

AUDITORS AUFSICHTSKOMMISSION

AUDITOR OVERSIGHT COMMISSION

Comments by the Auditor Oversight Commission on the

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 (COM (2011) 778 final; 2011/0389 (COD))

as well as on the

Proposal for a regulation of the European Parliament and of the Council on specific requirements regarding statutory audit of public interest entities (COM (2011) 779 final; 2011/0359 (COD))

I. Introduction

Since 2005 the Auditor Oversight Commission (AOC) has been carrying out the public oversight on the Chamber of Public Accountants and the associated auditors independently from the profession and not subject to any instructions. The AOC's remit comprises the professional examination and aptitude test for foreign auditors, licensing, revocation of licenses and registration, disciplinary oversight, quality assurance and the adoption of professional standards. The AOC has thereby the ultimate responsibility in Germany for the independent public oversight on statutory auditors according to Article 32 of the Directive 2006/43/EC.

On 7th December 2010 the AOC issued a statement on the Green Paper of the European Commission "Audit Policy: Lessons from the crisis". The statement can be found on the website of the AOC.¹

The AOC is making the following comments on the regulatory proposals by the European Commission (White Paper) published on 30th November 2011. The AOC comments only on those sections in the White Paper that are directly related to the remit and area of responsibility of the AOC and thereby contributes its experiences from the public oversight of the audit profession:

II. Focal points from the perspective of the AOC

Improving the audit quality is a key objective of an independent public oversight on statutory auditors. It is an essential theme in the AOC's activities which therefore welcomes the regulatory proposals by the European Commission as far as they serve the objective of improving the quality and independence of the audits. This includes in particular the proposals to strengthen the oversight on auditors of public interest entities. From the perspective of the AOC a differentiation in the requirement of the oversight on auditors of public interest entities and other statutory auditors would make sense.

¹ www.apak-aoc.de/publikationen/sonstige.asp (only available in German)

The AOC's positions on the focal points of the regulatory proposals of the European Commission can be summarised as follows:

- **Principles of public oversight**

From the perspective of the AOC there is no need to amend or supplement Article 32 of the Directive 2006/43/EC as proposed. Some provisions clarifying the direct operative responsibility of the public oversight on statutory auditors of public interest entities and the structure of such oversight would be sufficient. The EU principles of public oversight on auditors should therefore differentiate between auditors of public interest entities and other statutory auditors.

- **Prohibition of the provision of non-audit services**

Prohibiting certain "non-audit services" by the auditors of public interest entities for the audited entity is welcomed. However, from the perspective of the AOC the regulatory proposal stating that depending on a certain amount of annual audit revenues neither direct nor indirect non-audit services for public interest entities may be offered is disproportionate. A prohibition of specific services would appear to be sufficient to ensure independence.

- **Duration of the audit engagement – external rotation**

From the perspective of the AOC the benefits of an external rotation outweigh with regard to the perception of the independence of auditors of public interest entities ("independence in appearance"). The maximum term of an audit engagement, however, could generally be increased to ten years.

- **Quality assurance – "Inspections"**

In the interest of a clear regulation of responsibilities and in order to avoid double burdens and overlapping reviews, it should be clarified that auditors of public interest entities are not subject to the quality assurance system pursuant to Article 29 of the Directive 2006/43/EC if it has been ascertained that in addition to audits of public interest entities other statutory audits would also be included in the inspections according to Article 40 of the proposed regulation on a random basis.

III. 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 (Draft Directive)

1) Definition of an "audit" (Article 1 no. 2 b) of the Draft Directive)

It has been proposed to extend the definition of an "audit" for the purposes of Art. 2 a) No. 1) of Directive 2006/43/EC, by, among others, the audits of annual accounts or consolidated accounts "performed by small companies on a voluntary basis".

The new definition would considerably extend the scope of application of the Directive. Such voluntary audits of companies which are not subject to statutory audit requirements are

currently also performed by persons/professional groups that are not licensed as auditors for the purposes of Directive 2006/43/EC (e.g. tax advisors). The new definition would subject this kind of service and other persons/professional groups completely to the requirements of the Directive 2006/43/EC, for instance in view of qualifications, licencing, the performance of audits (application of international audit standards), professional oversight and quality assurance. Such voluntary audits would have to be integrated for example in the quality assurance system pursuant to sections 57a ff. WPO (= Article 29 of the Directive 2006/43/EC).

From the viewpoint of the AOC it is questionable whether broadening the definition is necessary, taking into account the interference in the professional freedom of those concerned and the increased burden for the public oversight bodies. It is also questionable in what way this is required for the protection of public interests.

Moreover, according to the proposals, voluntary audits of companies would not be included in the proposals on simplified audits (Article 1 no. 20 Draft Directive) since the new Article 43b (small companies) would only refer to audits *required* by the member states, i.e. statutory audits according to the law of the member states.

2) Providing quality assurance reports to interested parties (Article 1 no. 14 a) iii) of the Draft Directive)

The sub-paragraph to be added after Article 29 k) in the version of the Draft Directive proposes that quality assurance reports have to be made available by the public oversight bodies to “interested parties“ upon request.

The AOC generally promotes more transparency in terms of public oversight. The term “interested parties“ is, however, completely nondescript so that a general obligation to publish must be assumed here. Since this involves dealing with fundamentally sensitive information, more clarity appears necessary in this respect, including which circle of persons is meant, which parts of the report are to be published or possibly even generally have to be published, whereby a differentiation could be made between findings with regard to the audit firm's system of quality control and findings on the performance of individual audit engagements (cf. in addition also the explanations under IV. 11)).

3) Principles of public oversight (Article 1 no. 15 and 16 of the Draft Directive)

The proposed new version of Article 32 of the Directive 2006/43/EC and the introduction of a new Article 32a provide for extensive amendments to the system of independent public oversight.

Up until now, Directive 2006/43/EC has provided for a “system of public oversight for the audit profession“ that also permits a delegation of the oversight functions mentioned in Article 32 to different bodies. According to the proposal made by the European Commission, an “authority“ (in terms of a publicly commissioned body) would be exclusively responsible for these functions both directly and operatively. The new version would not allow for any delegation of tasks. A delegation would only be permissible according to the new Article 32a with regard to the approval and registration (Article 1 no. 16 Draft Directive).

This proposal would have a significant impact not only on the German oversight system and would exclude any kind of (responsible) participation in public oversight, apart from approval and registration by the Chamber of Public Accountants (WPK) which is a corporation under public law in Germany.

It is true that the AOC has indicated, inter alia in its annual work reports, that the German oversight system is in need of reform. However, in its considerations the AOC always emphasised that only the reorganisation of responsibilities for the professional oversight of auditors of public interest entities (i.e. in Germany listed entities (section 319a HGB (German Commercial Code))) is of special significance. However, the structure of the oversight system can and should differentiate between these auditors and other statutory auditors.

The aforementioned need to reform the German oversight system essentially results from the Directive 2006/43/EC since the German system had been established in 2005 even before the introduction of the Directive. It also results from the further development of a standing international practice in the field of the oversight on auditors of public interest entities.

From the perspective of the AOC there is no need to amend or supplement Article 32 of the Directive 2006/43/EC as proposed. Some provisions as “add-ons“ to clarify the responsibility of the public oversight on statutory auditors of public interest entities and the structure of such oversight would be sufficient, as for example in Article 35 ff. of the proposed regulation on specific requirements of the audit at public interest entities (Draft Regulation).

The EU principles of public oversight on auditors should therefore differentiate between auditors of public interest entities and other statutory auditors.

A (responsible) participation of organisations related to the profession or a statutory delegation of supervisory functions to such organisations under the ultimate responsibility and ultimate decision-making competence of a body independent of the profession is still a reasonable option in the opinion of the AOC, limited to the audits of non-public interest entities. The participation of the profession in the oversight not only causes a joint responsibility to ensure and assert the quality of statutory audits. It also enables an efficient and unbureaucratic oversight in terms of costs and facilities for the broad range of the audit profession.

4) Cooperation with auditors' oversight bodies in third countries (Article 1 no. 23 of the Draft Directive)

It is proposed pursuant to Article 47 paragraph 2 lit. b) of the Directive 2006/43/EC to add a new letter ba), according to which the exchange of work papers and other documents with third country authorities shall not undermine the protection of commercial interests of the audited entity.

From the perspective of the AOC it is questionable whether this would establish a new obstacle when exchanging confidential information with third country authorities; the term “commercial interests“, providing they go beyond the protection of rights to industrial and intellectual property, is also very broadly defined and could only be fulfilled with difficulty, meaning that the auditors' oversight body would have to coordinate each individual case with the audited entity.

Due to the comprehensive obligations of secrecy to which the auditors' oversight bodies are themselves subject, commercial secrets are sufficiently protected. To what extent third country authorities could guarantee a sufficient level of protection is exhaustively assessed by the European Commission in the preparation of adequacy decisions according to Article 47 paragraph 3 of the Directive 2006/43/EC. Furthermore, when making inquiries, third country authorities must substantiate according to Article 47 paragraph 2 of Directive 2006/43/EC why the requested information is necessary to fulfil their tasks. Only such information will be ultimately transferred.

Regarding the relationship between Article 47 in the version of the Draft Directive and Article 13 of the Draft Regulation, see also the explanation under item IV. 3).

5) Miscellaneous

Registering and overseeing third country auditors (Article 45, 46 of the Directive 2006/43/EC)

The Draft Directive does not provide for any significant changes to the regulations for the registration and oversight of auditors from third countries.

The AOC proposes excluding auditors approved in the EU from the definition of "third country auditors" for the purposes of Article 2 no. 3 and 4 of the Directive 2006/43/EC (also in the version according to the Draft Directive) and with this from the obligation of registration and oversight according to Article 45 of the Directive 2006/43/EC. Alternatively, it could be clarified that audits carried out by auditors approved in the EU for companies that have their registered offices outside of the EU and whose securities are traded at a regulated market in the EU are subject only to the oversight, including quality assurance procedures, in their home countries. Assuming the home country principle, it is not comprehensible why publicly overseen auditors already approved in the EU should be subject to further registration and oversight in another EU member state. This is particularly the case if for example, according to the new Article 3a, 3b (Article 1 no. 4 Draft Directive) even audits of listed companies could be temporarily or occasionally performed by persons approved in other member states or if the approval of audit firms according to Article 3b in another member state could be achieved in a simplified procedure. In addition, Article 47 paragraph 3 of the Draft Regulation also provides for the member states not being able to impose any further requirements on the auditor of public interest entities in the cases where the registered office of the audited company and trading centres of the securities are not identical. Taking into account the simplified regulations on providing cross-border services as well as licensing in other member states, it also needs to be clarified which oversight body in general is responsible for the audits affected by Article 45 of Directive 2006/43/EC, if these are provided by an auditor licensed in the EU (either the home country of the EU auditor or member state/s, in which the securities of the company registered in a third country are traded).

The European Commission is currently conducting further assessments on the equivalence of the oversight systems in third countries on the basis of Directive 2006/43/EC. The benchmark is thereby the principles of public oversight from Article 32 of the current Directive 2006/43/EC. With this, the European Commission is setting standards which it questions itself with the new regulatory proposals (cf. above III. 4)), for example with regard to the majority conditions in the

oversight and the absolute independence of the oversight from the profession. Consequently, oversight systems in third countries, which would still be recognised today as equivalent could no longer be equivalent in terms of the Community Law in three to five years after the implementation of the regulatory proposals. Against this background, the European Commission should check whether further equivalent assessments make sense at present.

IV. Proposal for a regulation of the European Parliament and of the Council on specific requirements regarding statutory audit of public interest entities (Draft Regulation)

1) Audit fees – coordination with public oversight bodies (Article 9 of the Draft Regulation)

Article 9 paragraph 3 of the Draft Regulation provides for a limit of the total fees received from a public interest entity in relation to the total annual fees received by an audit firm. This type of regulation is to be welcomed to ensure economic independence.

At the same time it is planned that, when reaching a certain fee share, the audit committee of the audited entity and the responsible auditors' oversight body have to be informed. The threshold values thereby deviate slightly from each other (information by the audit committee, among others, at "more than 15%", i.e. "greater than 15%" and information by the auditors' oversight body at "15% or more", i.e. "greater than/equal to 15%"). An adjustment would make sense.

2) Prohibition of the provision of non-audit services (Article 10 of the Draft Regulation)

Article 10 paragraph 3 of the Draft Regulation provides for a prohibition on the provision of certain "non-audit services" by the auditors of public interest entities. In Germany, auditors of public interest entities in particular are already subject to a prohibition in providing certain non-audit services. The regulatory proposal is essentially consistent with these bans and is welcomed in this respect.

Furthermore, article 10 paragraph 5 of the Draft Regulation provides for non-audit services not being allowed to be provided by auditors for public interest entities neither directly nor indirectly from a certain amount of annual audit revenues. From the viewpoint of the AOC, this type of regulation is disproportionate in view of the considerable consequences for the affected firms (economic and personnel-related). To ensure independence, a prohibition of specific services like in Article 10 paragraph 3 of the Draft Regulation appears to be sufficient and also appropriate because this interferes far less with the professional freedom of those concerned.

In addition to the regulatory proposals the AOC suggests to restrict the ratio of audit and non-audit fees that may be received from *one* client. The total fees charged by the auditor are already published today, itemised by the audited company according to services for the purposes of Article 43 paragraph 1 no. 15 of Directive 78/660/EEC. However, there is no clear, enforceable regulation that could justify an intervention by the oversight body in the case of a significant discrepancy between audit and non-audit services provided for *one* client which would result in a possible danger for the economic independence of the auditor.

3) Transfer of documents to third country auditors and third country authorities (Article 13 of the Draft Regulation)

Article 13 paragraph 2 of the Draft Regulation provides for auditors being allowed to transfer work papers and other documents to the responsible third country authorities “under conditions determined in Article 47 of Directive 2006/43/EC“. Article 47 paragraph 4 of Directive 2006/43/EC provides for this being permissible inter alia only in exceptional cases and only in connection with investigations. Within the meaning of regulatory clarity, the reference could be made more precise in Article 13 paragraph 2 of the Draft Regulation.

4) Audit of the consolidated accounts (Article 18 of the Draft Regulation)

Article 18 paragraph 2 of the Draft Regulation provides for the group auditors having to inform the auditors’ oversight body when the fulfilment of certain obligations in connection with third country auditors is not possible according to Article 18 paragraph 1 sub-paragraph 1 letter c) of the Draft Regulation. It remains unclear why such information is necessary. The group auditor already has to document this situation, to perform additional audit procedures as far as possible, and finally to assess to what extent sufficient audit evidence exists to support his opinion and which effect the situation has on his (overall) opinion. The obligation to inform the auditors’ oversight body would merely lead to an additional administrative burden for all those involved without the quality of the audit being increased or the oversight being facilitated.

5) Reporting to the authorities responsible for the oversight of public interest entities (Article 25 of the Draft Regulation)

Going beyond the regulation inter alia in Article 55 of the Directive 2004/39/EC and Article 53 of the Directive 2006/48/EC, Article 25 of the Draft Regulation provides for a more comprehensive duty of the auditor to notify the competent authorities responsible for the oversight of the public interest entities. However, when introducing such extensive disclosure requirements for the auditor, the advantages and disadvantages of a restriction of the obligation of secrecy on the part of the auditor in relation to the interests of the public for more transparency would have to be carefully considered. From the AOC’s point of view, however, it is doubtful whether this makes sense and is necessary except for audits of banks and financial services institutes.

It seems to be more appropriate to introduce duties of cooperation by the auditor in the framework of the accounting oversight (enforcement), such as for example in Germany duties towards the German Financial Reporting Enforcement Panel or the German Federal Financial Supervisory Authority (see for example section 370 paragraph 4 sentence 2 WpHG (German Securities Trading Law)).

6) Duration of the audit engagement – external rotation (Article 33 of the Draft Regulation)

Article 33 of the Draft Regulation provides for restrictions in the duration of audit engagements, which would generally lead to an external rotation of the auditor after six years or after nine years in the case of a joint audit. A four-year cooling-off phase applies in this respect.

In the case of introducing the external rotation, possible advantages with regard to the perception of the independence of the auditors (“independence in appearance”) would have to

be weighed against possible negative impacts for the audit quality due to the increased risk in the case of a first time audit of a new auditor.

From the perspective of the AOC, the benefits of an external rotation predominate with a view to the perception of the independence of the auditor. However, a restriction of the maximum term to six years appears to be too short. The term should be generally increased to ten years. It should thereby be taken into account that in the case of each mandatory rotation the current auditor would take special care with a “fresh, sceptical look”, particularly towards the end of the term with a view to transferring the engagement to another audit firm.

Article 33 paragraph 3 of the Draft Regulation provides for the responsible auditors' oversight authority to be able to extend the maximum term in exceptional cases. In the case of an extension of the maximum term to ten years, this kind of exceptional regulation would not be necessary. If this kind of exceptional regulation remains, the way it is handled in practice could turn out to be problematic if the exceptional (“hardship”) cases are not specified any further. In addition, a consistent approach by the oversight bodies in the member states would have to be guaranteed. If this regulation is endorsed, the development of guidelines to implement Article 33 paragraph 3 of the Draft Regulation should be included in the catalogue of Article 46 paragraph 3 of the Draft Regulation (coordination through ESMA).

7) Surveillance of the activities of auditors and audit firms of public interest entities (Article 35 et seqq. of the Draft Regulation)

Competent authorities (Article 35 of the Draft Regulation)

Article 35 paragraph 1 of the Draft Regulation lists independent bodies who should be primarily responsible for the oversight on auditors of public interest entities, which includes also the competent authority referred to in Article 32 of the Directive 2006/43/EC.

From the perspective of the AOC it would make sense if the authority competent for the oversight on auditors of public interest entities is the same as the competent authority having the ultimate responsibility for the purposes of Article 32 of Directive 2006/43/EC. By this, the specific expertise for the oversight body would be concentrated in one unit which would essentially contribute towards efficiency and effectiveness.

Article 35 paragraph 2 of the Draft Regulation lists further bodies that could be entrusted with the oversight, either fully or partially. The list also includes the bodies according to Article 35 paragraph 1 letters a) and b) of the Draft Regulation, however not the body according to letter c), i.e. the competent authority referred to in Article 32 of the Directive 2006/43/EC. It is presumed that this is an editorial error; in any case, it is not clear what would prevent an inclusion of that competent authority in the list. In addition, the competent authority referred to in Article 32 of Directive 2006/43/EC is not included in the cooperation with other responsible authorities on a national level according to Article 39 of the Draft Regulation, since this merely refers to Article 35 paragraph 2 of the Draft Regulation under letter b).

Article 35 paragraph 2 letter h) of the Draft Regulation refers to an “Article 97 of Directive 2009/110/EC”, which does not exist.

Powers of the competent authorities (Article 38 Draft Regulation)

Article 38 of the Draft Regulation contains provisions on ensuring the supervisory and investigatory powers of the competent authority for the auditors of public interest entities. These provisions are welcomed.

However, the provisions in Article 38 paragraph 2 letters c) and d) are unclear. Letter c) contains a circular reasoning. In the case of letter d) it is unclear whether “application“ refers to support provided by the judicial authorities (for example judicial enforcement of powers with regard to auditors subject to the oversight).

Cooperation with other competent authorities at national level (Article 39 of the Draft Regulation)

Article 39 of the Draft Regulation states that the competent authorities responsible for auditors of public interest entities should work together with other authorities, in particular the accounting enforcers (for example financial service authorities, banking supervisors). This is expressly welcomed.

However, it should be clarified that in order to perform the respective tasks and to ensure a mutual flow of information, it must also be possible to exchange information subject to confidentiality.

8) Quality assurance – “Inspections“ (Article 40 Draft Regulation)

Article 40 of the Draft Regulation describes the tasks performed by the competent authorities for auditors of public interest entities in connection with regular quality assurance procedures (inspections) and with this essentially the procedure according to the relevant Recommendation 2008/362/EC of the European Commission issued on 6th May 2008. A binding guideline of this procedure is welcomed.

However, a clarification of the relationship between the procedure according to Article 40 of the Draft Regulation and the quality assurance system according to Article 29 of the Directive 2006/43/EC would be useful.

Pursuant to Article 1 of the Directive 2006/43/EC in the version of the Draft Directive (cf. Article 1 no. 1 of the Draft Directive), Article 29 of the Directive 2006/43/EC does not apply to *audits* of public interest entities, i.e. it is an exception linked to a particular type of audit, but it is not connected to the person of the *auditor*.

Auditors of public interest entities, however, also perform other statutory audits, so that they would be subject to the procedure according to Article 40 of the Draft Regulation as well as to that according to the Directive with the respective audits.

In the interest of a clear regulation of responsibilities, to avoid double burdens and overlapping reviews (in particular with regard to audit firms’ policies and procedures (“firm review”)), it should be clarified that auditors of public interest entities are not subject to the quality assurance system pursuant to Article 29 of the Directive 2006/43/EC if it has been ascertained

that in addition to audits of public interest entities other statutory audits would also be included in the inspections according to Article 40 of the proposed regulation on a random basis.

9) Market monitoring (Article 42 Draft Regulation)

Article 42 of the Draft Regulation provides for a procedure on market monitoring where the competent authorities would be obliged to a regular reporting to ESMA, EBA and EIOPA. In order to guarantee consistent reporting by the competent authorities in the member states, the development of relevant guidelines should be included in the catalogue of Article 46 paragraph 3 of the Draft Regulation (coordination by ESMA).

10) Contingency planning (Article 43 of the Draft Regulation)

Article 43 of the Draft Regulation provides for the development of contingency plans at least by the six largest audit firms of large public interest entities in each member state. In this respect the competent authorities would be required to publish annually a list of the six largest audit firms. The contingency plans are to be transmitted to the competent authority which does not officially approve them. However, it can submit a statement, also on the drafts.

From the perspective of the AOC, it is not yet clear which benefits the development of such contingency plans would have and to what extent this could contribute towards the safeguarding the continuity of the audits and their quality.

11) Transparency of competent authorities (Article 44 of the Draft Regulation)

Along with the annual publication of activity reports, work programmes and overall results on the quality assurance procedures (inspections) by the competent authorities, Article 44 of the Draft Regulation also provides for a publication of individual findings and conclusions from the inspections.

The AOC supports the proposals for more transparency on the findings of the inspections. However, the regulation on the publication of individual inspection results in Article 44 letter d) of the Draft Regulation needs to be clarified.

Inspections by competent authorities lead to findings and conclusions of different significance. On the one hand, they concern the audit firms' internal systems of quality control and on the other hand the performance of audit engagements and compliance with relevant standards.

Today, the inspected audit firms are already informed of all findings and conclusions from the inspections, as it is intended in Article 40 paragraph 6 of the Draft Regulation. However, only significant findings and conclusions from an individual inspection should be published according to Article 44 letter d) of the Draft regulation.

In addition, it should be clarified what category of findings should be published, i.e. whether only the significant findings and conclusions with regard to the system of quality control should be published or also significant findings with regard to the performance of an individual audit engagement (either anonymised or by stating the audited entity). Whilst a general publication of the findings and conclusions with regard to the system of quality control would be justifiable since they concern the inspected audit firm only, a general publication of the

findings on the performance of an individual audit engagement could impair the interests of the audited entity. This is in particular relevant when the findings do not necessarily question the correctness of the audit opinion and consequently do not indicate any errors on the accounting side.

Furthermore, it could be considered to publish significant findings and conclusions only when the concerned audit firm has not taken measures to remediate detected deficiencies within the twelve-month period referred to in Article 40 paragraph 6 of the Draft Regulation. Here, a difference could also be made between both categories of findings (i.e. with regard to the system of quality control or the performance of an audit engagement).

12) Coordination through ESMA (Article 46 of the Draft Regulation)

Article 46 of the Draft Regulation provides for the cooperation between the competent oversight authorities for auditors of public interest entities being organised through ESMA. The Draft Directive also provides for a coordinating role of ESMA in questions of licensing as well as adopting International Standards on Auditing (ISA) (Article 6, 14 and 26 of the Directive 2006/43/EC in the version of the Draft Directive). For this purpose, ESMA would establish a permanent internal committee pursuant to Article 41 of the Regulation (EU) No. 1095/2010, which comprises the competent authorities for auditors of public interest entities. The competent authorities referred to in Article 32 of the Directive 2006/43/EC would only be invited for certain questions depending on the agenda.

Today the AOC is already very much involved in the promotion and coordination of direct institutional cooperation between the auditors' oversight bodies in the European Economic Area.

However, it is questionable whether establishing a permanent internal committee according to Article 41 of the regulation (EU) No. 1095/2010 can guarantee that the European auditors' oversight bodies will be able to organise their cooperation as well as their very own affairs independently and without any instruction by third parties, or to what extent other bodies in ESMA are able to decide (ultimately) on matters of auditor oversight. In the member states, the majority of the public auditors' oversight bodies are organised independently from the securities regulators. In this regard, the experience and the expertise from auditor oversight do not necessarily lie with the bodies represented in ESMA. From the perspective of the AOC it must therefore be clarified that the permanent internal committee of the auditors' oversight bodies can decide autonomously and independently within ESMA in matters referring to statutory audits. If this cannot be guaranteed within ESMA, the AOC advocates establishing an independent organisation of European auditors' oversight bodies as a "level 3 committee".

The provision that the competent authorities referred to in Article 32 of the Directive 2006/43/EC (providing they are not also responsible for the oversight of auditors of public interest entities) shall only be invited to certain agenda points of the meetings of the permanent internal committee should be reconsidered. Beyond the licensing, registration and relationship to third countries, there are possible further topics to which these authorities could contribute their expertise as well as valuable experience. In this respect it should be regulated that the internal committee may also be able to invite the competent authorities referred to in Article 32 of Directive 2006/43/EC if required on other agenda items of mutual

interest. This is all the more relevant if ESMA takes on all existing and ongoing tasks of the European Group of Auditors' Oversight Bodies (EAOB) according to Article 46 paragraph 1 sub-paragraph 4 of the Draft Regulation, since otherwise the competent authorities solely responsible for the purposes of Article 32 of the Directive 2006/43/EC would have no other European platform to coordinate their tasks or to share experiences.

Reference is made to items IV. 6) and 9) to include further topics in the catalogue of Article 46 paragraph 3 of the Draft Regulation (development of guidelines).

13) Exchange of information (Article 48 of the Draft Regulation)

Article 48 paragraph 1 of the Draft Regulation provides for an exchange of information between the "competent authorities referred to in Article 35". The AOC assumes that rather the "authorities responsible for the oversight of auditors of public interest entities according to Article 35" are meant here since otherwise all institutions mentioned in Article 35 of the Draft Regulation – irrespective of their responsibility according to the regulation – would be included in the mutual information obligation (even amongst each other).

14) European Quality Certificate (Article 50 of the Draft Regulation)

Article 50 of the Draft Regulation provides for the introduction of a European Quality Certificate which will be issued by ESMA in agreement with the competent authority of the member state concerned upon request by an audit firm. This is meant to be a voluntary measure.

Issuing this certificate raises serious concerns from the point of view of the AOC. It is at least questionable whether this offers the users of the audit an added value when simultaneously the results of individual inspections according to Article 44 paragraph 6 Draft Regulation would be published.

In addition, this certificate, which would only be awarded to auditors of public interest entities according to the proposal, could make access to this market segment even more difficult for other auditors since companies might insist on such a certificate when appointing an auditor. Moreover, the certificate could also serve the auditors of public interest entities as a competitive advantage over other auditors even in the market segment regarding non-PIEs.

Even if this is a voluntary measure, it can be assumed that a large majority of auditors of public interest entities will endeavour to acquire this certificate for marketing reasons, irrespective of the cost of such a certificate. This would lead to a significant strain on personnel for ESMA and the concerned auditors' oversight bodies, whereby it is doubtful whether this would be justifiable considering the benefit of such a voluntary certificate.

In addition the question must be raised to what extent ESMA – and indirectly also the competent authority of the member state concerned – would be accountable for the audit quality of the concerned firm with the certification. Even if this was not intended or even if this would be explicitly excluded, it is very likely that there will be a corresponding expectation by the public.

15) Colleges of competent authorities (Article 53 of the Draft Regulation)

Article 53 regulates the establishment and organisation of colleges of regulators.

The AOC supports the establishment of colleges and is already actively involved in a number of such colleges, which were set up by the competent authorities, for example with regard to KPMG Europe LLP and Ernst & Young Europe LLP, i.e. audit firms integrated on a European level.

From the perspective of the AOC, however, the establishment and organisation of colleges should not be formalised too much. The auditors' oversight bodies should have in this respect the greatest possible freedom in organizing the colleges including the choice of topics in terms of a quick, efficient and uncomplicated cooperation, which is precisely the advantage of such type of cooperation.

If a detailed listing of the areas in which colleges can be set up is required at all, reference should be made to Article 53 paragraph 1 of the Draft Regulation as well as to Article 49 of the Draft Regulation (cooperation in quality assurance procedures).

16) Cooperation with third country authorities (Article 57 et seqq. of the Draft Regulation)

Agreement on exchange of information (Article 57 Draft Regulation)

Pursuant to Article 57 paragraph 1 of the Draft Regulation, the competent authorities of the member states and ESMA may enter into cooperation agreements with third country authorities.

The question is raised here as to what extent ESMA may enter into agreements on the exchange of information with responsible bodies from third countries without itself being responsible for the oversight of the auditors. In addition, the question must be raised whether such an agreement would take precedence over the bilateral agreements of the competent authorities in the member states.

The confidential information ESMA has in its possession would come from the competent authorities in the member states only. Based on their operative responsibility they should also agree themselves directly the type and scope of the cooperation with responsible bodies from third countries. ESMA or the permanent internal committee according to Article 46 paragraph 1 sub-paragraph 2 of the Draft Regulation could, however, play a coordinating role.

Disclosure of information received from third countries (Article 58 of the Draft Regulation)

Article 58 of the Draft Regulation regulates the conditions under which confidential information received from third country authorities can be disclosed.

From the perspective of the AOC, it must be ensured that such a regulation does not impair the exchange of information and the cooperation between the competent authorities on a national as well as a European level.

Disclosure of information transferred to third countries
(Article 59 of the Draft Regulation)

Article 59 of the Draft Regulation regulates the conditions under which confidential information which the competent authorities in the EU have transferred to third country authorities may be disclosed. Explicit prior consent is necessary in this respect.

First, it should be noted that the term “disclosure” used in the English version of Article 58 as well as Article 59 of the Draft Regulation is translated in the German version of Article 58 of the Draft Regulation with “publication“ and in Article 59 of the Draft Regulation with “transfer“.

Second, from the experience of the AOC it is to be pointed out that such a consent-based regulation leads to difficulties in practice when the laws of the third country require a mandatory transfer of information to certain bodies in that third country. Since a transfer of confidential information to third countries always requires an adequacy decision by the European Commission in accordance with Article 47 paragraph 3 of Directive 2006/43/EC (cf. Article 57 paragraph 3 of the Draft Regulation), it would be assessed already in preparation of such a decision as to what extent an obligation of the third country authority exists to transfer information to another body in that third country and to what extent this meets the adequacy requirements. Should the adequacy be then confirmed, it is well acceptable that the third country authority transfers such information to another body in the third country based on its statutory obligations.

17) Publication of sanctions and measures (Article 64 of the Draft Regulation)

Article 64 of the Draft Regulation provides for a publication by name of sanctions and measures against auditors of public interest entities.

From the perspective of the AOC, a general publication appears to be disproportionate as it is trading off the public interest in transparency against the privacy rights of the concerned auditors. However, from the AOC’s point of view, a publication by name may be considered in case of a severe breach of professional duties .

It should also be taken into account that according to Article 61 of the Draft Regulation each member states would determine nationally how breaches should be sanctioned, i.e. there would be no common European framework or benchmark to determine sanctions. A general obligation to publish sanctions and measures according to Article 64 of the Draft Regulation could then, however, create a wrong impression with regard to the adherence to the professional duties by auditors in the member states.

The provisions in Article 64 sub-paragraph 2 of the Draft Regulation as well as Article 67 paragraph 2 of the Draft Regulation on the reporting of imposed sanctions and measures to ESMA are redundant in the proposed form. Article 67 paragraph 2 of the Draft Regulation refers to “measures, sanctions and fines disclosed to the public”, whereby according to Article 64, each sanction and measure would have to be published anyway, albeit in exceptional cases on an anonymised basis.