

EUROPEAN PARLIAMENT

2004



2009

Session document

A6-0014/2009

26.1.2009

REPORT

on implementation of Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts
(2008/2247(INI))

Committee on Legal Affairs

Rapporteur: Bert Doorn

Rapporteur for opinion (*):
Ieke van den Burg, Committee on Economic and Monetary Affairs

(*) Associated committee – Rule 47 of the Rules of Procedure

CONTENTS

	Page
MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION	3
EXPLANATORY STATEMENT	8
OPINION OF THE COMMITTEE ON ECONOMIC AND MONETARY AFFAIRS	11
RESULT OF FINAL VOTE IN COMMITTEE.....	14

MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION

on implementation of Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts (2008/2247(INI))

The European Parliament,

- having regard to Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts¹,
 - having regard to its resolution of 21 February 2008 on the Commission's 23rd Annual report on monitoring the application of Community law (2005)²,
 - having regard to its resolution of 21 October 2008 on monitoring the application of Community law – 24th annual report from the Commission³,
 - having regard to its resolution of 4 September 2007 on better lawmaking 2005: application of the principles of subsidiarity and proportionality – 13th report⁴,
 - having regard to its resolution of 4 September 2007 on better regulation in the European Union⁵,
 - having regard to Rule 45 of its Rules of Procedure,
 - having regard to the report of the Committee on Legal Affairs and the opinion of the Committee on Economic and Monetary Affairs (A6-0014/2009),
- A. whereas Parliament has repeatedly stated that there is a point to EU legislation only if it is complied with in the Member States, and whereas monitoring of the transposition and application of EU legislation by Member States must therefore be stepped up; whereas Parliament has proposed that the rapporteur responsible be given a progress report after the transposition deadline has expired,
- B. whereas Directive 2006/43/EC (“the Directive”) was adopted by Parliament and the Council on 17 May 2006 and the period for transposition in the Member States expired on 29 June 2008, and whereas there must be an examination as to whether transposition has proceeded correctly,
- C. whereas the “scoreboard” published by the Commission, whilst identifying which articles have been implemented by whom, provides no information on the way in which

¹ OJ L 157, 9.6.2006, p. 87.

² Texts adopted, P6_TA(2008)0060.

³ Texts adopted, P6_TA(2008)0494.

⁴ OJ C 187 E, 24.7.2008, p. 67.

⁵ OJ C 187 E, 24.7.2008, p. 60.

implementation has proceeded or on whether national rules meet the minimum standard set by the Directive,

- D. whereas the objective of the Directive is, first, to optimise the quality of audits of annual accounts throughout the EU, thus increasing confidence in such reporting and improving the situation in the financial markets, and, second, to establish a level playing-field for the accountancy sector within the internal market,
- E. whereas implementation of the Directive in Member States must be checked by reference to this twin objective,
 - 1. Notes that the Directive was adopted in response to the crisis that followed the collapse of Enron; emphasises that the current financial crisis highlights the importance of high-quality accounting and auditing practices; deplors the fact that only 12 Member States have transposed the Directive in full; urges the Commission to ensure its immediate transposition and enforcement;
 - 2. Notes with concern that transposition of the crucial notions of “public-interest entity”¹ (PIE) and “network”² is leading to differing interpretations among Member States; stresses in this connection that for an undertaking identified as a PIE, and also for the accountant auditing that undertaking, the Directive introduces various far-reaching obligations; notes further that the Directive also introduces various additional obligations for audit firms covered by the definition of “network”; observes that further consideration is needed with regard to the impact of the definition of “network” and the lack of legal clarity regarding the liability of firms for the actions of other firms that belong to the same network; fears in general that a patchwork of definitions will lead to legal uncertainty and high costs of compliance and will thus, ultimately, adversely affect attainment of the Directive's objective; therefore calls on the Commission to undertake a comprehensive review of the implementation of the definitions and the discernible effects of their introduction, and to seek clarity regarding the long-term policy priorities for the EU in this area and the way in which these may best be achieved, in consultation with the Member States;
 - 3. Notes that many Member States have not yet implemented Article 41 of the Directive, under which Member States must require PIEs to set up an audit committee or comparable body; is of the opinion that this requirement is an important means of guaranteeing the independence of statutory audits of PIEs' annual accounts;
 - 4. Stresses that recent experience shows the need for frequent and high-quality interaction within audit committees and between independent directors, supervisory boards and auditors, and that non-executive board members should consider carefully the possibility of having meetings without executive board members being present;
 - 5. Concludes that certain Member States have implemented the Directive's requirement of auditor rotation within a maximum of seven years with a very short rotation period of as little as two or three years; doubts that such short rotation periods enhance the quality and

¹ Article 2(13) of the Directive.

² Article 2(7) of the Directive.

continuity of statutory audits of PIEs, and points out that they hamper the auditors' and audit firms' sound understanding of the audited entity;

6. Regrets that not all Member States have introduced the system of public oversight required by the Directive; notes further that, in Member States where forms of public oversight have been introduced, there are considerable differences between them; notes that public oversight under the Directive must be organised in such a way that conflicts of interest are avoided; wonders, in the light of this, whether oversight authorities directly linked to national governments meet that requirement;
7. Considers it very important that the cooperation required under the Directive between public-oversight authorities should actually materialise, since intensive cooperation between oversight authorities fosters convergence between Member States and can prevent additional administrative burdens resulting from different national procedures and requirements;
8. Stresses that listed subsidiaries are subject to statutory audits; recommends that national law require that parent undertakings holding such subsidiaries be subject to statutory audits performed by auditors approved in accordance with the Directive;
9. Considers that there is a very significant lack of clarity in relation to the implementation of Article 47 of the Directive, which deals with the audit working papers; points out that, whilst Member States may allow the transfer to the competent authorities of a third country of audit working papers or other documents held by the statutory auditors or audit firms approved by them, there are legal and data-protection issues to be addressed in order to ensure that the information which EU auditors receive from their client companies is kept confidential and does not get into the public domain of third countries where such companies are listed or where the parent company is incorporated;
10. Calls on the Commission to make a careful evaluation of all national legislation transposing the Directive, to tackle resolutely the problems referred to in paragraphs 1 to 5 and to report to Parliament on this within two years; doubts whether the chosen method of minimum harmonisation is really the right way to realise the objectives of this and other internal-market-related directives, since the many derogations allowed by the Directive will lead to further fragmentation of the accountancy market; calls on the Commission to make use of clear concepts when harmonisation is being carried out;
11. Points out that undue delay in the approval of International Standards on Auditing (ISAs) could have an adverse effect on the regulatory environment, resulting in further fragmentation, which is contrary to the general objective of the Directive; requests the Commission, therefore, to avoid unnecessary delay in the adoption of ISAs and to launch a broad public consultation on their adoption;
12. Takes the view that careful monitoring and verification of the correct and timely implementation of EU legislation is an essential means of achieving better application of EU law and avoiding gold-plating practices that may occur on the basis of, for example, Article 40 of the Directive, which lays down a non-exhaustive list of requirements for transparency reporting;

13. Supports the Commission's guidance of, and close cooperation with, Member States, aimed at securing correct and timely implementation, for example by making use of transposition workshops as a forum for establishing consensus on the implementation of particular provisions of Community legislation; supports the use of correlation tables in the process of implementation as a means of achieving maximum convergence; is nevertheless of the opinion that still more has to be done to give clear guidance to Member States in the course of implementation and to steer Member States towards an unequivocal implementation of Community legislation;
14. Strongly emphasises that any quasi-legislative measure within the scope of the Directive can only be adopted pursuant to the application of the regulatory procedure with scrutiny, accompanied where appropriate by an evaluation of its impact;

Recommendation on quality assurance

15. Welcomes Commission Recommendation 2008/362/EC of 6 May 2008 on external quality assurance for statutory auditors and audit firms auditing public interest entities¹; subscribes to the established view that it is important to have independent external quality assurance reviews in line with the Directive's objective of enhancing the quality of audits and the credibility of published financial information; endorses, moreover, the established view that the total independence and impartiality of inspections and inspectors are of the utmost importance;
16. Urges the Commission to promote national quality assurance structures, in close collaboration with the Member States, which ensures independent and external quality assurance for accountancy firms; stresses, in this connection, that the European legislative authority must confine itself to general framework provisions set out in the Directive and the recommendation and that it must be left to the profession to flesh out those rules;

Decision on the registration of third-country auditors

17. Takes note of Commission Decision 2008/627/EC of 29 July 2008 concerning a transitional period for audit activities of certain third country auditors and audit entities²; asks the Commission to communicate to Parliament its follow-up on the question of the registration of third-country auditors;

Auditors' liability

18. Notes that divergences between Member States' liability regimes might lead to regulatory arbitrage and undermine the internal market, but is aware of the differing levels of exposure linked to the size of audit firms and companies with which they deal; emphasises that liability claims often come from third countries in which such litigation is largely driven by contingency-fee arrangements; is reluctant to welcome such a litigation culture into the

¹ OJ L 120, 7.5.2008, p. 20.

² OJ L 202, 31.7.2008, p. 70.

European Union and asks for a more fundamental resolution to the perverse effects of such fee-driven practices;

19. Notes Commission Recommendation 2008/473/EC of 5 June 2008 concerning the limitation of the civil liability of statutory auditors and audit firms¹, which calls on Member States to limit the liability of accountants, with due regard for their own national legislation and circumstances; further notes the recommendation's objective of bolstering the level-playing field for undertakings and accountancy firms through greater convergence between Member States in this area; underlines that the objective of limiting the liability of auditors and audit firms proposed by the Commission recommendation must not violate the legal principles governing civil liability in certain Member States, such as the principle of the right to compensation for victims; underlines that, within the context of the current economic and financial crisis, the recommendation should not call into question the quality of the statutory audit or the confidence placed in the function of statutory audits; calls on the Commission to inform Parliament no later than in 2010 about the impact of, and the follow-up to, the recommendation, the important issue in this connection being, in particular, whether and to what extent, in accordance with the Directive's objective, the recommendation is leading to greater convergence between Member States; emphasises that, in the event that further measures prove necessary, the Commission must undertake an impact study assessing the possible effects of limitation of civil liability of auditors and audit firms on the quality of audits, financial security and the concentration on the audit market;

Consultation on ownership rules

20. Welcomes the consultation initiated by the Commission on ownership rights in accountancy firms and looks forward with interest to the responses of stakeholders;

o

o o

21. Instructs its President to forward this resolution to the Council and the Commission.

¹ OJ L 162, 21.6.2008, p. 39.

EXPLANATORY STATEMENT

By virtue of its role as co-legislator the European Parliament has a great interest in the implementation of the Directive in the Member States. Correct and timely implementation is a very important step on the path to a consistent application of Community legislation within the internal market. It enhances the effectiveness of legislative measures. Therefore, the European Parliament will be more formally involved in the monitoring process of the implementation of European legislation in the Member States by reporting on the transposition of important EU legislation.

On 9 September 2008, a hearing was held in which stakeholder experts elaborated on the latest issues in the process of implementation.

In this report, evaluating the implementation in Member States, the rapporteur wishes to monitor and report in how far the goals of the Directive have been met or are expected to be met. Central question is if the Member States implementation measures maximize the quality of audits and if they reach a level playing field for the audit sector.

Definitions

The implementation of the definition of *Public Interest Entity* leads to differences in interpretation between Member States. Several additional obligations are directly linked with the definition of PIE, for instance the requirement of PIEs to establish an audit committee. Auditors of PIEs are moreover required to publish annual transparency reports and are subject to a stricter inspection regime than other auditors. It is therefore essential that the Commission together with the Member States strive for an unequivocal implementation of the definition of PIE in all Member States.

The implementation of the definition of network leads to divergent national legislative provisions. Inconsistencies between national definitions of network result in an unnecessarily excessive administrative burden for the networks. It also would bear the inherent risk for the registered audit firms of inadvertently not being compliant with the relevant provisions in all Member States.

There are additional requirements directly linked to firms that belong to a network, for example the identification of the network for registration of a firm in different Member States. The Directive obliges audit firms, when applying for registration in a Member State, to indicate if they form part of a network, and identify the network. If there is no consistent definition of network in Member States, a considerable fragmentation of legislative measures will be the result, which is clearly opposite to the objectives of the Directive.

Audit committee

The role of an audit committee is important to reach independent audits, and thus to maximise the quality of audits. The audit committee must monitor all the aspects of financial reporting process and the independence of the auditors and the audit firm. The audit committee

requirement proofs to be a difficult rule to implement, due to the considerable corporate governance components involved.

The Commission's guiding role is necessary to steer the Member States in the right direction towards a workable and compliant regime for audit committees.

Rotation of audit partners

Which implemented rotation periods would be in line with this requirement? A strictly formal interpretation would lead to the conclusion that any rotation period less than 7 years would be in compliance with the Directive. It can however truly be doubted whether very short rotation periods could attain the overall goal of this Directive, being the maximization of quality of audits. The audit practice emphasises that audit partners need sufficient time to get profoundly acquainted with the audited entity. Therefore too short rotation periods would affect the result of the auditor's work. The Commission should carefully monitor if periods for rotation on national level help to attain better audits.

Instrument of harmonisation

From the implementation activities in Member States it is observed that there exists an undeniable tension between the Directive's main objectives (among which the creation of an equal playing field for the European audit practice) and the very nature of the Directive, being minimum harmonisation. Moreover, implementation measures have been monitored that do not literally go counter the text of the Directive, but might impede the attainment of the Directive's objectives. This is particularly the case with rotation periods.

Therefore, your rapporteur wishes to challenge the appropriateness of minimum harmonisation as the chosen legislative instrument.

Article 95 of the Treaty is often the legal basis for Internal Market legislation. This article leaves it to the appreciation of the Commission to choose the appropriate instrument for legislation, regulation or directive. Where the form of a directive is chosen, the nature of harmonisation is often minimum harmonisation. The practice of implementation of directives in Member States and the application of EU legislation in general shows that Directives based on minimum harmonisation are not the legislative instruments preferred. It shows that unequivocal application of essential provisions for the sound functioning of the Internal Market is best guaranteed by the use of directives on the basis of total harmonisation or regulations.

Auditors' Liability

To date there are approximately nine Member States that have full liability caps for auditors in force. In a number of Member States draft legislation on such caps is currently in the drafting process. In a further number of Member States, there is a lively debate regarding liability of auditors going on.

In the process of further developments in national legislation, the perspective must be a maximum convergence of national regulations in accordance with the objectives of the Directive.

It is therefore that the Commission should publish an evaluation of those developments with regard to its Recommendation in order to inform the Parliament on the degree of follow-up in the Member States. Should a maximum of convergence not be the result, then the Commission should consider further legislative measures that prove more effective.

3.12.2008

OPINION OF THE COMMITTEE ON ECONOMIC AND MONETARY AFFAIRS

for the Committee on Legal Affairs

on implementation of Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts
(2008/2247(INI))

Rapporteur (*): Ieke van den Burg

(*) Associated committee – Rule 47 of the Rules of Procedure

SUGGESTIONS

The Committee on Economic and Monetary Affairs calls on the Committee on Legal Affairs, as the committee responsible, to incorporate the following suggestions in its motion for a resolution:

1. Notes that the Directive was adopted as a response to the crisis following the collapse of Enron; emphasises that the current financial crisis highlights the importance of high-quality accounting and auditing practices; deplores the fact that only 12 Member States have transposed the Directive in full; urges the Commission to ensure its immediate transposition and enforcement;
2. Stresses that recent experience shows the need for frequent and high-quality interaction within audit committees and between independent directors, supervisory boards and auditors and that non-executive board members should consider carefully the possibility of having meetings without executive board members present;
3. Deplores the fact that not all Member States have set up an adequately resourced independent public oversight of auditors; stresses that this gap should be closed and that coordination between the national public oversight bodies should be strengthened; urges for mutual recognition with third-country oversight authorities;
4. Notes that divergences between Member States' liability regimes might lead to regulatory arbitrage and undermine the internal market, but is aware of the differing levels of exposure linked to the size of audit firms and companies with which they deal; emphasises that

liability claims often come from third countries in which such litigation is largely driven by contingency fees arrangements; is reluctant to welcome such a litigation culture into the European Union and asks for a more fundamental resolution to the perverse effects of such fee-driven practices;

5. Welcomes the Commission's recommendation relating to the limitation of the civil liability of auditors; encourages Member States to implement that recommendation;
6. Stresses that listed subsidiaries are subject to statutory audits; recommends that national law require that parent undertakings holding such subsidiaries be subject to statutory audits performed by auditors approved in accordance with the Directive.

RESULT OF FINAL VOTE IN COMMITTEE

Date adopted	2.12.2008
Result of final vote	+: 26 -: 0 0: 0
Members present for the final vote	Mariela Velichkova Baeva, Paolo Bartolozzi, Zsolt László Becsey, Sebastian Valentin Bodu, Sharon Bowles, Udo Bullmann, David Casa, Manuel António dos Santos, Christian Ehler, Jonathan Evans, José Manuel García-Margallo y Marfil, Jean-Paul Gauzès, Robert Goebbels, Donata Gottardi, Louis Grech, Othmar Karas, Wolf Klinz, Astrid Lulling, Gay Mitchell, Sirpa Pietikäinen, John Purvis, Peter Skinner, Margarita Starkevičiūtė, Ivo Strejček, Sahra Wagenknecht
Substitute(s) present for the final vote	Harald Ettl

RESULT OF FINAL VOTE IN COMMITTEE

Date adopted	20.1.2009
Result of final vote	+: 22 -: 0 0: 0
Members present for the final vote	Carlo Casini, Bert Doorn, Monica Frassoni, Giuseppe Gargani, Neena Gill, Klaus-Heiner Lehne, Katalin Lévai, Antonio López-Istúriz White, Manuel Medina Ortega, Hartmut Nassauer, Aloyzas Sakalas, Eva-Riitta Siitonen, Francesco Enrico Speroni, Diana Wallis, Rainer Wieland, Jaroslav Zvěřina, Tadeusz Zwiefka
Substitute(s) present for the final vote	Brian Crowley, Eva Lichtenberger, József Szájer, Jacques Toubon, Ieke van den Burg