RECOMMENDATIONS

COMMISSION

COMMISSION RECOMMENDATION

of 6 May 2008

on external quality assurance for statutory auditors and audit firms auditing public interest entities

(notified under document number C(2008) 1721)

(2008/362/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular Article 211 thereof,

Whereas:

(1) External quality assurance for the statutory audit is fundamental for high audit quality. It adds credibility to published financial information and provides better protection of shareholders, investors, creditors and other interested parties. Any external quality assurance system should therefore be objective and independent from the auditing profession.

(2) Articles 29 and 43 of Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC [1] establishes high-level criteria for quality assurance systems for all statutory auditors and audit firms. It incorporates some of the ideas contained in Commission Recommendation 2001/256/EC of 15 November 2000 on quality assurance for the statutory audit in the European Union: minimum requirements [2].

(3) However, parts of that Recommendation, which are related to statutory audit of public interest entities, have been overtaken by recent international developments and tendencies to introduce, for such audits, external quality assurance systems, which are managed independently from the auditing profession and where quality assurance reviews are performed by persons other than practising auditors.

(4) The criteria laid down in Directive 2006/43/EC still allow for considerable differences in the way external quality assurance systems for statutory auditors and audit firms are currently organised in Member States. It should be avoided that the interested parties perceive audit quality of statutory auditors and audit firms in Member States differently, in particular with respect to Article 34 of Directive 2006/43/EC. Directive 2006/43/EC also encourages public oversight systems of Member States to find a co-ordinated approach to the carrying-out of quality assurance reviews.

(5) Co-operation between Member States is a priority with regard to audits of public interest entities. Further guidance should be given to quality assurance systems for statutory auditors and audit firms performing audit in such entities. Therefore, it is appropriate to provide for a new Recommendation which is more in line with the current state of affairs than Recommendation 2001/256/EC and which takes into account new international trends as well as specific needs of the Member States. However, there is no need to provide detailed guidance with regard to the quality assurance systems for statutory auditors and audit firms auditing entities other than public interest entities.

[1] OJ L 157, 9.6.2006, p. 87. Directive as amended by Directive 2008/30/EC of the European Parliament and of the Council (OJ L 81, 20.3.2008, p. 53).
[2] OJ L 91, 31.3.2001, p. 91.

(6) Inspections should contribute to enhancing audit quality in an inspected statutory auditor or an audit firm and should be of regular and preventive nature. They should aim at building and maintaining confidence in statutory audit and thus ultimately in financial markets. Therefore, this Recommendation should not concern ad-hoc investigations resulting from the possible violations of laws and regulations.

(7) In order to enhance the quality of audits within the Communities, independent oversight bodies should play a more active role in the inspections of audit firms. Guidance should be provided for the independence of the inspection system. With regard to execution of inspections, the possible role of public oversight authorities, professional associations and other appropriate bodies, as well as the role of experts should be clarified. Clarifications with regard to the funding of the quality assurance system are also necessary.

(8) Article 43 of Directive 2006/43/EC requires quality assurance reviews for statutory auditors and audit firms of public interest entities to be carried out at least every three years. A public oversight system could face difficulties in recruiting a sufficient number of inspectors to conduct on-site reviews in each inspection. Therefore, it should be possible that, under certain conditions, experts who are not inspectors also participate in on-site reviews.

(9) In order to ensure that the final report on an inspection is followed by the statutory auditor or audit firm concerned and that it provides them with sufficient guidelines to avoid reported problems in the future, an effective communication should take place between the inspectors and that statutory auditor or audit firm both before the final report is adopted and in the follow-up phase.

(10) To improve accountability of the quality assurance system and comparability within the Community, the annual report on the overall results of inspections should include key performance information that would enable an evaluation to be made of both the resources used and the efficiency and effectiveness of the quality assurance system.

(11) In the light of new international developments, in particular the involvement of appropriate bodies and experts in the execution of inspections, the Commission intends to evaluate the situation in 2011,

HEREBY RECOMMENDS:

Subject matter

1. This Recommendation provides guidance for implementing independent quality assurance systems for statutory auditors and audit firms conducting an audit of public interest entities in accordance with Articles 29 and 43 of Directive 2006/43/EC.

2. Where a Member State decided to exempt certain public interest entities in accordance with Article 39 of the Directive 2006/43/EC, the Member State should also exempt such public interest entities from the scope of measures adopted in the light of this Recommendation.

Definitions

3. The definitions set out in Article 2 of Directive 2006/43/EC apply to this Recommendation. For the purposes of this Recommendation, also the following definitions apply:

(a) 'public oversight authority' means a competent authority within the meaning of Article 2(10) of Directive 2006/43/EC, which represents a public oversight system that is based on the principles set out in Article 32 of that Directive;

(b) 'inspector' means a reviewer, who meets the requirements set out in point (d) of the first subparagraph of Article 29(1) of Directive 2006/43/EC, is employed by a public oversight authority or another appropriate body to which execution of inspections has been delegated;

(c) 'inspections' means quality assurance reviews of statutory auditors and audit firms, which are led by an inspector and which do not represent an investigation within the meaning of Article 32(5) of Directive 2006/43/EC;

(d) ‘expert’ means a natural person, who has specific expertise in financial markets, financial reporting, auditing or other fields relevant for inspections, including practising statutory auditors.

Independence of the quality assurance system

4. A public oversight authority should assume ultimate responsibility for the external quality assurance system for statutory auditors and audit firms auditing public interest entities. Member States should not designate as a public oversight authority any association or body affiliated with the accounting or audit profession.

5. Statutory auditors and audit firms auditing public interest entities should be subject to inspections that are executed by a public oversight authority, either exclusively, or together with another appropriate body in accordance with point 6.

6. It should be possible for tasks related to the execution of the inspections to be delegated to another appropriate body provided that the accountability of such body to the public oversight authority is ensured and that the latter retains at least the following responsibilities:

(a) approval and, if considered appropriate by the public oversight authority, amendment of the inspection methodologies, including inspection and follow-up manuals, reporting methodologies and periodic inspection programmes;

(b) approval and, if considered appropriate by the public oversight authority, amendment of inspection reports and follow up reports;

(c) approval and, if considered necessary by the public oversight authority, assignment of inspectors for each inspection;

(d) issuance of recommendations and instructions of any form to the body to which the tasks have been delegated.

7. The public oversight authority should have the right to participate in inspections and to get access to inspection files, audit working papers and other documents of relevance.

8. All funding arrangements for the quality assurance system, including those concerning the level of funding and financial control, should not be subject to approval or veto by persons or organisations that are representatives of or otherwise affiliated with the accounting profession, the audit profession or an audit firm. The level of funding should enable the public oversight authority to be sufficiently equipped with staff supporting it in implementing points 6 and 7.

9. If funds for the quality assurance system are provided by statutory auditors or audit firms subject to inspections, any fee or other contribution payable by them should be mandatory and required to be paid in full on a timely basis.

Independence of inspections

10. A public oversight authority should ensure that appropriate policies and procedures related to the independence and objectivity of the staff, including inspectors, and the management of the inspection system, are put in place.

11. A person, who is a practising statutory auditor or is employed or otherwise associated with a statutory auditor or an audit firm, should not be allowed to act as an inspector.

12. A person should not be allowed to act as an inspector in an inspection of the statutory auditor or audit firm until at least two years have elapsed since that person ceased to be a partner or employee of that auditor or in that audit firm or to be otherwise associated therewith.

13. Inspectors should declare that there are no conflicts of interests between them and the statutory auditor and audit firm to be inspected. Inspectors who make an incomplete or false declaration should be excluded from carrying out inspections and should be subject to effective, proportionate and dissuasive penalties.

14. Inspectors should be remunerated in connection with inspections only by the public oversight authority or by the body to which execution of inspections has been delegated. Inspectors should not receive any remuneration from the reviewed statutory auditor, audit firm or their networks.

15. If a public oversight authority considers that specific expertise is essential for the proper conduct of an inspection, inspectors should be assisted by experts. Such experts should act under the direct control of an inspector and should be subject to the requirements referred to in points 10, 12 to 14.

Methodological guidance for conducting inspections

16. When there is temporarily an insufficient number of inspectors available in a Member State to carry out on-site inspections, a public oversight authority should have the right to decide that experts perform on-site reviews, provided that those experts meet the requirements set out in point (d) of the first subparagraph of Article 29(1) of Directive 2006/43/EC, that they are fully accountable to the public oversight authority and that inspectors carry out on-site reviews in the same statutory auditor or audit firm at least every six years.

17. The scope of inspections should cover:

(a) an assessment of the design of the internal quality control system of the audit firm;

(b) adequate compliance testing of procedures and a review of audit files of public interest entities in order to verify the effectiveness of the internal quality control system;

(c) in the light of the inspection findings under points (a) and (b), an assessment of the contents of the most recent annual transparency report published by a statutory auditor or an audit firm in accordance with Article 40 of Directive 2006/43/EC.

18. At least the following internal control policies and procedures of the statutory auditor or the audit firm should be reviewed:

(a) compliance by the statutory auditor or the audit firm with applicable auditing and quality control standards, and ethical and independence requirements, including those related to Chapter IV and Article 42 of Directive 2006/43/EC, as well as relevant laws, regulations and administrative provisions of the Member State concerned;

(b) the quantity and quality of resources used, including compliance with continuing education requirements as set out in Article 13 of Directive 2006/43/EC;

(c) compliance with the requirements set out in Article 25 of Directive 2006/43/EC on the audit fees charged.

19. For the purposes of testing compliance, at least a significant part of audit files should be selected on the basis of an analysis of the risk of an inadequate execution of the statutory audit.

Outcome of inspections

20. Inspection findings and conclusions on which recommendations are based, including the findings and conclusions related to a transparency report, should be properly communicated to and discussed with the inspected statutory auditor or audit firm before an inspection report is finalised. The inspected statutory auditor or audit firm should be granted a period not exceeding 12 months from the issuance of the inspection report to take action in respect of recommendations on the internal quality control system of the audit firm. If the inspected statutory auditor or audit firm did not give the appropriate follow up to the recommendations, the public oversight authority should disclose major deficiencies found in the internal quality control system.

21. A public oversight system should have the right, in accordance with the due process of law as provided for in the Member State concerned, to take disciplinary actions or impose penalties in respect of statutory auditors and audit firms.

22. The public oversight authority should at least inform the public in a timely and appropriate manner about any final disciplinary actions taken or penalties imposed in respect of statutory auditors and audit firms in relation to the execution of the statutory audit. It should identify the statutory auditor or audit firm concerned and describe the major deficiencies which have given rise to such actions or penalties.

23. In the cases where it has been established during an inspection that a transparency report published by a statutory auditor or an audit firm in accordance with Article 40 of Directive 2006/43/EC contains information, including that on the effectiveness of the internal quality control system of the audit firm, that a public oversight authority considers significantly misleading, it should ensure that the transparency report is amended accordingly without delay.

Transparency on the overall results of the quality assurance system

24. Public oversight authorities should report annually on the overall results of the quality assurance system. The report should include information on recommendations issued, follow-up on the recommendations, disciplinary actions taken and penalties imposed. It should also include quantitative information and other key performance information on financial resources and staffing, and the efficiency and effectiveness of the quality assurance system.

Follow-up

25. Member States are invited to inform the Commission of actions taken in light of this Recommendation by 6 May 2009.

Addressees

26. This Recommendation is addressed to the Member States.

Done at Brussels, 6 May 2008.

For the Commission

Charlie McCREEVY

Member of the Commission