



Mr. Klaus-Heiner Lehne
Chair of the Committee on Legal Affairs
European Parliament
Bât. Altiero Spinelli – 10E205
Rue Wiertz 60
B - 1047 BRUSSELS

23 May 2012

Ref.: FRP/PRJ/SKU/SRO

Dear Mr. Lehne,

Re: FEE audit related comments on the Legal Affairs Committee (JURI) Draft Reports dated 28 March 2012 and 8 May 2012 on the EC proposal for the Accounting Directive – continued

Recently, we provided you with two letters dated 24 February and 23 April 2012, respectively and indicated we would write a separate letter on audit related matters. FEE* hereby provides comments on some of the amendments related to audit currently discussed in JURI regarding the EC proposal for the Accounting Directive¹.

We believe that these issues and our comments thereon are also relevant to other European Parliament Committees dealing with the EC proposals for the Accounting Directive.

We hope our comments, based on the experience and expertise of European accountants, may be of help to the Members of the European Parliament when considering these important matters. Should you wish to discuss any of these points in more details, please contact our CEO, Olivier Boutellis-Taft (obt@fee.be).

Sincerely,

Philip Johnson
President

¹ EC proposal for the Directive on the Annual Financial Statements, Consolidated Financial Statements and Related Reports of Certain Type of Undertakings



Cc:

Mr. Wolf Klinz, Rapporteur for opinion on the Accounting Directive

Ms. Franziska Katharina Brantner, Rapporteur for opinion on the Accounting and Transparency Directive

Ms. Fiona Hall, Rapporteur for opinion on the Accounting and Transparency Directive

Mr. Helmut Scholz, Rapporteur for opinion on the Accounting and Transparency Directive

Ms. Arlene McCarthy, Rapporteur for the Transparency Directive

Ms. Sirpa Pietikäinen, Rapporteur for opinion on the Transparency Directive

Mr. Elmar Brok, Chair of AFET

Ms. Eva Joly, Chair of DEVE

Mr. Vital Moreira, Chair of INTA

Mr. Sajjad Karim, Rapporteur on the Audit Reform Directive and Regulation

Mr. Syed Kamall, MEP

Rapporteurs for opinion on the Audit Reform Directive and Regulation:

Ms. Kay Swinburne

Mr. Jürgen Creutzmann

Mr. Sebastian Valentin Bodu

Mr. Antonio Masip Hidalgo

Ms. Alexandra Thein

Ms Eva Lichtenberger

Mr. Jiri Mastálka

Ms. Sharon Bowles, Chair of ECON

Ms. Amalia Sartori, Chair of ITRE

Mr. Malcolm Harbour, Chair of IMCO

Danish Presidency of the Council of the European Union:

Mr. Martin Bresson, Minister Counsellor, General Coordination at COMPET

Ms. Mette Toftdal Grolleman, Counsellor for Business and Growth, Company Law at COMPET

Accounting and auditing should not be characterised as burdens, especially not for medium-sized undertakings

- (1) In our first letter to you dated 24 February 2012, we indicated that we find it inappropriate that the EC Proposal for the Accounting Directive characterises accounting including the preparation of the financial statements and auditing as "burdens" without recognising its beneficial role and added-value to corporate management and the economy as well as its public interest dimension.
- (2) We added that auditing provides independent and objective assurance designed to add to the credibility and reliability of the financial information and contributes to enhancing the operational effectiveness of the internal control system related to financial reporting.
- (3) In our letter, our comments focused mainly on the audit requirement for small undertakings as the EC Proposal for the Accounting Directive was entirely clear on the need to require an audit for all other undertakings at European level, a position that we find appropriate.
- (4) We would like to reiterate that our previous comments about the benefits of auditing related to public policy goals such as stakeholders' information, investors' protection, markets' stability, the reduction of transaction costs and the cost of capital and access to finance, are equally important for medium-sized undertakings.
- (5) Indeed, the lack of audited financial information could lead to a significant reduction in the quality and usefulness of the financial information available to users such as trade creditors, business partners, managers, investors, employees, etc. Reliable and relevant financial information to users is a significant contributor to the efficient functioning of the economy and internal market. It also supports integration of new economies into the EU and dissemination of best practices.
- (6) A sound financial reporting framework and the robust and independent assurance that audit provides are essential, in particular at a time where the European economy still needs to recover, growth be fostered and trust rebuilt. We would be seriously concerned that, in such circumstances, the vast majority of undertakings would not have an audit. Therefore, changing Article 34.1 in the report dated 8 May 2012 (amendment 160) in a way that would delete the audit requirement for small and moreover for medium sized undertakings, would be counterproductive and would undermine the European economy.
- (7) Based on the comments made above, we believe it is crucial that the European requirement to audit the financial statements of medium sized undertakings is maintained.

Specify the audit requirement for small companies²

- (8) In our first letter to you dated 24 February 2012, we indicated we believe that Member States should continue to be able to decide whether they want to exempt small companies from audit requirements, as they are best placed to determine the actual need of the small companies to be exempted from audit based on the principle of proportionality, the relative size of companies and the characteristics of the economy.
- (9) In order to further clarify the audit requirement for small companies, we recommend amending Recital (31) by explicitly stating that the Accounting Directive should not prevent Member States from having an audit on the financial statements of all or part of their small undertakings, taking into account the specific conditions and needs of small undertakings.
- (10) Additionally, we support the view that Article 34.1 specifies an audit requirement for small undertakings with a Member State option to exempt some or all small undertakings from this requirement in line with Article 51 of the existing Directive.
- (11) The criteria for the general requirement for auditing should, as proposed by the European Commission, continue to be determined by the Member State with respect to either the individual or the consolidated financial statements.

Auditor's opinion on assumptions underlying prospective financial information in the management report

- (12) We noted that an amendment no. 77 to Article 34 - dealing with the content of the audit report - was tabled. It states: "*The statutory auditor shall also express an opinion on: [...] (c) whether prospective financial information included in the management report has been appropriately prepared on the basis of reasonable assumptions.*" This is an additional requirement to the consistency check between the financial statements and the management report as proposed by the European Commission.
- (13) As audit profession we are ready to meet the growing needs of users of financial statements and make our audit reports more informative, comprehensive and exhaustive.
- (14) While evidence may be available to support the assumptions on which the prospective financial information is based, such evidence is itself generally future oriented and, therefore, speculative in nature, as distinct from the evidence ordinarily available in the audit of historical financial information. Therefore, it may be difficult for the auditor to obtain a level of assurance sufficient to provide a positive expression of opinion that the assumptions are free of material misstatement. For further details, reference is made to paragraphs 8 and 9 of the International Standard on Assurance Engagement ISAE 3400 on "The Examination of Prospective Financial Information"³

² In this letter, small companies refer to both undertakings and groups as defined by the EC proposal for the Accounting Directive.

³ See <http://www.ifac.org/sites/default/files/downloads/b013-2010-iaasb-handbook-isa-3400.pdf>

- (15) Based on the above we suggest to delete the proposed amendment no. 77 and retain subparagraph 2 of Article 34.1⁴ from the original EC text with additions which would result in the following wording:

“The statutory auditor shall also report concerning:

a) the consistency of the management report with the financial statements for the same financial year and

b) whether the management report has been prepared in accordance with the applicable legal requirements (Amendment 76).

The auditor shall also state that:

c) based on his knowledge and the understanding of the entity and its environment obtained during the course of the audit, the management report as a whole suitably presents the company’s position, the opportunities and principal risks and uncertainties of its likely future development.”

- (16) This would ensure that auditors:
- Not only perform a consistency check between the management report and the financial statements; but
 - Also state whether the management report as a whole is suitable in the context of the auditor’s knowledge and understanding of the company’s business obtained during such audit.
- (17) We would also like to draw your attention to the fact that Article 22.6 of the European Commission proposed Audit Regulation⁵ states that “Article 35 of the Directive on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings shall not apply to audit reports of public-interest entities.” This means that currently the proposals for the auditor to express an opinion on the management report in the audit report would only be required for entities other than Public Interest Entities which Member States have not exempted from the obligation to prepare a management report and *not for Public Interest Entities*.

Contents of the management report on which an auditor expresses an opinion

- (18) Consequently, to ensure internal consistency between the articles of the Accounting Directive, Article 20 *Contents of the management report* would need additional rewording. We would suggest the following changes:
- paragraph 1:
The management report shall include at least a ~~fair review~~ suitable presentation of the development and performance of the undertaking’s business and of its position, together with a description of the opportunities, principal risks and uncertainties that it faces. ~~The review~~ presentation shall be a balanced and comprehensive analysis [...]

⁴ Subparagraph 2 of Art. 34. 1 in the EC proposal states that *the statutory audit shall also express an opinion concerning the consistency of the management report with the financial statements for the same financial year.*

⁵ EC proposal for a Regulation of the European Parliament and of the Council on specific requirements regarding statutory audit of public-interest entities.

- (19) The related recital 15 would need similar replacement of *fair review* with *suitable presentation*, which would read as follows:
Recital (15) The management report and the consolidated management report are important elements of financial reporting. A suitable ~~fair review~~ suitable presentation of the development of the business and of its position should be provided, in a manner consistent with the size and complexity of the business. [...]

***About FEE**

FEE (Fédération des Experts-comptables Européens – Federation of European Accountants) is an international non-profit organisation based in Brussels that represents 45 institutes of professional accountants and auditors from 33 European countries, including all of the 27 EU Member States.

FEE has a combined membership of more than 700.000 professional accountants, working in different capacities in public practice, small and big accountancy firms, businesses of all sizes, government and education, who all contribute to a more efficient, transparent and sustainable European economy.