



SURVEY ON THE ROLE OF SECURITIES REGULATORS IN AUDITOR OVERSIGHT OF PUBLIC LISTED COMPANIES AND ON THEIR POWERS IN RELATIONSHIP TO AUDITORS OF THESE COMPANIES

**1. Introduction to the survey and Executive summary**

European securities regulators have the task of maintaining market confidence, and one of the key elements that underpins market confidence is the credibility added by high quality audits of financial statements. Companies cannot be admitted or maintained to listing on a securities market unless their financial statements have been audited. CESR-Fin, as the committee of European Securities Regulators therefore has a strong interest in the quality of audit. CESR Audit Task Force has a mandate from CESR-Fin to monitor current work undertaken in the area of auditing. As part of this mandate, in November 2005, CESR Audit Task Force considered it useful to understand the relationship between the Securities Regulators, the auditors and their oversight system and conducted a survey of the role of securities regulators, their powers in relation to auditors of public listed companies and their role in auditor oversight bodies (AOBs) within the European Union<sup>1</sup>, to obtain a better understanding of the relationships.

The picture that emerges from this survey is one where only a few securities regulators have a direct role in supervising auditors, but a larger number of securities regulators play an indirect role in the supervision of auditors e.g. through membership of the auditor oversight bodies. Certain combined<sup>2</sup> regulators within the European Union have specific powers with respect to auditors (e.g. over the auditor's duty to report in respect of certain financial institutions), but these powers arise from their role as banking supervisors, not as securities regulators. Therefore these specific powers are not covered extensively in this survey. The majority of securities regulators have a wide range of powers to request information from auditors in respect of company prospectuses, but their powers are limited in other respects in relation to auditors.

Auditors audit a large number of companies in the European Union that are not listed companies, and therefore the composition of the auditor oversight bodies may reflect this wider constituency. Securities regulators may have a role to play here as part of auditor oversight, as they regulate the most significant issuers listed on the stock markets. However, for auditor oversight in the majority of member states, securities regulators role is as a member of the auditor oversight body, not as the only oversight body of auditors.

With the enactment of the 8<sup>th</sup> Directive on Statutory Audit, which will be implemented in member states by mid-2008, each member state has to establish an auditor oversight body. Some member states are still in the process of establishing these auditor oversight bodies, so the situation as set out in this report is likely to change over the next two years. Indeed the situation in members' states was changing as this report was drafted. In the Netherlands, from 1<sup>st</sup> October 2006, the Dutch securities regulator will take over the oversight of auditors and increase its powers in this area. In Italy, in December 2005, a new law was passed which strengthened Consob's powers in respect of auditor oversight. These changes are reflected in this survey, but for all other member states, the survey results reflect the situation as at 1<sup>st</sup> October 2005.

With the complete implementation of the Transparency and Prospectus Directives, the information in the survey on the powers of the securities regulator to question the auditors with respect to the

<sup>1</sup> Including Norway and Iceland

<sup>2</sup> Regulators where there is one authority which regulates, for example, both banking institutions and securities markets



issuance of prospectuses will also change. It would therefore be useful to maintain a database of this information and update it annually.

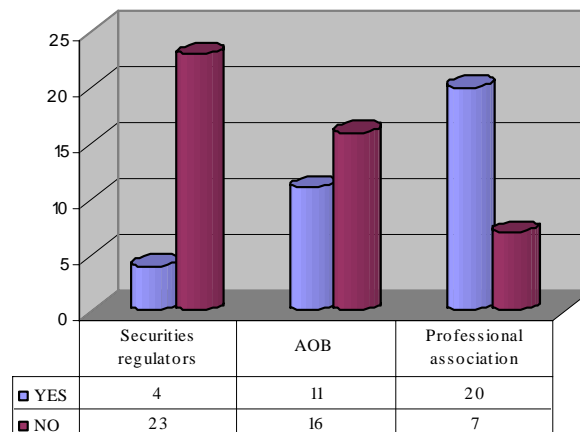
All CESR-Fin members completed the questionnaire, however not all members answered every question. Where the question was not answered, it was assumed the answer was 'No'. The detailed responses are analyzed in part 2I.

CESR Audit Task Force hopes this survey will be helpful in understanding the particular roles and powers that securities regulators have in relation to auditors of public listed companies and the relationship between securities regulators and auditor oversight bodies, in individual member states. In this way, member states can share their experience in this area. Many thanks to all those who helped complete the survey.

## 2. Summary of the responses

### PART I - REGISTRATION RULES, APPOINTMENT, RENEWAL of APPOINTMENT OR DISMISSAL, REMOVAL OF AUDITORS OF PUBLIC LISTED COMPANIES

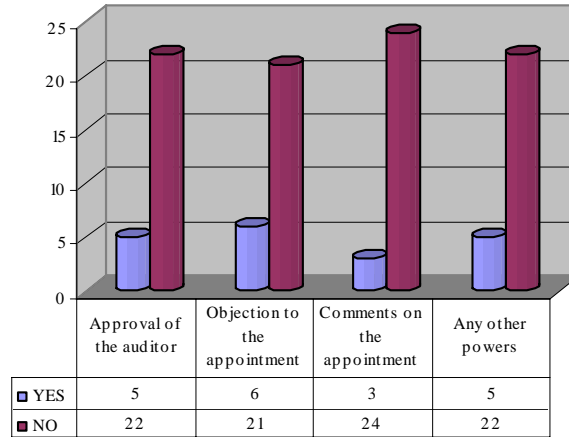
**Table 1 - (Q1-Q2) Registration of the auditor of a public listed company**



Among member states, 11 member states require the auditor of a public listed company to register with an auditing oversight body. In some jurisdictions, auditors of public listed companies are registered with both the auditor oversight body and the professional association.

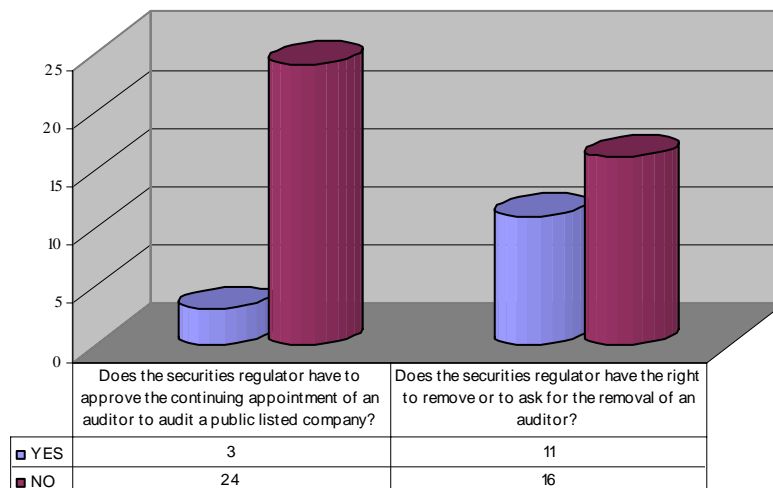
Moreover, there is a separate registration requirement for auditors of public listed companies in only three CESR member states, and in these cases the securities regulators are also the auditor oversight bodies.

**Table 2 - (Q3) Does the securities regulator have rights in relation to the initial appointment of an auditor to audit a public listed company?**



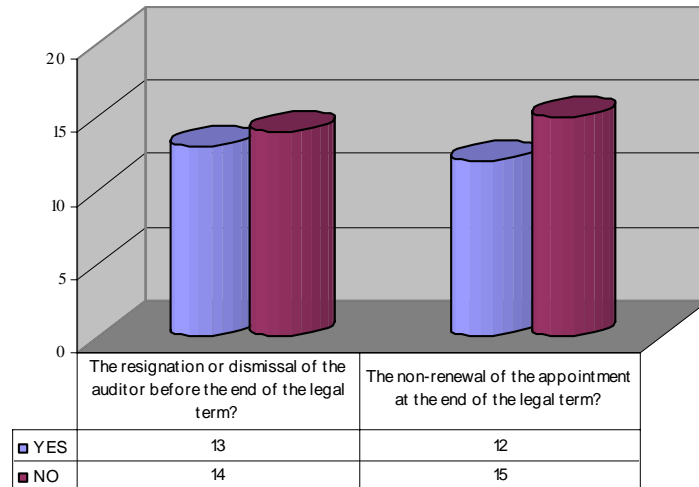
In conclusion, very few securities regulators have rights in relation to approval of the initial appointment of auditors of a public listed company. Some securities regulators can nevertheless express objections with respect to the appointment of the auditor. These objections can cover such matters as the auditor's independence or competence.

**Table 3 - (Q4) Approval of the continuing of the appointment of an auditor / right to remove or ask for the removal of an auditor**



Very few securities regulators have rights to approve the continuing appointment of an auditor of a public listed company. On the other hand, a large number of members have the right to remove or ask for the removal of an auditor of a public listed company.

**Table 4 - (Q5) Is the securities regulator notified of...**

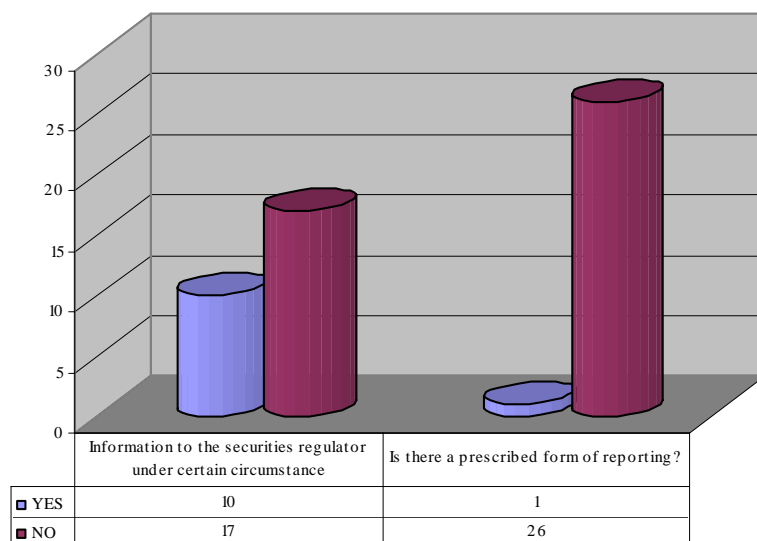


In about half of CESR members, the securities regulator is notified of the resignation, the dismissal or the non-renewal of the appointment of the auditor of a public listed company. In some cases, this arises from the requirement to notify price sensitive information (and the dismissal or non-renewal of the appointment of an auditor may be regarded in particular circumstances as price sensitive information) to the market.

In conclusion, for this first part of the survey which is related to the registration, the appointment and the removal of auditors of public listed companies in Europe, there is a variety of practice across CESR members. The majority of securities regulators are not involved in the registration, appointment, dismissal or removal of the auditors of public listed companies.

**PART II – EXCHANGE OF INFORMATION BETWEEN THE AUDITORS OF PUBLIC LISTED COMPANIES AND SECURITIES REGULATORS**

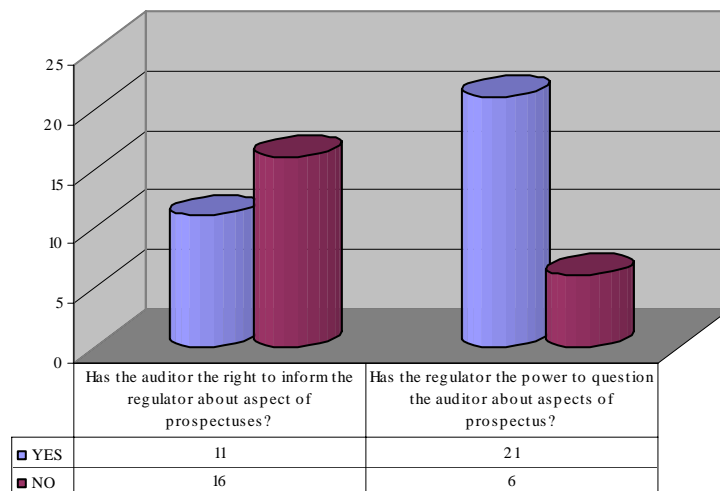
**Table 5 - (Q7) Information to the securities regulator under certain circumstances...**



In some member states, under certain circumstances, the auditor of a public listed company must inform the securities regulator about certain matters. The circumstances under which the auditor must inform the securities regulator are, for example, when some information comes to the attention of the auditor during the performance of his audit. However, if the company is in the financial services sector e.g. a bank or financial intermediary, then there are requirements that the auditor must inform the combined regulator, in their capacity as banking supervisor. These requirements are not noted as a ‘yes’ in the above table as they flow from the role of the CESR members as banking supervisors rather than as securities regulators.

Generally, there is no prescribed way of reporting.

**Table 6 - (Q8-Q9) Right to inform the regulator / Power to question the auditor on prospectuses**

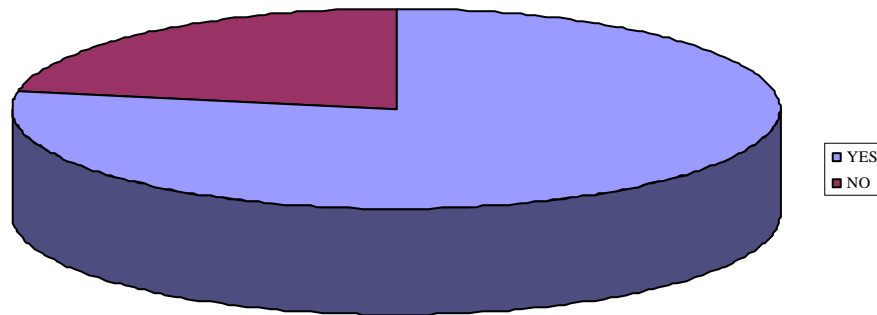


Though few securities regulators have powers with respect to the appointment, registration, oversight and dismissal of auditors, this changes when one considers the role of securities regulators, auditors and the issuance of prospectuses.

In almost half of member states, the auditor of a public listed company has the right to inform the securities regulator about certain aspects of a prospectus.

In addition, 75% of the securities regulators have the right to question the auditor about aspects of a prospectus, in particular during the approval process of this prospectus. The questions are mostly related to the financial information included in a prospectus and where there is a need to submit a new report. This survey was undertaken based on information available at 1<sup>st</sup> October 2005. With the complete implementation of the Prospectus Directive in all member states, the number of member states where there will be the right to question auditors about aspects of the prospectus will change. The implementation will have an impact on the rights and duties of auditors in relation to prospectuses and reporting to securities regulators.

**Table 7 - (Q10) Has the regulator the power to question the auditor about a public listed company?**



In the majority of the member states, the securities regulator also has the power to question an auditor about a public listed company. However, such powers may be used in different circumstances. In some cases the securities regulator has powers in respect of investigations over market manipulation. In other cases there are also some powers to question the auditor about aspects of the financial reporting information e.g. over particular disclosures.

**PART III –THE SECURITIES REGULATORS’ INVOLVEMENT IN AUDITORS’ OVERSIGHT**

**Table 8 – (Q11) Description of the securities regulator’s involvement in the following elements of auditor oversight**

	Statutory regulations concerning audit	Auditing standards	Ethic & independence standards	Quality control standards
Initiates	4	3	3	3
Comments	15	15	15	15
Approves	2	2	2	3
Interprets	3	3	4	2
Enforces	4	5	5	5
No involvement	11	10	11	11

Few securities regulators are directly involved in the elements of auditors’ oversight mentioned above. However, at least half of the securities regulators will provide input to the standard setting in each of these aspects.

Those few securities regulators who initiate the standards in these areas generally are also those who approve, interpret and enforce the standards.

Here it is important to appreciate the context in which these auditing standards are set. One reason why securities regulators are not the only bodies involved in standard setting, is that a statutory audit is required for many companies that are not listed on securities markets. Therefore standards on audit practice, quality control and auditor independence need to reflect the wider constituency.

**Table 9 – (Q12) Application of the securities regulator’s participation in any other aspects of auditor oversight**

	Yes	No
Investigation of audit failures	10	17
Inspection of public accounting firms	5	22
Inspection of audit working papers	5	22
Supervision or monitoring the conduct of peer review	3	24
Determining remedial and corrective actions / referral of violations to the body in charge of disciplinary actions.	7	20
Taking sanctions against the auditor for breaches of securities regulators	8	19
Determining remedial and corrective actions	12	15

As this table illustrates, securities regulators have very little direct involvement in auditor oversight, except in those member states where they are the auditor oversight body for listed companies. In other member states, the only area where many securities regulators are involved in the oversight activity is in determining remedial actions or the referral of violations to the body in charge of disciplinary actions.

**Table 10 – (Q13) More details of any formal relationship that exists between the securities regulator and the auditor oversight body**

The regulator is the AOB <sup>3</sup>	4
The regulator is a member of the AOB	9
Consultation between the regulator and the AOB	6
No formal relationship	8

Though the securities regulator acts as the independent auditor oversight body in only four Member States, it is a member of the Board of the auditor oversight body in another nine Member States. However, not all member states have yet developed auditor oversight bodies in accordance with the 8<sup>th</sup> Directive. This survey provides a guide to the extent of securities regulators’ involvement in auditor oversight as at October 2005. As the 8<sup>th</sup> Directive is implemented fully in member states, and auditor oversight bodies are established or further developed, it is likely that this involvement may change across CESR jurisdictions.

### **3. Conclusion**

There are a variety of practices within CESR jurisdictions regarding the involvement of securities regulators in auditor oversight. However, a clear picture seems to emerge of two models of involvement:

- In a minority of CESR jurisdictions, the securities regulator is also the auditor oversight body and directly supervises most aspects of auditing.
- In the majority of CESR jurisdictions, the securities regulators have some indirect involvement in auditor oversight, for example through membership of the auditor oversight board and/or through input to the standard setting process for auditing practices.

With respect to powers in relation to auditors of public listed companies, the majority of securities regulators are not involved in the registration, appointment, dismissal or removal of the auditors of

<sup>3</sup> In acting as AOB, two of the securities regulators focus on public listed companies



public listed companies. Four CESR members are directly involved in auditor oversight, through their responsibility for registration, inspection, enforcement and sanctions. Some CESR members, as combined regulators, in their role as banking supervisors, have specific powers with respect to the appointment, resignation and removal of auditors.

Most CESR members have powers to request information from the auditors in respect of the auditors' involvement with prospectuses.

External audit as the verification of the financial statements of public listed companies has a very important role to play in underpinning orderly securities markets. Sustaining market confidence is a key objective for the securities regulators who are members of CESR-Fin. However, many entities other than those that are listed on securities markets are required to have an audit and therefore securities regulators are not the only organizations interested in ensuring the quality of audits. Auditor oversight bodies are likely to reflect the wider constituency covered by the requirement to have a statutory audit.

Many of these auditor oversight bodies have only recently been established. With the enactment of the 8<sup>th</sup> Directive on 18<sup>th</sup> May 2006, and its implementation over the next two years, it will be interesting to see how the role of securities regulators and auditor oversight bodies develops. In particular, with the complete implementation of the Transparency and Prospectus Directives, it will be interesting to observe how securities regulators and auditor oversight bodies interpret their respective roles and organize their relationships.