



**COUNCIL OF
THE EUROPEAN UNION**

Brussels, 24 May 2013

9693/13

LIMITE

**DRS 99
CODEC 1113**

**Interinstitutional File:
2011/0389 (COD)
2011/0359 (COD)**

NOTE

From: General Secretariat
To: Council

No. prev. doc.: 9518/13 DRS 97 CODEC 1064

No. Cion prop.: 16971/11 DRS 121 CODEC 2039
16972/11 DRS 122 CODEC 2040

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

I. INTRODUCTION

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

2. The proposals arose from the Commission Green Paper of October 2010, initiating a consultation on Audit Policy, in the aftermath of the global financial crisis and in the general context of financial market reform. The Green Paper opened a debate on the role and function of the auditor in the operating environment for auditors and the broader context of financial stability. The combined proposals for a Directive and a Regulation constitute a comprehensive approach to addressing issues across the audit spectrum.

II PROGRESS REPORT

3. Under the Danish and Cyprus Presidencies, the Working Party on Company Law undertook a first examination of the Commission proposals and held discussions on specific topics.
4. Under the Irish Presidency meetings have been held on 9 January, 23 January, 6 February, 20 February, 6 March, 20 March, 3 April, 17 April, 29-30 April, and 15 May 2013.
5. Negotiations were initially conducted in seven Presidency compromise Packages numbered 1-3, 4a, 4b, 5a and 5b, covering specific topics relating to the audit proposals.
6. Building on its earlier compromise proposals as contained in the above mentioned Packages, the Presidency presented to the meeting of the Council Working Party on 15 May consolidated compromise texts (doc. 9379/13 and 9380/13, dated 13 May 2013) on both the Directive and the Regulation.
7. On the basis of the discussions at Working Party level, the Presidency has identified three main outstanding issues: mandatory rotation of auditors and audit firms; restriction on the provision of related financial audit services and prohibition of non-audit services; and cooperation of national audit oversight bodies.
8. The Presidency's intention is to seek political guidance from the Competitiveness Council on 29 May 2013, with a view to assisting its efforts to reach a compromise on these issues. In order to structure the debate at the Council, the Presidency has prepared the questions set out under point III.

9. On 24 May 2013, the Permanent Representatives Committee took note of this Presidency Progress Report and the questions prepared to structure the orientation debate at the Competitiveness Council on 29 May 2013.
10. Working Party meetings have been scheduled for 31 May and 14 June with a view to further discussing the Presidency compromise texts, on the basis of the guidance that Ministers will be invited to give at Council level.
11. In parallel, the European Parliament has progressed its work on the draft Directive and Regulation; the Legal Affairs Committee adopted its report on the proposals on 25 April 2013.

III. QUESTIONS FOR THE ORIENTATION DEBATE

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

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

Delegations expressed divergent views on the issue of mandatory rotation in the discussions in the Working Party.

As a compromise, the Presidency proposal of 13 May provides for a maximum period of engagement of 7 years (8 years for joint audit), renewable, subject to the satisfaction of certain criteria, for a maximum of 7 further years (8 years for joint audit). In addition, the Presidency compromise foresees that, on an exceptional basis, the Public Interest Entity may request the competent authority to grant another extension to re-appoint the statutory auditor or audit firm for a maximum of 2 further years (3 years for joint audit).

Question: Could you agree with the Presidency compromise proposal in relation to mandatory rotation of auditors and audit firms in a spirit of compromise?

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

In order to address the need to reinforce independence and professional scepticism, the Commission proposed to limit the services that statutory auditors and audit firms of Public Interest Entities are allowed to carry out emphasising that the auditor should focus on audit. The Commission proposed to differentiate the following services:

1. audit services - the main focus of the auditor;
2. related financial audit services - allowed within certain limits;
3. non-audit services that are fundamentally incompatible with the independent public-interest function of audit to their audited entities in all cases - not allowed;
4. non-audit services that are not fundamentally incompatible with the audit services - the audit committee or the competent authority would be empowered to assess, depending on the concrete circumstances, whether or not they may be provided to the audited entity.

The Commission proposed to limit the provision of related financial audit services to no more than 10 % of the fees paid by the audited entity for the statutory audit.

Delegations expressed concerns as to whether this limitation would allow statutory auditors and audit firms to provide related financial audit services to the extent necessary or required by legislation.

In order to meet these concerns and in order to facilitate a reasonable compromise, the Presidency proposed to increase this threshold to no more than 70 % of the fees paid in any three year period. In addition, services related to audit work imposed by Union legislation would be excluded.

Under the Presidency proposal this limitation is applicable to all services that do not feature on the list of prohibited services ("black list") which it proposes.

The concept and content of a list of prohibited services ("black list") only, with auditors permitted to provide all other services that do not feature on this list was developed by the Presidency in response to a request from delegations for a simpler system of permitted/prohibited services. It was also designed to meet the objectives of reinforcing the independence of auditors and the avoidance of conflict of interest, on which there were divergent views in the working group as to how this could be achieved and on the specific services that should be prohibited.

Questions: Could you agree to the principle of having a black list only? Could you agree to the content of this black list as proposed in the Presidency compromise (doc. 9380/13)? Could you agree with the Presidency compromise proposal of having a limitation on the provision of allowed services to no more than 70 % of the fees paid in any three year period excluding services related to audit work imposed by Union legislation?

3. Cooperation of national audit oversight bodies

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

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

So far, two alternatives have emerged in the discussions at Working Party level.

The Presidency compromise proposal of 13 May which attempts to address concerns expressed by several delegations as regards the Commission proposal, by providing the creation of a Committee of European Auditing Oversight Bodies (CEAOB) within ESMA, composed of the members of EGAOB and having decision making powers. A number of delegations proposed an alternative to ESMA, (doc. 9531/13 dated 14 May 2013), namely the strengthening of existing co-operation provided under the EGAOB, by means of the establishment by Directive of a body to be known as the “European Board of Auditors’ Oversight Bodies” (EBAOB), in parallel with the dismantlement of the EGAOB by repeal - either by Directive or Regulation of the instrument under which it was established (COM-Decision 2005/090/EC).

Question: Could you agree with the Presidency compromise proposal on the creation of a Committee of European Auditing Oversight Bodies (CEAOB) within ESMA in a spirit of compromise?

III. CONCLUSION

The Council is invited to take note of the Presidency Progress Report set out in point II and to hold an orientation debate on the basis of the questions set out in point III at its meeting on 29 May 2013.
