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EUROPEAN ATOMIC ENERGY
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ECONOMIC AND SOCIAL COMMITTEE

DOSSIER IND/84 EIGHTH DIRECTIVE

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REPORT

of the Section for Industry, Commerce, Craft and Services

on the

Proposal for an Eighth Directive pursuant to

Article 54(3)(g) of the EEC Treaty

concerning the Approval of Persons responsible

for carrying out Statutory Audits of the

Annual Accounts of Limited Liability Companies

(Doc. COM (78) 168 fin)

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CES 1121/78 fin

I. GENERAL

1. The Section considers that the draft Directive under review is a logical follow-up to the Commission's proposal for a Statute for European Companies, the fourth Directive on the annual accounts of limited liability companies and the draft fifth and seventh Directives on group accounts and the structure of sociétés anonymes. These documents already specify that the accounts of the relevant companies are to be audited by specially authorized persons. It is thus logical to submit a draft Directive on the approval of auditors (*).

2. The obligation on limited liability companies to have their annual accounts checked by independent, qualified persons is a protection for shareholders and third parties. The draft eighth Directive lays down minimum requirements as to the independence and professional qualifications of auditors of annual accounts, the purpose being to ensure equivalent minimum protection for shareholders, workers, third parties and the public in all member countries. Having regard to the current differences in the rules and regulations of the member countries, the Study Group endorses this aim. However, implementation of the Directive should not, without due cause, lead to an easing of requirements in the Member States with more stringent authorization standards.

(*) The term "auditors" is used, in the interests of simplicity, to mean "persons responsible for carrying out statutory audits of the annual accounts of limited liability companies".

3. The Section welcomes the stringency of the requirements laid down by Articles 4 and 5 of the draft Directive with respect to the qualifications of auditors. The Section considers this to be absolutely vital, since auditors must have a high level of theoretical knowledge and practical ability if statutory audits of limited liability companies are to provide a real protection. The Section therefore accepts the principle, laid down in the draft Directive, that statutory audits may be carried out only by persons who have "passed an examination of professional competence at graduate or an equivalent level of training".

3.1. A number of members stressed the need for a high level of qualifications, but doubted whether the draft Directive will guarantee a high level. The draft Directive dealt with the question of examinations of professional competence in very general terms, so that there was no guarantee that examination requirements would be the same throughout the Community. Furthermore, the transition arrangements were very liberal; if the Member States exploited all their possibilities, the draft Directive's aim of a minimum protection throughout the Community might be jeopardized.

4. A vital element in auditors' qualifications is independence. The Section realizes the difficulties involved in a legal definition of "independence". It nevertheless considers that the authors of the draft Directive were right to try and lay down criteria for the independence of auditors of annual accounts.

5. The Section endorses the draft Directive, subject to the specific comments given below.

II. SPECIFIC COMMENTS

1. Article 1

1.1. The draft Directive under review applies only to persons responsible for statutory audits of the types of company specified in Article 1. At first sight this is logical, given the links between the draft Directive under review, the fourth Directive and the draft fifth and seventh Directives. However, there is a disadvantage. If the Community adopts further Directives under EEC Treaty Article 58(2), prescribing audits for the annual accounts of other types of company, it will be necessary to make special arrangements for the authorization of persons to carry out such audits.

The Section thinks this would be too complicated. It considers that Article 1 should be reworded to extend the draft Directive to include the authorization of persons responsible for carrying out statutory audits of the annual accounts of companies under subsequent Directives.

1.2. A number of members point out that several Member States stipulate audits of the annual accounts of types of companies not mentioned in Article 1. If the present list is retained, two types of auditors for compulsory audits might be recognized in these Member States - the recognition of one type being governed by the draft

Directive and that of the other by municipal law. The members in question propose that the draft Directive should cover all companies within the meaning of EEC Treaty Article 58 (second paragraph) which are required to have their annual accounts audited.

1.3. A number of other members endorse this proposal, with the qualification that if it is accepted Member States should be entitled to lay down exceptional arrangements for certain companies.

1.4. Other members disagree. They point out that so far Community Directives only prescribe statutory audits for the types of company mentioned in Article 1. It is therefore logical for the draft 8th Directive to be confined to the authorization of persons entrusted with such audits. Furthermore, any Member State can broaden the scope of the draft Directive if it wishes. Indeed, in the interests of future alignment it is desirable to apply the draft Directive to persons entrusted with statutory audits under municipal law. However, this must be left to the Member States.

1.5. Another group of members argues that for practical reasons it may be fair to lay down varying requirements for those responsible for statutory audits. For instance, there is a difference between companies using a commercial accounts system and those using administrative accounting. Accordingly, this group of members feels that the possibility of two types of auditors should not be ruled out.

2. Article 2

2.1. The Section considers that legal persons and other types of professional companies and associations should be allowed to carry out statutory audits only if a number of special conditions are satisfied. The Section therefore welcomes the fact that the Commission has laid down special conditions in Article 2. However, the following detailed changes should be made :

- a) The Section endorses the rule that when a professional association or professional company has to select persons to audit the annual accounts of a limited liability company, such selection may be effected solely by persons who meet the requirements of the draft Directive (Article 2 (2, first indent)). However, the phrase "appointment or removal" is misleading since it seems to refer to appointment or removal by the competent bodies of the company whose accounts are being audited. The clause in question should be clarified to make it clear that it refers to the internal selection procedure of the professional association or company providing the auditor.

- b) The Section accepts that the second indent of Article 2(2)(a) is proposed because of the situation at present obtaining in a number of Member States. Thus the provision is doubtless unavoidable. The present wording means, however, that up to the entry into force of implementing measures, it will be possible to form professional companies and associations in which persons not authorized to carry out statutory audits have a majority holding. It is only after the implementing measures come into

force that the formation of such companies and associations will be prohibited and persons who are not authorized auditors will not be allowed to enlarge their holdings in existing companies and associations so as to acquire a majority of their capital.

The Section has doubts about the wisdom of allowing so much time to elapse before the ban becomes effective. It fears that the announcement of an impending ban might stimulate an undesirable trend. Attempts should be made in liaison with the Member States to prevent this happening.

The Section also points out that a majority of voting rights, as well as a majority capital holding, can confer control. The Section recommends that the clause be amended accordingly.

- c) The Section agrees that, in the interests of the company whose accounts are being audited, it is necessary to ensure that audit reports and documents relating thereto do not come to the knowledge of unauthorized persons, and that their confidentiality is protected.

However, statutory auditing by professional companies and associations will be seriously impeded by the present wording of the third indent, of Article 2(2)(a), since it makes it impossible to call in specialists such as data-processing experts,

statisticians, etc. This cannot be the purpose of such a protection clause. The Section therefore proposes deleting the phrase "and that these are withheld from the knowledge of the abovementioned persons". The Section considers that it is quite sufficient if the confidentiality of audit reports and related documents is protected.

2.2. A number of members like the Section as a whole, accept ~~the compromise laid down in the second indent of Article 2(2)(a).~~ But they want a number of conditions to be specified in addition to those proposed by the Section. These members consider that (a) within a period to be laid down, professional companies and firms not caught by the ban must show the appropriate authorities that their memorandum of association and rules, and/or the rules of the professional organization to which they are affiliated, ensure the practical independence of natural persons entrusted with the audit of annual accounts; (b) the draft Directive must stipulate that, after a transition period, members of the profession must have a majority in all companies.

2.3. Other members are opposed in particular to the last request made by the above-mentioned members. They stress that there are no grounds for doubting the independence of existing professional companies or associations in which a majority of the capital is held by persons who are not authorized auditors. Such a move would call into question the compromise that has been laboriously achieved and perhaps the entire draft Directive.

2.4. Yet other members doubt whether it is right to prohibit in absolute terms majority holdings in professional companies or associations by persons who are not authorized auditors. These members consider such a prohibition to be expedient as far as private individuals are concerned, but they think that the required independence is definitely guaranteed in the case of professional companies or associations in which the State has the say, so that the possibility of forming State-controlled professional companies must be kept open.

3. Article 3

3.1. As already stressed in the General Comments, the Section considers independence to be an essential element in an auditor's qualifications. The same applies to good repute. The term "persons of good repute" used in this Article will not in the Section's view give rise to any major difficulties of interpretation, but the word "independent" could be misconstrued in such a way that only self-employed persons would qualify for approval. In the part of the Explanatory Memorandum dealing with Article 3, the Commission states that "the role of an auditor can be said to be incompatible with any activity which is of a kind that may limit his independence". The Section therefore suggests that no reference be made to independent persons in Article 3, and that the independence of auditors be dealt with solely in Article 11.

3.2. Some members point out that, although in all Member States independence is a prerequisite for carrying out a statutory audit, this is not universally the case when auditors are first authorized. These members consider that the provisions proposed for Article 11 guarantee

the independence they too regard as essential. It is not therefore necessary, in their view, to make any reference to independence in Article 3.

4. Article 4(1)

4.1. In the Section's view, a high level of professional competence is needed to carry out the tasks of an auditor. The Section points out that the requirements laid down in this and the following Articles are minimum ones and that some Member States have more stringent requirements. It also notes that the methods of training differ greatly from one Member State to another.

After giving due consideration to all the various aspects, the Section comes to the conclusion that, viewed overall, the provisions of this paragraph are reasonable. They guarantee a sufficient level of competence on the part of those entrusted with statutory audits.

4.2. Some members draw particular attention to the differences between the Member States' training methods and stress that this paragraph lays down only the level of training and not the actual training courses.

4.3. Other members feel that the phrase "or an equivalent" should be deleted. This would emphasize that the examination of professional competence must be at graduate level, but that it is not necessary for candidates to have carried out the relevant studies at a university.

5. Article 4(2)

5.1. The Section points out that Article 4(2), read in conjunction with Article 4(1) and Article 5(1) (3) and (4), is unclear. Article 4(1)

talks of an examination of professional competence, while Article 4(2), by referring to Article 5, which deals separately with the testing of theoretical knowledge and the testing of practical knowledge, gives the impression that there are to be two separate tests. The derogation provisions of Article 5(4) strengthen this impression.

5.2. After detailed discussion, the Section considers that there should be one examination of professional competence, which would simultaneously cover both theoretical and practical knowledge. The Section urges the Commission to clarify Articles 4 and 5 on these lines. However, as the Section attaches the same importance to practical as to theoretical knowledge, it feels in principle that candidates should not normally be allowed to sit this examination till they have successfully completed the practical training mentioned in Article 5(3). The Section refers to its comment on Article 5(4).

5.3. Some members consider that, in view of the purpose of the examination, the draft Directive should specify that the examination is to be partly oral and partly written. These members recommend amending Article 4(2) to read :

"Such examination, the general content of which is set out in Article 5, shall comprise written and oral tests which guarantee in the most appropriate manner a good level of theoretical knowledge of subjects relevant to the auditing of accounts and the ability to apply such knowledge in practice".

6. Article 5(1)

6.1. The Section considers the list of subjects to be necessary in order to guarantee as far as possible that the tests will be equivalent. For this reason, too, the Section proposes that the detailed statement of subjects contained in the Explanatory Memorandum be reproduced in a non-binding Appendix to the draft Directive. This Appendix would provide the Member States with guidance, and thus further help to ensure the equivalence of tests.

6.2. In addition, the Section recommends establishing a committee which would propose changes in the list of examination subjects, in the light of the changing requirements of auditing practice. The relevant professional bodies should be represented on this committee.

7. Article 5(2)

7.1. The Section takes the view that the university degree or equivalent qualification referred to must be of a standard equivalent to that of the theoretical test required under Articles 4 and 5.

8. Article 5(3)

Some members feel that this provision is too restrictive if the practical training involves "principally" the statutory audit of the annual accounts of companies. They therefore suggest that the latter half of the sentence after the word "Directive" be reworded as follows :

".... and ensuring adequate experience in the auditing of annual accounts."

9. Article 5(4)

9.1. As stated under 5.2., the Section considers that, in principle, the practical training mentioned in Article 5(3) should be completed before admission to the examination of professional competence. However, in some Member States practical skills are inculcated during the period of theoretical training, so that it might be possible to pass the examination of professional competence before completion of the practical training stipulated in Article 5(3). The Section cannot shut its eyes to this situation, but nevertheless feels that nobody should become an approved auditor till he has acquired adequate practical experience which can only be provided by the training mentioned in Article 5(3). In this spirit, the Section accepts the derogation made in Article 5(4), while stressing that approval must not be granted till after successful completion of the practical training mentioned in Article 5(3).

9.2. The Section points out that the practical training referred to in Article 5(4) is the practical training specified in Article 5(3). It is therefore illogical to state that only "part" of such practical training may take place after the examination of professional competence. The Section asks the Commission to consider this point.

9.3. Some members feel that, as at present worded, Article 5(4) could hamper the adjustment of training to new circumstances. They therefore want the phrase "all or" to be inserted before "part" in the first line of Article 5(4).

9.4. Other members propose that the second half of this paragraph be worded as follows:

"Article 5(4)

.... examination of professional competence has been passed. In such cases, approval shall not be granted on the passing of the examination of professional competence; rather, the competent authorities shall ascertain, on completion of the three years' practical training, whether the candidate has the practical ability necessary for the discharge of his duties and, if so, they shall certify this and grant approval accordingly."

10. Article 6

10.1. The Section proposes that the word "supervised" in paragraph 1, sub-paragraph (b), be deleted. It is already clear from the reference to Article 5(3) or (4) what practical training is meant.

10.2. According to a number of members, the exception allowed by Article 6(1)(a) is not acceptable. These members point out that under this clause, unlike all other approval procedures, it is not necessary to have practical experience in auditing. In their view, such practical experience - especially in statutory auditing - is vital. The members concerned therefore recommend adding the following at the end of Article 6(1)(a) :

"law and accountancy; at least three of these years must have been spent mainly on statutory audits with an auditor approved pursuant to this Directive, or"

10.3. Other members propose adding the subjects mentioned in Article 6(1)(a) to those covered by the examination of professional competence.

11. Article 7

11.1. The Section appreciates that when the Directive is being applied exceptions will be necessary, given the difficulties which will inevitably arise in the changeover from national to Community rules. As a matter of principle it would, however, urge that the exceptions be confined to the absolutely unavoidable, and it refers in this connection to Article 9 of the draft Directive, which it thinks should be strictly applied. The Section also considers that the reference made in Article 7 to Article 11 should be deleted, since Article 11 covers rules for the appointment of auditors and not those for their approval.

12. Article 8

12.1. Here, too, the Section suggests deletion of the reference to Article 11.

13. Article 9

13.1. According to a number of members the provisions of Article 7(2), in conjunction with Article 9, are acceptable only if the transitional measures mentioned in Article 7(2) apply solely to persons who show, by a transitional examination, that they possess the knowledge and practical competence prescribed by Article 4(2) for statutory auditors. The members in question therefore propose adding the following to Article 9 :

"... under Article 4. In order to prove fitness, the person concerned must pass an additional examination showing that he possesses, especially in the field of statutory audits, the knowledge and professional competence stipulated in Article 4(2)".

14. Article 10

14.1. The Section notes that it is not a question here of rules binding on the Member States. The second sentence of sub-paragraph (a) of paragraph 1, however, obliges the Member States to recognize as equivalent qualifications obtained in another Member State. The Section considers that this provision goes too far, bearing in mind that the draft Directive lays down minimum requirements and, in particular, given the exceptions provided for in Article 7. This provision could possibly induce some Member States to pursue a restrictive policy on the approval of auditors from other Member States. The Section therefore proposes that the provision be reviewed. The sentence in question should be deleted, or amended to specify that qualifications obtained in another Member State are to be recognized as equivalent if the approval granted in that other Member State was granted after an examination of professional competence pursuant to Article 4. The Section agrees that it should also be necessary to demonstrate adequate legal knowledge, as stipulated in Article 10(1)(b).

14.2. The Section also requests that the reference to Article 11 be deleted.

15. Article 11 (*)

15.1. The Section is pleased that this Article gives a number of objective criteria calculated to ensure that an auditor entrusted

(*) The Section notes a serious translation error in the English version of Article 11(2), which wrongly talks of "benefits". The term "credits" employed in the French version should be translated into English by "loans". The Section urges the appropriate Commission departments to review carefully the translations into the various languages, so as to avoid errors (for instance, Article 6(2) of the Italian version).

with a statutory audit will be independent of the company whose accounts are to be audited. The Section has already pointed to the need for the independence of auditors to be dealt with entirely in Article 11. This Article should accordingly be expanded by rewording paragraph 1 to read:

"Only an approved person whose independence is sufficiently guaranteed in relation to ... may audit the accounts of that company. He may not pursue other activities liable to jeopardize his independence."

As regards paragraph 3, the Section considers the limit of 10% of turnover to be acceptable, although it would point out that the disciplinary authorities apply other yardsticks particularly in the case of new entrants to the profession and also persons ending their professional activity. However, the Commission should spell out what it means by "turnover".

The Section also draws attention to the close connection between Article 11 of the Draft 8th Directive and Articles 53-57 of the Draft 5th Directive on the structure of sociétés anonymes, (*) which gives detailed criteria for the independence of auditors. The

(*) OJ No. C 131, 13 December 1972

Section would refer in particular to Article 57 of the Draft 5th Directive, which lays down principles for the remuneration of auditors. In view of this connection, the Section considers that either the two Draft Directives should be adopted together or the provisions of the Draft 5th Directive should be incorporated in the Draft 8th Directive.

15.2. Some members take the view that no useful purpose is served by mentioning specific criteria in this Article, on account of the many possible ways in which independence can be impaired. They consider that a general wording would be more effective and suggest the following:

"Approved persons who for any reason whatsoever may be presumed not to be in a position to carry out an objective audit of certain accounts must not take part in the audit of those accounts".

15.3. Other members point out that under German law, annual accounts will automatically be null and void if Article 11(1) as at present worded is infringed. This is not, however, desirable in the interests of legal certainty. Under Article 11(1) it should be possible to contest the appointment of auditors only if reasonable objective grounds can be shown. The members in question therefore propose that the phrase "on reasonable objective grounds" be inserted in the first line of Article 11(1), after "does not".

15.4. A number of members feel that no reference should be made to "independence" in Article 3, and that Article 11 should be expanded accordingly. They also consider that the ceiling of 10% of turnover is too high. Accordingly, these members propose the following changes:

a) Article 11(1) to read:

"Only an approved person whose independence is sufficiently guaranteed in relation to ... may audit the accounts of that company. He may not pursue other activities liable to jeopardize his independence."

b) Article 11(3) to be amended as follows:

- "- '10% of his turnover' should be replaced by '5% of his turnover'; special rules should be laid down for persons who have just entered the profession;
- If appropriate, turnover should also be related to the turnover of the corresponding legal person;
- Authorizations granted as an exception should be issued as far in advance as possible by the disciplinary authorities (or appropriate authorities);
- Turnover should include both revenue from statutory audits and any revenue from consultative activity
- Particulars on the breakdown of turnover should be notified regularly - and at least yearly - to the disciplinary or appropriate authorities. These particulars should comprise:
 - . Frequency distribution of the various percentages of total turnover accounted for by single clients
 - . Breakdown of revenue into (i) revenue from statutory audits (and consultative activities having a close logical link with such audits) and (ii) revenue from consultative activities having nothing to do with audits."

15.5. Another group of members is very dissatisfied with the present Draft Article 11 as regards the independence of the auditor.

Their point is that independence cannot be guaranteed and that the wording of Article 11 should not even imply, let alone claim, otherwise. They believe, however, that it should primarily be the function of Member States to take appropriate measures concerning the independence of auditors. They would therefore like Article 11 to be prefaced by wording such as

"Member States shall take appropriate measures in connection with the independence of auditors in line with the provisions set out below."

Article 11(1) should accordingly read:

"An auditor who is so circumstanced that, for any reason, there are doubts as to whether he would carry out an objective audit of a particular set of accounts should not participate in the audit of those accounts."

These members consider that the intention of the Commission would be better expressed if the following wording were used in Article 11(2):

"An auditor of a company's accounts shall not, either directly or through another person, enter into any financial relationship on his own behalf with that company or any associated company if such relationship would impair his objectivity."

On Article 11(4), they think that the phrase "complete moral and financial independence" is obscure. The concept is difficult to define and impossible to achieve. Consequently, the Article should finish as follows:

"... to carry out their duties as auditors with objectivity and due conscientiousness."

16. Article 12

16.1. The list is to be brought up to date regularly and any interested party can examine it at any time. In these circumstances, a number of members consider it unnecessary to stipulate that the list is to be published every year. The members in question feel, however, that interested parties should be able to obtain specific particulars from the list, and not just be entitled to examine it. These members therefore propose deleting the word "annually" in Article 12(3), and ending the paragraph as follows:

"... in order to examine the exact list of approved persons or obtain specific particulars from it."

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