COUNCIL OF
THE EUROPEAN UNION

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Council adopts new EU rules on audit of company accounts

The Council adopted today[*] a directive updating, and introducing additional EU rules on the audit of company accounts, aimed at reinforcing the reliability of company financial statements by establishing minimum requirements for statutory audit of annual accounts and consolidated accounts *(3667/05).* The Council accepted all of the European Parliament amendments in first reading.

The directive broadens the scope of application of existing EU legislation (directive 84/253/EEC) by specifying the duties of statutory auditors, their independence and ethics, introducing requirements for external quality assurance, in particular with a view to ensuring better public oversight over the audit profession and improving co-operation between oversight bodies in the EU. It also amends directives 78/660/EEC and 83/349/EEC on accounting.

The new measures are intended to help improve quality audits within the EU and hence underpin confidence in the functioning of EU capital markets. They will also provide a basis for cooperation with oversight bodies of third countries to take account of globally interconnected capital markets.

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[*] The decision was taken at the Agriculture and Fisheries Council meeting, without discussion.

The directive's main provisions are as follows:

Statutory auditor and audit firm are separately defined in order to provide more clarity in the scope of legislation. The new provisions reflect the fact that since 1984, audit firms have grown in size and importance, and a considerable number of the new provisions deal specifically with audit firms.

Public interest entities: the directive requires the audit firms that carry out statutory audit of public interest entities to provide a detailed public report that gives an insight into the audit firm and the network to which it belongs. The report must include the date of the last quality assurance review, policies on continuing education requirements and a break-down of fees charged by the audit firm.

The requirement to set up an independent audit committee will strengthen monitoring of the financial reporting process and the statutory audit and help to prevent any possible undue influence of the executive management on the financial reporting of the audited entity.

Registration: member states must ensure that each statutory auditor and audit firm is identified in an electronic public register and that the registration information is kept updated.

For audit firms, the register must show the size of the audit firm by indicating the number of all statutory auditors employed by or associated as partners or otherwise with the audit firm. The register must contain information on the owners and members of the management of the audit firm, and must comprise information on the membership of a network.

Independence: the directive establishes the principle whereby a statutory auditor or an audit firm must be independent from the audited entity and in no way be involved in decision-taking of the audited entity.

Quality assurance and auditing standards: the directive introduces a requirement for all statutory auditors and audit firms to be subject to a system of quality assurance, organised in a manner that remains independent from the reviewed statutory auditors and audit firms and subject to public oversight. Furthermore, statutory audits must be carried out in accordance with international standards on auditing.

Investigations and sanctions: the directive establishes a principle whereby member states organise effective systems of investigation and sanctions, which may be civil, administrative or criminal. They must provide for appropriate disclosure to the public.

Public oversight: the directive sets out principles aimed at ensuring that oversight has sufficient public integrity and independence.

Appointment, dismissal and communication: procedures for appointment of the statutory auditor or audit firm seek to ensure that the statutory auditor or audit firm is independent from those that prepare the financial statements of the audited entity.

The directive introduces a principle where by the statutory auditor or audit firm can only be dismissed if there is a significant reason why the statutory auditor cannot finalise the audit. The reasons for dismissal and resignation must be disclosed to the responsible oversight authorities.

Competent authorities: member states must designate competent authorities responsible for approval, registration, quality assurance, inspection and discipline for the purposes stipulated by the directive and must cooperate with each other. They must be organised such as to prevent conflicts of interest. An obligation of professional secrecy applies to all persons who work or have worked for competent authorities.

International aspects: auditors and/or audit firms from third countries that issue audit reports in relation to securities traded in the EU must be registered in the EU and be subject to member state systems of oversight, quality assurance and investigations and sanctions. Only auditors or audit firms that meet quality criteria equivalent to the directive can be registered.

The directive allows for exemption from registration, oversight, quality assurance and investigations and sanctions only if audit firms from third countries are subject to equivalent systems of registration and oversight.

Fees: the directive introduces changes to current EU legislation by requiring audited companies to disclose total fees paid to the statutory auditor or audit firm, broken down by fees for audit services, other assurance services, tax services and other non-audit services.

Transposition: member states are required to adopt provisions to comply with the new directive within two years of its entry into force. The directive comes into force twenty days after its publication in the Official Journal of the EU.