT OF STATUTORY AUDITORS OR AUDIT FIRMS BY PUBLIC-INTEREST ENTITIES

Article 31

Audit Committee

1. Each public-interest entity shall have an audit committee. <u>The audit committee shall be either a stand-alone committee of the public-interest entity or a committee of the supervisory board.</u> The audit committee shall be composed of non-executive members of the administrative body and/or members of the supervisory body of the audited entity and/or members appointed by the general meeting of shareholders of the audited entity or, for entities without shareholders, by an equivalent body.

   At least one member of the audit committee shall have competence in accounting and/or auditing.

   For public-interest entities as defined

   (a) in point 13(a) of Article 2 of Directive 2006/43/EC, that had an average market capitalisation of more than EUR <u>20 0</u>00 000 on the basis of end-year quotes for the previous three calendar years and

(b) in points 13(b) to (f) of Article 2 of Directive 2006/43/EC, which on their balance sheet date has a balance sheet total exceeding EUR 20 000 000

at least one member of the audit committee shall have competence in auditing and another member in accounting and/or auditing.

The committee members as a whole shall have competence relevant to the sector in which the audited entity is operating.

A majority of the members of the audit committee shall be independent of the audited entity. The chairman of the audit committee shall be appointed by its members and shall be independent of the audited entity.

2. By derogation from paragraph 1 of this Article, Member States may decide that in the case of public-interest entities which meet the criteria set out in points (f) and (t) of Article 2(1) of Directive 2003/71/EC of the European Parliament and of the Council, the functions assigned to the audit committee may be performed by the administrative or supervisory body as a whole, provided that where the chairman of such a body is an executive member, he or she is not the chairman of the audit committee.

3. By derogation from paragraph 1, Member States may decide that the following public-interest entities are not required to have an audit committee:

(a) any public-interest entity which is a subsidiary undertaking within the meaning of Article 1 of Directive 83/349/EEC if the entity complies with the requirements in paragraphs 1 to 3 of this Article at group level;

(b) any public-interest entity which is an undertaking for collective investment in transferable securities (UCITS) as defined in Article 1(2) of Directive 2009/65/EC or an alternative investment fund (AIF) as defined in Article 4(1)(a) of Directive 2011/61/EU.

(c) any public-interest entity the sole business of which is to act as issuer of asset backed securities as defined in Article 2(5) of Commission Regulation (EC) No 809/2004;

(d) any credit institution within the meaning of Article 1(1) of Directive 2006/48/EC whose shares are not admitted to trading on a regulated market of any Member State within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC and which has, in a continuous or repeated manner, issued only debt securities admitted to trading in a regulated market, provided that the total nominal amount of all such debt securities remains below EUR 100 000 000 and that it has not published a prospectus under Directive 2003/71/EC.

[…]

4. […]

5. […]

6. Without prejudice to the responsibility of the members of the administrative, management or supervisory bodies, or of other members who are appointed by the general meeting of shareholders of the audited entity, the audit committee shall, *inter alia*:

   (a) monitor financial reporting process and submit recommendations or proposals to ensure its integrity;

   (b) monitor the effectiveness of the undertaking's internal control, internal audit where applicable, and risk management systems;

   (c) monitor the statutory audit of the annual and consolidated financial statements and monitor the completeness and integrity of the draft reports in accordance with Articles 22 to 23;

   (d) review and monitor the independence of the statutory auditors or audit firms in accordance with [Articles 5, 6, 7, 8 and 11 as transferred to the Directive], and in particular the provision of additional services to the audited entity in accordance with Article 10;

   (e) be responsible for the procedure on the selection of statutory auditor(s) or audit firm(s) and recommend the statutory auditor(s) or audit firm(s) to be appointed in accordance with Articles 32.

Article 32
Appointment of the statutory auditors or audit firms

1. For the purposes of the application of Article 37 of Directive 2006/43/EC, for the appointment of statutory auditors or audit firms by public-interest entities, the conditions set out in paragraphs 2 to 6 of this Article shall apply.

   Where Article 37(2) of Directive 2006/43/EC applies, the public-interest entity shall inform the competent authority of the use of the alternative systems or modalities referred to in that Article.

2. The audit committee shall submit a recommendation to the administrative or supervisory board of the audited entity for the appointment of statutory auditors or audit firms. The audit committee shall justify the recommendation made.

[…] The recommendation shall contain at least two choices for the audit engagement and the audit committee shall express a duly justified preference for one of them. When it concerns the renewal of an audit engagement in accordance with Article 33(3), the audit committee shall, for the preparation of its recommendation, take into consideration any findings and conclusions on the recommended statutory auditor or audit firm referred to in Article 40(6) and published by the competent authority pursuant to Article 44(d).

In its recommendation, the audit committee shall state that its recommendation is free from influence by a third party and that no contractual clause as referred to in paragraph 7 has been imposed upon it.

3. […] The recommendation of the audit committee referred to in paragraph 2 of this Article, shall be prepared following a selection procedure organized by the audited entity respecting the following criteria:

(a) the audited entity shall be free to invite any statutory auditors or audit firms to submit proposals for the provision of the statutory audit service on the condition that Article 33(2) is respected. […]

(b) the audited entity shall be free to choose the method to contact the invited statutory auditor(s) or audit firm(s) and shall not be required to publish a call for tenders in the *Official Journal of the European Union* and/or in national gazettes or newspapers;

(c) the audited entity shall prepare tender documents for the intention of the invited statutory auditor(s) or audit firm(s). Those tender documents shall allow them to understand the business of the audited entity and the type of statutory audit that is to be carried out. The tender documents shall contain transparent and non-discriminatory selection criteria that shall be used by the audited entity to evaluate the proposals made by statutory auditors or audit firms;

(d) the audited entity shall be free to define the selection procedure and may conduct direct negotiations with interested tenderers in the course of the procedure;

(e) where, in accordance with national law or Union law, the competent authorities referred to in Article 35, require statutory auditors and audit firms to comply with certain quality standards, those standards shall be included in the tender documents;

(f) the audited entity shall evaluate the proposals made by the statutory auditors or audit firms in accordance with the selection criteria predefined in the tender documents. The audited entity shall prepare a report on the conclusions of the selection procedure, which shall be validated by the audit committee. The audited entity and the audit committee shall take into consideration any findings or conclusions of any inspection report on the applicant statutory auditor or audit firm referred to in Article 40(6) and published by the competent authority pursuant to Article 44(d);

(g) the audited entity shall be able to demonstrate to the competent authority referred to in Article 35 that the selection procedure was conducted in a fair manner.

The audit committee shall be responsible for the selection procedure referred to in the first subparagraph.

For the purposes of point (a) of the first subparagraph, the competent authority referred to in Article 35(1) shall make public a list of the auditors and audit firms concerned which shall be updated on an annual basis. The competent authority shall use the information provided by statutory auditors and audit firms pursuant to Article 28 to make the relevant calculations.

4. Public-interest entities which meet the criteria set out in points (f) and (t) of Article 2(1) of Directive 2003/71/EC shall not be required to apply the selection procedure referred to in paragraph 4.

5. The proposal of the administrative or supervisory board to the general meeting of shareholders or members of the audited entity for the appointment of statutory auditors or audit firms shall include the recommendation made by the audit committee.

If the proposal of the administrative or supervisory board departs from the recommendation of the audit committee, the proposal shall justify the reasons for not following the recommendation of the audit committee.

6. In the case of a credit institution or insurance undertaking, the administrative or supervisory board shall submit its draft proposal to the competent authority referred to in Article 35(2).

7. Any contractual clause entered into between a public-interest entity and a third party restricting the choice by the general meeting of shareholders or members of that entity pursuant to Article 37 of Directive 2006/43/EC to certain categories or lists of statutory auditors or audit firms to carry out the statutory audit of that entity shall <u>have no legal effect</u>.

The public-interest entity shall inform the competent authorities referred to in Article 35 of any attempt by a third party to impose such a contractual clause or to otherwise influence the decision of the general meeting of shareholders on the selection of a statutory auditor or audit firm.

8. Where the audited entity is exempted from the obligation to have an audit committee, the audited entity shall decide which body or organ of the entity shall perform its functions for the purposes of the obligations set out in this Article.

9. Member States may decide that a minimum number of statutory auditors or audit firms shall be appointed by public-interest entities in certain circumstances and establish the conditions governing the relations between the auditors or firms appointed.

   If a Member State establishes such requirement, it shall inform the Commission and ESMA thereof.

10. […]

Article 33
Duration of the audit engagement

1. The public-interest entity shall appoint a statutory auditor or audit firm for an initial engagement of at least one year which can be renewed.

   […]

   The maximum duration of the combined engagements shall not exceed seven years. […]

   Where throughout a continuous engagement of seven years more than one statutory auditor or audit firm has been appointed, the maximum duration of the engagement of each statutory auditor or audit firm shall not exceed eight years.

2. After the expiry of the maximum duration of the engagement referred to in paragraph 1, the statutory auditor or audit firm or any members of its network within the Union, where applicable, shall not undertake the statutory audit of the public-interest entity concerned until a period of at least four years has elapsed.

3. By way of derogation from paragraphs 1 and 2, the maximum duration period referred to in paragraph 1 subparagraph 2 and 3 may recommence only once and only if one or more of the requirements set out in subparagraphs (a) or (b) is satisfied:

(a) a public tendering process for the statutory audit is conducted, in accordance with paragraphs 2 to 6 of Article 32; or

(b) a comprehensive assessment of the audit engagement is performed by the audit committee.

The maximum duration periods referred to in paragraph 1 subparagraph 2 and 3 shall only recommence if, upon a recommendation of the audit committee, the administrative or supervisory board in accordance with national law proposes to the general meeting of shareholders to renew the engagement and the proposal meets its approval.

3a After the expiry of the maximum engagement referred to in paragraph 1 subparagraph 2 and 3, or paragraph 3, as appropriate, on an exceptional basis the public interest entity may request the competent authority referred to in Article 35(1) to grant an extension to re-appoint the statutory auditor or audit firm for an additional engagement. In case of appointment of more than one statutory auditor or audit firm, this third engagement shall not exceed three years. In case of appointment of one statutory auditor or audit firm, this third engagement shall not exceed two years.

4. The key audit partner(s) responsible for carrying out a statutory audit shall cease his, her or their participation in the statutory audit of the audited entity after a period of seven years from the date of appointment has elapsed. He, she or they may participate in the statutory audit of the audited entity again after a period of at least three years.

The statutory auditor or audit firm shall establish an appropriate gradual rotation mechanism with regard to the most senior personnel involved in the statutory audit, including at least the persons who are registered as statutory auditors. The gradual rotation mechanism shall be undertaken in phases on the basis of individuals rather than of a complete team. It shall be proportionate in view of the scale and the dimension of the activity of the statutory auditor or audit firm.

The statutory auditor or audit firm shall be able to demonstrate to the competent authority that such mechanism is effectively applied and adapted to the scale and the dimension of the activity of the statutory auditor or audit firm.

Article 33a
Hand-over file

1. Where a statutory auditor or audit firm is replaced by another statutory auditor or audit firm, the former statutory auditor or audit firm shall provide the incoming statutory auditor or audit firm with a handover file. Such file shall include relevant information concerning the audited entity as may reasonably be necessary to understand the nature of the business and the internal organisation of the audited entity and to ensure the continuity of the statutory audit and the comparability with the audits carried out in previous years.

   The former statutory auditor or audit firm shall also grant access to the incoming statutory auditor or audit firm to the additional reports to the audit committee referred to in Article 23 of previous years and to any information transmitted to competent authorities pursuant to Articles 25 and 27.

   The former statutory auditor or audit firm shall be able to demonstrate to the competent authority that such information has been provided to the incoming statutory auditor or audit firm.

2. ESMA shall develop draft regulatory technical standards to specify technical requirements on the content of the handover file referred to in paragraph 1.

   Power is delegated to the Commission to adopt the regulatory technical standards referred to in paragraph 6 in accordance with Article 10 of Regulation (EU) No 1095/2010.

Article 34
Dismissal and resignation of the statutory auditors or audit firms

1. Without prejudice to Article 38(1) of Directive 2006/43/EC, the audited entity and the statutory auditor or audit firm shall inform the competent authority concerning the dismissal or resignation of the statutory auditor or audit firm during the term of appointment and give an adequate explanation of the reasons thereof.

   Where a Member State has appointed competent authorities for the purpose of Title III of this Regulation in accordance with Article 35(2), such competent authority shall forward this information to the competent authority referred to in Article 35(1).

2. Shareholders, which represent 5% or more of the voting rights or the share capital, or the competent authorities referred to in Article 35(1) or 35(2) shall be able to bring a claim before a national court for the dismissal of the statutory auditor(s) or audit firm(s) where there are proper grounds.

TITLE IV

SURVEILLANCE OF THE ACTIVITIES OF AUDITORS AND AUDIT FIRMS CARRYING OUT STATUTORY AUDIT OF PUBLIC-INTEREST ENTITIES

CHAPTER I

COMPETENT AUTHORITIES

Article 35
Designation of competent authorities

1. Competent authorities responsible for carrying out the tasks provided for in this Regulation and for ensuring that the provisions of this Regulation are applied,shall be amongst the following:

   (a) the competent authority referred to in Article 24(1) of Directive 2004/109/EC;

   (b) the competent authority referred to in Article 24(4)(h) of Directive 2004/109/EC;

   (c) the competent authority referred to in Article 32 of Directive 2006/43/EC.

2. By derogation from paragraph 1, Member States may decide that the responsibility for ensuring that all or part of the provisions of Title III of this Regulation are applied shall be entrusted to, as appropriate, at least the competent authorities referred to in:

   (a) Article 24(1) of Directive 2004/109/EC;

   (b) Article 24(4)(h) of Directive 2004/109/EC;

   (c) Article 40 of Directive 2006/48/EC;

   (d) Article 30 of Directive 2009/138/EC;

(e) Article 20 of Directive 2007/64/EC;

(f) Article 3(1) of Directive 2009/110/EC;

(g) Article 48 of Directive 2004/39/EC;

(h) Article 97 of Directive 2009/110/EC;

(h) Article 44 of Directive 2011/61/EU.

3. Where more than one competent authority has been designated pursuant to paragraphs 1 and 2, those authorities shall be organised in such a manner that their tasks are clearly allocated.

4. Paragraphs 1, 2 and 3 shall be without prejudice to the rights of a Member State to make separate legal and administrative arrangements for overseas European territories for whose external relations that Member State is responsible.

5. The competent authorities shall be adequately staffed, with regard to capacity and expertise, and shall have the adequate resources in order to be able to fulfill their tasks provided for under this Regulation.

6. The Member States shall inform […] the Commission of the appointment of competent authorities for the purposes of this Regulation.

The Commission shall consolidate this information and make it public.

Article 36
Conditions of independence

The competent authorities and any authority to which the competent authority referred to in Article 35(1) has delegated tasks shall be independent of statutory auditors and audit firms.

The competent authority may consult experts, as referred to in Article 40(1)(c), for the purpose of carrying out specific tasks and may also be assisted by experts when this is essential for the proper execution of its tasks. The competent authority shall not involve these experts in any decision which it makes in these instances.

A person shall not be involved in the governance of those authorities if in the course of the three previous years he or she:

(a) has carried out statutory audits of public-interest entities;

(b) held voting rights in an audit firm;

(c) was member of the administrative, management or supervisory body of an audit firm;

(d) was an employee of or otherwise associated with an audit firm.

The funding of those authorities shall be secure and free from any possible undue influence by statutory auditors and audit firms.

Article 37

Professional secrecy - competent authority

The obligation of professional secrecy shall apply to all persons who are or have been employed <u>or independently contracted</u> by <u>or involved in the governance of</u> competent authorities or by any authority to <u>which</u> the competent authority referred to in Article 35(1) has delegated tasks. <u>[…]</u>

Article 38
Powers of competent authorities

1. Without prejudice to Articles 40 and 41, in carrying out their tasks under this Regulation, the competent authorities or any other public authorities of a Member State may not interfere with the content of audit reports.

2. In order to carry out their tasks under this Regulation, the competent authorities shall, in conformity with national law, have all the supervisory and investigatory powers that are necessary for the exercise of their functions. They shall exercise their powers in any of the following ways:

   (a) directly;

   (b) in collaboration with other authorities;

   (c) under their responsibility by delegation to entities to which tasks have been delegated according to Article 35(2);

(d) by application to the competent judicial authorities.

3. In order to carry out their tasks under this Regulation, the competent authorities shall, in conformity with national law, have the power in their supervisory capacity to:

(a) access any document, <u>related to the statutory audit or other documents held by statutory auditors or audit firms</u>, in any form relevant to the carrying out of their tasks and to receive or take a copy thereof;

(b) demand information from any person and if necessary to summon and question a person with a view to obtaining information;

(c) carry out on-site inspections with or without announcement;

(d) require records of telephone and data traffic <u>related to the statutory audit or other documents held</u> by statutory auditors and audit firms;

(e) refer matters for criminal prosecution;

(f) request experts to carry out verifications or investigations;

(g) take the administrative measures and sanctions referred to in <u>Article 30 of Directive 2006/43/EC.</u>

The competent authorities may use the powers referred to in the first subparagraph only in relation to statutory auditors and audit firms carrying out statutory audit of public-interest entities, persons involved in the activities of statutory auditors and audit firms carrying out statutory audit of public-interest entities, audited entities, their affiliates and related third parties, third parties to whom the statutory auditors and audit firms carrying out statutory audit of public-interest entities have outsourced certain functions or activities, and persons otherwise related or connected to statutory auditors and audit firms carrying out statutory audit of public-interest entities.

4. <u>The powers referred to in paragraph 3 shall be exercised in full compliance with the principles of respect for private life and with the right of defence. The exercise of the powers in (a), (c) and (d) of paragraph 3 shall require […] prior intervention of a</u> judicial authority.

5. Where a cooperative within the meaning of Article 2(14) of Directive 2006/43/EC, a savings bank or a similar entity as referred to in Article 45 of Directive 86/635/EEC, or a subsidiary or a legal successor of a cooperative, a savings bank or a similar entity as referred to in Article 45 of Directive 86/635/EEC is required or permitted under national law to be a member of a non-profit-making auditing entity, the Member State may decide that this Regulation shall not apply to the statutory audit of such entity provided that the principles of independence laid down in Directive 2006/43/EC are complied with by the statutory auditor carrying out the statutory audit and by persons who may be in a position to influence the statutory audit. […]

Where a cooperative within the meaning of Article 2(14), or a similar entity as referred to in Article 45 of Directive 86/635/EEC, is required or permitted under national provisions to be a member of a non-profit-making auditing entity, an objective, reasonable and informed party would not conclude that the membership-based relationship compromises the statutory auditor's independence, provided that when such an auditing entity is conducting a statutory audit of one of its members, the principles of independence are applied to the auditors carrying out the audit and those persons who may be in a position to exert influence on the statutory audit.

The Member State shall inform ESMA of such exceptional situations of non-application of certain provisions of this Regulation. It shall communicate to ESMA the list of provisions of this Regulation that have not been applied to the statutory audit of the entities referred to in paragraph 5 and the reasons that justified the exemption granted for such non-application.

6. The processing of personal data processed in the exercise of the supervisory and investigative powers pursuant to this Article shall be carried out in accordance with Directive 95/46/EC.

Article 38a
Delegation of tasks

The competent authority referred to in Article 35(1) may delegate tasks to other authorities or bodies designated by law only as regards the approval and registration of statutory auditors and audit firms. Any execution of tasks by other authorities or bodies shall be expressly delegated by the competent authority. The delegation shall specify the delegated tasks and the conditions under which they are to be carried out. The authorities or bodies shall be organized in such a manner that there are no conflicts of interest. The ultimate responsibility for supervising compliance with this Regulation and the implementing measures adopted pursuant thereto shall lie with the delegating competent authority.

The competent authority shall inform the Commission and the competent authorities of Member States of any arrangement entered into with regard to the delegation of tasks, including the precise conditions for regulating the delegations'.

Article 39
Cooperation with other competent authorities at national level

The competent authority designated pursuant to Article 35(1) and, where appropriate, any authority to whom that competent authority has delegated tasks shall cooperate at national level with:

(a) the competent authorities responsible for the approval and registration of statutory auditors and audit firms pursuant to Directive 2006/43/EC;

(b) the authorities referred to in Article 35(2), whether they have been designated competent authorities for the purposes of this Regulation or not;

(c) the financial intelligence units and the competent authorities referred to in Articles 21 and 37 of Directive 2005/60/EC.

For the purposes of this cooperation, the obligations under Article 37 shall apply.

CHAPTER II

QUALITY ASSURANCE, INVESTIGATION, MARKET MONITORING, CONTINGENCY PLANNING AND TRANSPARENCY OF COMPETENT AUTHORITIES TASKS

Article 40

Quality assurance

1. For the purposes of this Article:

   (a) "inspections" means quality assurance reviews of statutory auditors and audit firms, which are led by an inspector and which do not represent an investigation within the meaning of Article 41;

   (b) "inspector" means a reviewer who meets the requirements set out in point (a) of the second subparagraph of paragraph 4 of this Article and is employed by a competent authority;

(c) "expert" means a natural person, who has specific expertise in financial markets, financial reporting, auditing or other fields relevant for inspections, including practising statutory auditors.

2. The competent authorities <u>designated under</u> Article 35(1) shall establish an effective system of audit quality assurance.

The competent authority shall carry out quality assurance reviews of statutory auditors and audit firms that carry out statutory audits of public-interest entities at least every three years.

3. The competent authority shall be responsible for the quality assurance system and shall organise it in a manner that is independent of the reviewed statutory auditors and audit firms.

The competent authority shall have the following responsibilities which may not be delegated to any association or body affiliated with the accounting or audit profession:

(a) approval and amendment of the inspection methodologies, including inspection and follow-up manuals, reporting methodologies and periodic inspection programmes;

(b) approval and amendment of inspection reports and follow up reports;

(c) approval and assignment of inspectors for each inspection.

The competent authority shall allocate adequate resources to the quality assurance system.

4. The competent authority shall ensure that appropriate policies and procedures related to the independence and objectivity of the staff, including inspectors, and the management of the inspection system are put in place.

The competent authority shall comply with the following criteria when appointing inspectors:

(a) inspectors shall have appropriate professional education and relevant experience in statutory audit and financial reporting combined with specific training on quality assurance reviews;

(b) a person who is a practicing statutory auditor or is employed or otherwise associated with a statutory auditor or an audit firm shall not be allowed to act as an inspector;

(c) a person shall not be allowed to act as an inspector in an inspection of the statutory auditor or audit firm until at least two years have elapsed since that person ceased to be a partner or employee of that auditor or in that audit firm or to be otherwise associated therewith;

(d) inspectors shall declare that there are no conflicts of interest between them and the statutory auditor and audit firm to be inspected.

The competent authority may contract experts for carrying out specific inspections when the number of inspectors within the authority is insufficient. The competent authority may also be assisted by experts when this is essential for the proper conduct of an inspection. In such instances, the competent authorities and the experts shall comply with the requirements of this paragraph. Experts shall be independent from professional associations and bodies.

5. The scope of inspections shall cover:

(a) an assessment of the design of the internal quality control system of the audit firm or of the statutory auditor;

(b) adequate compliance testing of procedures and a review of audit files of public interest entities in order to verify the effectiveness of the internal quality control system;

(c) in the light of the inspection findings under points (a) and (b) of this paragraph, an assessment of the contents of the most recent annual transparency report published by a statutory auditor or an audit firm in accordance with Article 27.

At least the following internal control policies and procedures of the statutory auditor or the audit firm shall be reviewed:

(a) compliance by the statutory auditor or the audit firm with applicable auditing and quality control standards, and ethical and independence requirements, including those related to Chapter IV of Directive 2006/43/EC and [Articles 5 to 10 of this Regulation], as well as relevant laws, regulations and administrative provisions of the Member State concerned;

(b) the quantity and quality of resources used, including compliance with continuing education requirements as set out in Article 13 of Directive 2006/43/EC;

(c) compliance with the requirements set out in Article 9 on the audit fees charged.

For the purposes of testing compliance, at least a significant part of audit files shall be selected on the basis of an analysis of the risk of an inadequate carrying out of the statutory audit.

The competent authorities shall also periodically review the methodologies used by statutory auditors and audit firms to carry out statutory audit.

Inspections shall be appropriate and proportionate in view of the scale and complexity of the activities of the reviewed audit firm or statutory auditor.

6. The findings and conclusions of inspections on which recommendations are based, including the findings and conclusions related to a transparency report, shall be communicated to and discussed with the inspected statutory auditor or audit firm before an inspection report is finalised.

Recommendations of inspections shall be implemented by the inspected statutory auditor or audit firm within a reasonable period set by the competent authority. Such period shall not exceed 12 months in the case of recommendations on the internal quality control system of the audit firm.

7. The inspection shall be the subject of a report which shall contain the main conclusions of the quality assurance review.

Article 41
Investigation

The competent authorities designated under Article 35(1) shall establish effective systems of investigation with a view to detecting, examining and preventing inadequate carrying out of the statutory audit of public-interest entities.

Where a competent authority contracts experts for carrying out specific assignments, the authority shall ensure that there are no conflicts of interest between these experts and the statutory auditor or audit firm under investigation.
These experts shall comply with the same requirements as those provided for at Article 40(4) of this Regulation.

Article 42
Market monitoring

1. The competent authorities designated under Article 35(1) or the competition authorities of the Member States, as appropriate, shall regularly monitor the developments in the market for providing statutory audit services to public-interest entities.

   The competent authorities shall in particular assess the following:

   (a) the risks arising from high concentration, including the demise of audit firms with significant market share, the disruption in the provision of statutory audit services whether in a specific sector or across sectors, the further accumulation of risk in the market and the impact on the overall stability of the financial sector;

   (b) the need to adopt measures to mitigate those risks.

2. By X X 20XX [*2 years after the entry into force of the Regulation*], and at least on a two-year basis thereafter, each competent authority or competition authority, whichever is appropriate, shall draw up a report on this issue and submit it to ESMA, EBA and EIOPA.

   ESMA, EBA and EIOPA shall use those reports to draw up a joint report on the situation at Union level. The report shall be submitted to the Commission, the European Central Bank and the European Systemic Risk Board.

Article 43

Contingency planning

[deleted]

Article 44
Transparency of Competent Authorities

Competent authorities shall be transparent and shall at least publish:

(a) annual activity reports regarding the tasks the competent authorities are required to carry out under this Regulation;

(b) annual work programmes regarding the tasks the competent authorities are required to carry out under this Regulation;

(c) a report on the overall results of the quality assurance system on an annual basis. This report shall include information on recommendations issued, follow-up on the recommendations, supervisory measures taken and penalties imposed. It shall also include quantitative information and other key performance information on financial resources and staffing, and the efficiency and effectiveness of the quality assurance system;

(d) the report referred to in Article 40(7), <u>which shall not serve to undermine the protection of the commercial interests of the audited entities and the statutory auditor and audit firm, including that of industrial and intellectual property.</u>

CHAPTER III

COOPERATION BETWEEN COMPETENT AUTHORITIES AND RELATIONS WITH THE EUROPEAN SUPERVISORY AUTHORITIES

Article 45
Obligation to cooperate

The competent authorities of the Member States shall cooperate with each other where it is necessary for the purposes of this Regulation, including in cases where the conduct under investigation does not constitute an infringement of any legislative or regulatory provision in force in the Member State concerned.

Article 46
ESMA

1. The cooperation between competent authorities shall be organised within the framework of ESMA.

<u>For this purpose, ESMA shall create a permanent internal committee pursuant to Article 41 of Regulation (EU) No 1095/2010.</u>

<u>1a. The internal committee shall be composed of the competent authorities referred to in Article 35(1) of this Regulation and the competent authorities referred to in Article 32 of Directive 2006/43/EC which heretofore constitute the European Group of Audit Oversight Bodies (EGAOB) created by Decision 2005/909/EC.</u>

1b. The internal committee shall have decision making power pursuant to Article 41(1) of Regulation (EU) No 1095/2010.

A draft decision of the internal committee shall be deemed adopted, unless the ESMA Board of Supervisors, within a maximum period of ten working days, considers that such draft decision undermines the principles set out in Article 1(5) of Regulation (EU) No 1095/2010.

If the ESMA Board of Supervisors objects to a draft decision, it shall state the reasons for doing so in writing.

ESMA shall cooperate with EBA and EIOPA within the framework of the Joint Committee of the European Supervisory Authorities established in Article 54 of Regulation (EU) No 1095/2010.

ESMA shall take over, as appropriate, all existing and on-going tasks from the European Group of Audit Oversight Bodies (EGAOB) created by Decision 2005/909/EC.

2. ESMA shall provide advice to the competent authorities in the cases provided for in this Regulation. The Competent authorities shall consider that advice before taking any final decision under this Regulation.

3. In order to facilitate the exercise of the tasks provided for in this Regulation, ESMA shall issue guidelines, in accordance with Article 16 of Regulation (EU) No 1095/2010, as appropriate, on:

   (a) common standards on the content and presentation of the report referred to in Article 22;

   (b) common standards on the content and presentation of the report referred to in Article 23;

   (c) common standards on the oversight activity of the audit committee referred to in Article 24;

   (d) common standards and best practices on the content and presentation of the report referred to in Article 27, including the statement referred to in Article 28;

   (e) common standards and best practices on the gradual rotation mechanism referred to in Article 33;

(f) common standards and best practices regarding the dismissal of auditors, in particular on the existence of proper grounds for it, as referred to in Article 34;

(g) enforcement practices and activities to be conducted by competent authorities under this Regulation;

(h) common standards and best practices for conducting quality assurance reviews provided for in Article 40, taking into consideration, in particular:

  (i) the different scale and dimension of activity of statutory auditors and audit firms and policies;

  (ii) the commonality of quality standards, policies and procedures to which members of networks of statutory auditors and audit firms adhere;

(i) common standards and best practices for conducting investigations provided for in Article 41;

(j) procedures for the exchange of information provided for in Article 48;

(k) procedures and modalities for cooperation with regard to quality assurance reviews provided for in Article 49;

(l) procedures and modalities for joint investigations and inspections provided for in Article 51;

(m) the operational functioning of the colleges provided for in Article 53, including on the modalities for determining the membership to the colleges, the selection of facilitators, the written arrangements for the operation of the colleges and the coordination arrangements between colleges.

ESMA shall consult EBA and EIOPA before issuing the guidelines referred to in the first subparagraph.

4. By X X 20XX [*four years after the entry into force of the Regulation*], and at least at on a two-year basis thereafter, ESMA shall prepare a report on the application of this Regulation.

ESMA shall consult EBA and EIOPA before making public its report.

In a report to be prepared by X X 20XX [*two years after the entry into force of the Regulation*], ESMA shall undertake an evaluation of the structure of the audit market .

For the purpose of this report, ESMA shall examine the influence of Member States' civil liability systems for statutory auditors on the audit market structure.

In a report to be prepared by ESMA by X X 20XX [*four years after the entry into force of the Regulation*], shall examine whether the competent authorities referred to in Article 35(1) are sufficiently empowered and have adequate resources to carry out their tasks.

In a report to be prepared by ESMA by X X 20XX [*six years after the end of the transitional period*], shall examine the following issues:

(a) the changes in the audit market structure;

(b) the changes in the patterns of cross-border activity, including as a result of the changes introduced to Chapter II of Directive 2006/43/EC by Directive xxxx/xx/EU;

(c) an interim assessment on the improvement of audit quality and the impact of this Regulation on small and medium-sized enterprises which are public-interest entities.

In a report, to be prepared by X X 20XX [*twelve years after the entry into force of the Regulation*], ESMA shall undertake an evaluation of the impact of this Regulation.

5. Before X X 20XX [*three years after the entry into force of the Regulation*] the Commission shall present a report, on the basis of the ESMA reports and other appropriate evidence, on the impact of the national liability rules for statutory auditors on the audit market structure. In the light of that report, the Commission shall take the steps it considers appropriate as a result of its findings.

Article 47
Home Member State principle

1. Member States shall respect the principle of Home Member State regulation and oversight by the Member State in which the statutory auditor or audit firm is approved and the audited entity has its registered office.

2. In the case of a statutory audit of consolidated financial statements, the Member State requiring the statutory audit of the consolidated financial statements may not impose additional requirements in relation to the statutory audit concerning registration, quality assurance review, auditing standards, professional ethics and independence on a statutory auditor or audit firm carrying out a statutory audit of a subsidiary established in another Member State.

3. In the case of a undertaking whose securities are traded on a regulated market in a Member State other than that in which that undertaking has its registered office, the Member State in which the securities are traded may not impose any additional requirements in relation to the statutory audit concerning registration, quality assurance review, auditing standards, professional ethics and independence on a statutory auditor or audit firm carrying out the statutory audit of the annual or consolidated financial statements of that undertaking.

Article 48
[Transferred to Directive as Article 49]
Exchange of information […]

Article 49
Cooperation with regard to quality assurance reviews

1. Competent authorities shall take measures to ensure effective cooperation at Union level in respect of quality assurance reviews.

2. The competent authority of one Member State may request the assistance of the competent authority of another Member State with regard to the quality assurance reviews of statutory auditors or audit firms belonging to a network carrying out significant activities in that Member State.

   […] In the event of an investigation or inspection with cross-border effect, the competent authorities of the Member States concerned may address a joint request to ESMA to coordinate the investigation or inspection.

3. Where a competent authority receives a request from a competent authority of another Member State to participate in the quality assurance review of a statutory auditors or audit firm belonging to a network exercicing significant activities in that Member State, it shall allow the requesting competent authority to participate in such quality assurance review.

   The requesting competent authority shall not have the right to access information which might adversely affect the sovereignty, security or public order of the requested Member State or breach national securities rules.

Article 50
European Quality Certificate
[deleted]

Article 51
Cooperation with regard to investigations or on-site inspections

1. Where a competent authority concludes that activities contrary to the provisions of this Regulation are being carried out or have been carried out on the territory of another Member State, it shall notify the competent authority of the other Member State of that conclusion in as specific a manner as possible. The competent authority of the other Member State shall take appropriate action. It shall inform the notifying competent authority of the outcome and, to the extent possible, of significant interim developments.

2. A competent authority of one Member State may request that an investigation is carried out by the competent authority of another Member State on the latter's territory.

   It may also request that some of its own personnel be allowed to accompany the personnel of the competent authority of that Member State in the course of the investigation, including with regard to on-site inspections.

   […]

   The investigation or inspection shall be subject throughout to the overall control of the Member State on whose territory it is conducted. However, in the event of an investigation or inspection with cross-border effect, the competent authorities of the Member States concerned may address a joint request to ESMA to coordinate the investigation or inspection.

3. The requested competent authority may refuse to act on a request for an investigation to be carried out as provided for in the first subparagraph of paragraph 2, or on a request for its personnel to be accompanied by personnel of a competent authority of another Member State as provided for in the second subparagraph of paragraph 2, in the following cases:

   (a) such an investigation or on-site inspection might adversely affect the sovereignty, security or public order of the requested Member State;

(b) judicial proceedings have already been initiated in respect of the same actions and against the same persons before the authorities of the requested Member State;

(c) a final judgment has already been passed in respect of the same actions on such persons by the competent authorities of the requested Member State.

Article 52

Cooperation with regard to contingency planning

[deleted]

Article 53
Colleges of competent authorities

1. […] In order to facilitate the exercise of the tasks referred to in Articles 40, 41, 51, and 61 with regard to specific statutory auditors, audit firms or their networks, colleges may be established with the participation of the competent authority of the home Member State and any other competent authority, provided that:

(a) the statutory auditor or audit firm is providing statutory audit services to public interest entities within its jurisdiciton; or

(b) a branch which is a part of the audit firm is established within its jurisdiction.

[…]

The competent authority of the home Member State shall act as facilitator.

2. With regard to specific networks, competent authorities of the Member States where the network exercises significant activities may request ESMA to establish a college with the participation of the requesting competent authorities.

[…]

3. Within 15 working days of the establishment of the college of competent authorities with regard to a specific network, its members shall select a facilitator. In the absence of agreement, ESMA shall appoint a facilitator among the members of the college.

Members of the college shall review the selection of the facilitator at least every five years to ensure the selected facilitator remains the most appropriate.

4. The facilitator shall chair the meetings of the college, coordinate the actions of the college and ensure efficient exchange of information among members of the college.

5. The facilitator shall, within 10 working days of his or her selection, establish written coordination arrangements within the framework of the college regarding the following matters:

(a) information to be exchanged between competent authorities;

(b) cases in which the competent authorities must consult each other;

(c) cases in which the competent authorities may delegate supervisory tasks in accordance with Article 54.

6. In the absence of agreement concerning the written coordination arrangements under paragraph 6, any member of the college may refer the matter to ESMA. The facilitator shall give due consideration to any advice provided by ESMA concerning the written coordination arrangements before agreeing their final text. The written coordination arrangements shall be set out in a single document containing full reasons for any significant deviation from the advice of ESMA. The facilitator shall transmit the written coordination arrangements to the members of the college and to ESMA.

Article 54
Delegation of tasks

The competent authority of the home Member State may delegate any of its tasks to the competent authority of another Member State subject to the agreement of that authority. Delegation of tasks shall not affect the responsibility of the delegating competent authority.

Article 55
Confidentiality and professional secrecy in relation to ESMA

1. The obligation of professional secrecy shall apply to all persons who work or who have worked for ESMA, or for any other person to whom ESMA has delegated tasks, including experts contracted by ESMA. Information covered by professional secrecy shall not be disclosed to another person or authority except where such disclosure is necessary for legal proceedings.

2. Paragraph 1 of this Article and Article 37 shall not prevent ESMA and the competent authorities from exchanging confidential information. Information thus exchanged shall be covered by the obligation of professional secrecy, to which persons employed or formerly employed by competent authorities are subject.

3. All the information exchanged under this Regulation between ESMA, the competent authorities and other authorities and bodies shall be considered confidential, except <u>[…]</u> where such disclosure is <u>required as a matter of law</u>.

Article 56
Protection of personal data

1. Member States shall apply Directive 95/46/EC to the processing of personal data carried out in the Member States pursuant to this Regulation.

2. Regulation (EC) No 45/2001 shall apply to the processing of personal data carried out by ESMA, EBA and EIOPA in the context of this Regulation.

CHAPTER IV

COOPERATION WITH THIRD COUNTRY AUTHORITIES AND WITH INTERNATIONAL ORGANISATION AND BODIES

Article 57
Agreement on exhange of information

1. The competent authorities and ESMA, upon request by a competent authority, may conclude cooperation agreements on exchange of information with the competent authorities of third countries only if the information disclosed is subject, in the third countries concerned, to guarantees of professional secrecy which are at least equivalent to those set out in Articles 37 and 55.

   […] Information shall only be exchanged under this Article where such exchange of information is necessary for the performance of the tasks of those competent authorities under this Regulation.

   Where such exchange of information involves the transfer of personal data to a third country, Member States shall comply with Directive 95/46/EC and ESMA shall comply with Regulation (EC) No 45/2001.

2. The competent authorities shall cooperate with the competent authorities or other relevant bodies of third countries regarding the quality assurance reviews and investigations of auditors and audit firms. Upon request by a competent authority, ESMA shall contribute to this cooperation and to the establishment of supervisory convergence with third countries.

3. Where the cooperation or exchange of information is related to audit working papers or other documents held by statutory auditors or audit firms, Article 47 of Directive 2006/43/EC shall apply.

Article 58
Disclosure of information received from third countries

The competent authority of a Member State or ESMA may disclose the information received from competent authorities of third countries only if it has obtained the express agreement of the competent authority that has transmitted the information and, where applicable, the information is disclosed only for the purposes for which that competent authority gave its agreement, or where such disclosure is required by national or EU legislation.

Article 59
Disclosure of information transferred to third countries

The competent authority of a Member State or ESMA shall require that information communicated by them to a competent authority of a third country may be disclosed by that competent authority to third parties or authorities only with the prior express agreement of the competent authority which has transmitted the information, in accordance with its national law and provided that the information is disclosed only for the purposes for which that competent authority of the Member State or ESMA has given its agreement, or where such disclosure is required by law in that third country.

Article 60
Cooperation with international organisation and bodies

ESMA shall cooperate with the international organisations and bodies issuing international auditing standards.

TITLE V

ADMINISTRATIVE SANCTIONS AND MEASURES

Article 61
Administrative sanctions and measure

[first part transferred to Directive, Article 30A]

Without prejudice to the supervisory powers of competent authorities and the right of Member States to provide for and impose criminal sanctions, Member States shall lay down the rules on administrative sanctions and measures to the infringements of this Regulation as referred to in Articles x x x of Directive 2006/43/EC and in its Annex and shall take all measures necessary to ensure that they are implemented.

Article 62

Sanctioning powers

[transferred to Directive, Article 30B]

Article 63

Effective application of sanctions
[transferred to Directive, Article 30C]

Article 64

Publication of sanctions and measures

[transferred to Directive, Article 30D]

Article 65

Appeal

[transferred to Directive, Article 30E]

Article 66

Reporting of breaches

[transferred to Directive, Article 30F]

Article 67

Exchange of information with [ESMA]

[transferred to Directive, Article 30G]

TITLE VI

DELEGATED ACTS, REPORTING AND TRANSITIONAL AND FINAL PROVISIONS

Article 68
Exercise of the delegation

1. The power to adopt delegated acts is conferred on the Commission subject to the conditions laid down in this Article.

2. […]

3. […]

4. As soon as it adopts a delegated act, the Commission shall notify it simultaneously to the European Parliament and to the Council.

5. […]

Article 69
Report

By X X 20XX [*five years after the end of the transitional period*] the Commission shall prepare a report on the application of this Regulation. The report shall take due account of the report prepared by ESMA referred to in the fourth subparagraph of Article 46(4).

Article 70
Transitional provision

1. By derogation from Articles 32and 33, the following requirements shall apply to contracts for the provision of statutory audit to public-interest entities which are in force at [date of entry into force of this Regulation]:

   (a) any audit contract entered into before XX/XX/XXXX [*the date of adoption of the Commission proposal*] which is still in force on [*the date of entry into force of this Regulation*] shall remain applicable for a maximum period of four accounting years after [*the date of entry into force of this Regulation*];

   (b) any audit contract entered into after XX/XX/XXX [*the adoption of the Commission proposal*] but before XX/XX/XXXX [*the date of entry into force of this Regulation*] and which is still in force shall remain applicable for a maximum period of five accounting years after XX/XX/XXXX [*the date of entry into force of this Regulation*];

   (c) when an audit contract referred to in points (a) or (b) of this paragraph expires or is terminated, the public-interest entity may renew such contract once with the same audit statutory auditor or audit firm, without the provisions Article 31(3) being applicable. Such renewed contract shall be subject to the following maximum duration:

      (i) 1 year: if the auditor has been providing services to the audited entity for a consecutive period exceeding 100 years;

(ii) 2 years: if the auditor has been providing services to the audited entity for a consecutive period between 51 and 100 years;

(iv) 3 years: if the auditor has been providing services to the audited entity for a consecutive period between 21 and 50 years;

(v) 4 years: if the auditor has been providing services to the audited entity for a consecutive period between 11 and 20 years;

(vi) 5 years: if the auditor has been providing services to the audited entity for a consecutive period not exceeding 10 years.

By derogation from the criteria set out in point (c), the audit contract may remain applicable until the end of the first accounting year ending after [*2 years after the entry into force of this Regulation*].

By derogation from points (a) to (c), when national rules establish a maximum duration of the contractual relationship between the statutory auditor or the audit firm and the audited entity which does not exceed 9 years and require the audited entity to select a different statutory auditor or audit firm when such maximum duration is reached, the audit contract may remain applicable until the end of that maximum duration period.

2. Article 33 shall apply to any audit contract entered into after […] [*the date of the entry into force of this Regulation*] but before […] [[*2 years after the entry into force of this Regulation*].

Article 32(3) shall only apply to such contract after the expiration or termination of the first renewal of such contract.

Article 71

National provisions

The Member States shall make such provision as is appropriate to ensure the effective application of this Regulation.

Article 72

Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.
It shall apply from [*2 years after the entry into force*].
However, Article 32(7) shall apply from […] [*the date of the entry into force of the Regulation*] and Article 10(5) shall apply from […] [*3 years after the entry into force of the Regulation*].

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the European Parliament *The President*	*For the Council* *The President*

ANNEX

[Transferred to the Directive]

[…]