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NOTE

From: General Secretariat
To: Company Law Attachés

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Subject: Proposal for a Regulation of the European Parliament and of the Council on
specific requirements regarding statutory audit of public-interest entities
- Presidency compromise text

Delegations will find attached a steering note and a revised Presidency compromise text.

Presidency Steering Note - Regulation

Company Law Attachés meeting

20/21 June, 2013

Changes for meeting on 20-21 June 2013 are marked out as underlining of text of Articles.

The meeting on 20/21 June will consider both the documents which issued for the Working Party meeting on 14 June last - 10922/13 DRS116 CODEC 1455 and 10923/13 DRS 117 CODEC 1456 as well as the documents on individual Articles circulated for the meeting on 20/21 June.

Article 10 - Prohibition of the provision of non-audit services

In line with Member States' suggestions, the Presidency has made a number of textual amendments to remove some anomalies and ambiguities. The Presidency has also amended paragraph 1(k) to ensure that auditors are not prevented from providing services in respect of "listing particulars" and has added a sub-paragraph to paragraph 2 to enable Member States to apply conditions to the provision of permitted non-audit services.

Some of the Member States' suggestions were of a relatively significant and fundamental nature and consequently could not, in the time available, be reflected in the latest text. It is, of course, open to delegations to raise these issues at the meeting and to suggest solutions.

Article 33 – Duration of the Audit Engagement

The Presidency has reflected on the discussions at the Working Party meeting on 14 June and has produced a text which incorporates a number of the suggestions made by Member States at that meeting. Some of the new elements are Member State flexibility as regards the one year period of engagement, scope for more than one renewal of the audit engagement and revised criteria in renewal of the audit engagement.

Article 46 – Establishment of CEAOB

In acceptance of the wishes of a large number of Member States that the proposal for the involvement of ESMA in the co-operation between Member State competent authorities is not acceptable, the Presidency is now bringing forward an alternative proposal which is largely based on the existing functions of the EGAOB. The draft Presidency proposal provides for options at Paragraph 1b on which Member States will be asked for views. The Presidency draft also sets out possible tasks which the proposed CEAOB would carry out and the views of Member States will be sought on these also.

The Presidency acknowledges that an alternative proposal was tabled on behalf of a number of Member States and circulated at a previous meeting (doc. ref. 9531/13 dated 14 May, 2013).

However, the Presidency is of the view that the proposal now being tabled may constitute a better alternative and will explain its views in this matter at the meeting.

Audit Reporting

ARTICLE 28 – DIRECTIVE

ARTICLES 22 AND 23 – REGULATION

These Articles have been again re-worked by the Presidency with a view to seeking final agreement at the meeting on 20/21 June.

CHAPTER II - QUALITY ASSURANCE, INVESTIGATION, MARKET MONITORING, ~~CONTINGENCY~~ PLANNING AND TRANSPARENCY OF COMPETENT AUTHORITIES TASKS

Articles 40 – 44 Regulation

The title of this Chapter has been re-worded to take account of the deletion of Article 43 (Contingency Planning).

The Articles in this Chapter (40-44) have been examined by the Presidency in the light of written comments provided by the delegations since the Compromise Texts of 13 May and 14 June 2013 were issued. They are presented to the meeting of 20-21 June for agreement in principle and in terms of the revised drafts of Articles 40, 41, 42 and 44, which take account of the comments of the Member States.

Article 40 – Quality Assurance

An error has been corrected in 40.4(b).

Article 41 – Investigation

Following consideration by the Presidency of a suggestion of one Member State, “preventing” in line 2 of sub-paragraph 1 of Article 41 has been amended to “detering”. Also on the suggestion of a Member State, the words “as defined in Article 40” have been inserted after “experts” in line 1 of the second sub-paragraph of Article 41, in the interests of clarity.

Article 42 – Market monitoring

Article 42.1(a) has been amended by the insertion of “any” before “audit firms” and the insertion of brackets around “s” of firms inspired by a MS comment.

Article 44 – Transparency of competent authorities

In response to the concerns of one Member State that this Article, as previously amended, did not provide sufficient protection for commercial secrets, the Presidency proposes the insertion of the word “specific” between “have” and “regard” in line 1 of 44(d).

General – technical Corrigenda

Article 26 – Disclosure of financial information

An error has been corrected in the final sentence of 26.4.

Article 70 – Transitional provision

Correction of minor errors.

1.1. Steering Note farewell message

Following the meeting on 20-21 June, the Presidency will endeavour to carry out a general technical “sweep” through the Articles of the Directive and Regulation before transfer to the incoming Lithuanian Presidency. Adieu from the Irish Presidency.

Presidency compromise text on specific Articles of the Regulation

Article 10

Prohibition of the provision of non-audit services

1. A statutory auditor or an audit firm carrying out the statutory audit of a public-interest entity shall not directly or indirectly provide to the audited entity, to its parent undertaking [...] or to its controlled undertakings any prohibited non-audit services in the financial year to which the audit of the financial statements in question relates in the financial year immediately preceding that financial year, in the period between the end of that financial year and the issuing of the audit report or in the period of twelve months immediately following the issuing of the audit report.

Where the statutory auditor or audit firm belongs to a network, no member of such network shall provide to the audited entity, to its parent undertaking [...] or to its controlled undertakings within the Union any prohibited non-audit services in the financial year to which the audit of the financial statements in question relates in the financial year immediately preceding that financial year, in the period between the end of that financial year and the issuing of the audit report or in the period of twelve months immediately following the issuing of the audit report.

For the purposes of this Article, prohibited non-audit services shall mean:

- (a) preparation of tax forms, payroll tax, customs duties and public support measures and support regarding tax inspections and inquiries by tax authorities unless support in respect of such inspections and enquiries is required by law;
- (b) calculation of direct and indirect tax and deferred tax;

- (c) provision of tax advice where the effectiveness of the advice depends on a particular accounting treatment or presentation in the financial statements;
- (d) [...] playing any part in the management or decision-making process of the audited entity including working capital management, providing financial reporting and forecasting, business process optimization, cash management, transfer pricing and creating supply chain efficiency. This subparagraph does not apply to reporting on financial reports or forecasts;
- (e) bookkeeping and preparing accounting records and financial statements;
- (f) payroll services;
- (g) designing and implementing internal control or [...] risk management procedures related to the preparation and/or control of financial information for inclusion in the financial statements or [...] financial information technology systems; [...]
- (h) valuation services, including valuations performed in connection with actuarial services or litigation support services; [...]
- (i) legal services, with respect to:
 - (i) the provision of general counsel,
 - (ii) negotiating on behalf on the audit client, or
 - (iii) acting in an advocacy role in the resolution of litigation; [...]
- [...]
- (j) participating in and influencing the audit client's internal audit and the provision of services related to the internal audit function;
- (k) corporate finance services, other than services related to information, not constituting a prospectus within the meaning of Directive 2003/71/EC¹, to be published by the public interest entity concerning the public offering or admission to trading of its securities; [...]

¹ OJ L 345, 31.12.2003, p. 64–89.

(l) human resources services with respect to:

(i) [...] management in a position to exert significant influence over the preparation of the accounting records or financial statements which are the subject of the statutory audit, where such services involve:

(1) searching for or seeking out candidates for such positions; or

(2) undertaking reference checks of candidates for such positions. [...]

(ii) structuring the organisation design and

(iii) cost control;

[...]

1A. Member States may [...] add to the list of prohibited non-audit services contained in paragraph 1 services which could represent a threat to independence. Member States shall communicate to the Commission any additions to the list referred to in paragraph 1

2. A statutory auditor or an audit firm carrying out statutory audit of public-interest entities may provide to the audited entity, to its parent undertaking or its controlled undertakings [...] services other than the prohibited non-audit services referred to in paragraph 1 subject to the approval of the audit committee after having properly assessed threats and potential safeguards to independence in accordance with Article 22d of Directive XXX.

Where the statutory auditor or audit firm belongs to a network, any member of such network may provide to the audited entity, to its parent undertaking and to its controlled undertakings within the Union [...] services other than the prohibited non-audit services referred to in paragraph 1 subject to the approval of the audit committee and after having properly assessed threats and potential safeguards to independence in accordance with Article 22d of Directive XXX.

Member States may establish additional rules setting out the conditions under which a statutory auditor, an audit firm or a member of a network to which the auditor or audit firm belongs may provide to the audited entity, to its parent undertaking or its controlled undertakings services other than the prohibited non-audit services referred to in paragraph 1. This paragraph does not apply to the carrying out of the statutory audit by a statutory auditor or audit firm.

3. When a member of the network to which the statutory auditor or the audit firm carrying out statutory audit of a public-interest entity belongs provides prohibited non-audit services to an undertaking incorporated in a third country controlled by the audited public-interest entity, the statutory auditor or the audit firm concerned shall assess whether his, her or its independence would be compromised by such provision of services by the member of the network. If his, her or its independence is affected, the statutory auditor or the audit firm shall apply safeguards in order to mitigate the threats caused by such provision of services in a third country. The statutory auditor or the audit firm may continue to carry out the statutory audit of the public-interest entity only if he, she or it can justify, in accordance with Article 22d of Directive XXX, that such provision of services does not affect his, her or its professional judgement and the audit report.

For the purpose of this subparagraph

- (a) Being involved in the decision-taking of the audited entity and the provision of the services referred to in points (d) (e) and (g) of paragraph 1 shall be considered as affecting such independence in all cases and be incapable of mitigation by any safeguards.
- (b) The provision of the services referred to in points (a) to (c), [...] (f) and (h) to (l) of paragraph 1 shall be presumed to affect such independence and therefore to require safeguards to mitigate the threats caused thereby.

[...]

4. [...]

5. The Commission shall be empowered to adopt delegated acts in accordance with Article 68 for the purpose of adapting the list of non-audit services referred to in paragraph 1 of this Article. When using such powers, the Commission shall take into account developments in auditing and the audit profession.

Article 22

Audit Report

1. The statutory auditor(s) or the audit firm(s) shall present the results of the statutory audit of the public-interest entity in an audit report.
2. The audit report shall be prepared in accordance with the provisions of Article 28 of Directive 2006/43/EC and additionally shall at least:
 - (a) *[transferred to Article 28(1)(a) of the Directive]*
 - (b) *[transferred to Article 28(1)(a) of the Directive]*
 - (c) explain, where additional reports, as required by the national law of the Member State, have been reviewed and/or audited, the scope of such review/audit;
 - (d) *[deleted]*
 - (e) indicate the date of the appointment and the period of total uninterrupted engagement including previous renewals and reappointments
 - (f) [...] state whether the statutory audit was conducted in accordance with the international standards on auditing as referred to in Article 26 of the Directive;
 - (g) *[transferred to Article 28(1)(a) of the Directive]*
 - (h) *[transferred to Article 23(2)(ea)]*
 - (i) *[transferred to Article 23(2)(eb)]*
 - (j) *[transferred to Article 23(2)(ec)]*

- (k) state whether , in the course of conducting the audit, he/she/it has become aware of any key areas of risk which have the potential to result in material misstatement of the annual or consolidated financial statements which have or have not been referred to in the management report;
- (l) provide a statement [...] on the appropriateness of management's use of the going concern assumption in the preparation of the financial statements in accordance with the applicable financial reporting framework, and a statement as to whether, based on the audit, the auditor(s) or audit firm(s) has identified any material uncertainty(ies) related to events or conditions that may cast significant doubt about the entity's ability to continue as a going concern that the auditor(s) or audit firm(s) believes should [...] be disclosed in accordance with the applicable financial reporting framework; [...]
- (m) *[transferred to Article 23(2)(ga)]*
- (n) explain to what extent the statutory audit was considered capable of detecting irregularities, including fraud;
- (o) [...]
- (p) confirm that the audit opinion is consistent with the additional report to the audit committee referred to in Article 23;
- (q) declare that the prohibited non-audit services referred to in Article 10(1) were not provided and that the statutory auditor(s) or the audit firm(s) remained independent of the audited entity in conducting the audit.; *[Second sentence transferred to Article 23(2)(a)]*
- (r) *[deleted]*
- (s) *[deleted]*
- (t) *[Deleted except the final sentence transferred to 28(1)(f) of the Directive]*
- (u) [...]
- (v) [...]
- (w) [moved to 28(1)(g) of directive]
- (x) Indicate what services in addition to the statutory audit were provided by the auditor or audit firm to the audited entity its parent undertaking and its controlled undertaking.

Member States may set additional requirements in relation to the content of the audit Report.

3. In the case of joint audits the statutory auditor(s) or audit firm(s) shall agree on the results of the statutory audit and submit a joint report and opinion. In case of disagreement, each statutory auditor or audit firm shall submit his, her or its opinion in a separate paragraph of the audit report and state the reason for the disagreement. [...]
4. Except as required at paragraph 2(p) above the audit report shall not contain any cross-references to the additional report to the audit committee referred to in Article 23 and shall be in clear and unambiguous language.
5. *[Included in Article 28(2) of the Directive]*
6. *[deleted]*
7. The statutory auditor or audit firm shall not use the name of any competent authority in such a way that would indicate or suggest endorsement or approval by that authority of the audit report.
8. The Commission shall be empowered to adopt implementing acts in accordance with Article XXX or the purpose of adapting the content of the audit report referred to in paragraph 2[(a) to (w)]. When using such powers, the Commission shall take into account developments in the international standards on auditing as referred to in Article 26 of Directive 2006/43/EEC.

Article 23

Additional report to the audit committee

1. The statutory auditor(s) or the audit firm(s) carrying out statutory audit of public interest entities shall submit an additional report to the audit committee of the audited entity. This additional report shall be issued simultaneously with the audit report referred to in article 22. Member States may additionally require that this additional report be submitted to the administrative or supervisory board of the audited entity.

If the audited entity does not have an audit committee, the additional report shall be submitted to the body performing equivalent functions within the audited entity.

The statutory auditor(s) or audit firm(s) shall give the opportunity to comment on the additional report to the management, administrative or supervisory body of the audited entity.

[...]

2. The additional report to the audit committee shall be in writing. It shall explain the results of the statutory audit carried out and shall at least:

(aa) [...]

- (a) include a declaration of independence as provided for in point (q) of Article 22(2).

Where the statutory audit was carried out by an audit firm, the report shall identify each key audit partner who was involved [...] in the audit and shall state that all members of the audit engagement team remained independent of the audited entity;

- (ab) Where the statutory auditor has outsourced any of his/her activities to outside statutory auditors or used the work of external experts, the report shall indicate that fact and confirm that the outside auditors and the external experts remained independent;

- (b) identify the dates of the meetings with the audit committee or the body performing equivalent functions within the audited entity;

- (c) identify the dates of the meetings, if any, with the management, administrative or supervisory body of the audited entity;

- (d) *[deleted]*

- (e) where two or more auditor(s) or audit firms have been appointed describe the distribution of tasks among the statutory auditor(s)s and/or the audit firm(s);

- (ea) describe the methodology used, including which categories of the balance sheet have been directly verified and which have been based on system and compliance testing, including an explanation of any substantial variation in the weighting of substantive and compliance testing when compared to the previous year, even if the previous year's statutory audit had been conducted by another statutory auditor(s) or audit firm(s);
- (eb) [...]
- (ec) disclose the quantitative level of materiality applied to perform the statutory audit for the financial statements as a whole and if applicable the materiality level or levels for particular classes of transactions account balances or disclosures, and disclose the qualitative factors which were considered when setting the level of materiality;
- (f) indicate and explain judgments about events or conditions identified during the course of the audit that may cast significant doubt on the entity's ability to continue as a going concern and whether they constitute a material uncertainty; and provide a summary [...] of all guarantees, comfort letters, undertakings of public intervention and other support measures that have been taken into account [...] when making a going concern assessment
- (g) [...]
- (ga) report on the entity's or, in case of consolidated financial statements, the parent undertaking's internal financial control system, including significant internal financial control deficiencies identified during the statutory audit, as well as the accounting system;
- (h) indicate and explain all instances or threats of non-compliance with laws, regulations or articles of association which were identified during the course of the audit and which the statutory auditor(s) or audit firm(s) consider may be important to the audit committee in order to fulfil its tasks;
- (i) assess the valuation methods applied to the various items in the annual or consolidated financial statements including any impact of changes of such methods

- (j) [...]
- (k) if applicable where stocktakes or physical verifications have taken place, confirm any attendance at stocktakes as well as the other instances of physical verification and indicate the proportion [...] of the total stock or other assets that was physically verified by the auditor(s) or audit firm(s);
- (l) indicate and explain the scope of consolidation in and the exclusion criteria applied to the non-consolidated entities applied by the audited entity in the case of a statutory audit of consolidated financial statements;
- (m) where applicable indicate which audit work is performed by third-country auditor(s), statutory auditor(s), third- country audit entity(ies) or audit firm(s) in case of a statutory audit of consolidated financial statements;
- (n) indicate whether all requested explanations and documents were provided by the audited entity.
- (na) [...]
- (nb) indicate
 - (i) significant difficulties, if any encountered during the audit;
 - (ii) significant matters if any arising from the audit that were discussed, or subject to correspondence with management; and
 - (iii) other matters, if any, arising from the statutory audit that in the auditor's professional judgement, are significant to the oversight of the financial reporting process.

Member states may set additional requirements in relation to the content of the additional report to the audit committee.

3. In the case of joint audits in the case of a disagreement between the appointed statutory auditors or audit firms on auditing procedures, accounting rules or any other issue regarding the conduct of the statutory audit, the reasons for such disagreement shall be explained in the additional report to the audit committee.

4. The additional report to the audit committee shall be signed and dated. Where an audit firm carries out the statutory audit, the additional report to the audit committee shall be signed by [...] the statutory auditor(s) carrying out the statutory audit on behalf of the audit firm.
5. Upon request, and in accordance with national law, the statutory auditor(s) or the audit firm(s) shall make available without delay the additional report to the competent authorities within the meaning of article 35(1) of this Regulation.

Article 26

Disclosure of financial information

1. An audit firm that carries out statutory audits of public-interest entities shall prepare and make public an annual financial report within the meaning of Article 4(2) of Directive 2004/109/EC at the latest four months after the end of each financial year.
2. The annual financial report and the annual income statement shall show the total turnover divided into fees from the statutory audit of annual and consolidated financial statements of public-interest entities and entities belonging to a group of undertakings whose parent undertaking is a public-interest entity, fees from the statutory audit of annual and consolidated financial statements of other entities and fees charged for permitted non-audit services.

The annual financial report or the annual income statement shall be audited. [...]

3. Where the statutory auditor or the audit firm belongs to a network, the statutory auditor or the audit firm shall provide the following additional information in the annual financial report or as an annex to the annual income statement or in the Transparency Report:
 - (a) the name of each statutory auditor or audit firm, based in the EU, belonging to the network;
 - (b) the country(ies) in which each statutory auditor or audit firm belonging to the network is qualified as statutory auditor or has his, her or its registered office, central administration or principal place of business;

- (c) the total turnover generated in the European Union by the statutory auditors and audit firms belonging to the network, resulting from the statutory audit of annual and consolidated financial statements;

By derogation from the first subparagraph, the statutory auditor or the audit firm may not provide the additional information where it is disclosed by the legal entity governing the network or another representative of the network. In this case, the statutory auditor or the audit firm shall indicate in the annex to the annual income statement or to the annual financial report where that information is accessible.

4. The annual financial report or annual income statement shall be published on the website of the statutory auditor or the audit firm and shall remain available on that website for at least five years from the date of first publication.

Statutory auditors and audit firms shall communicate to the competent authorities that the annual income statement or ~~to~~ the annual financial report has been published on the website of the statutory auditor or the audit firm.

Article 33
Duration of the audit engagement

1. A public-interest entity shall appoint a statutory auditor or audit firm for an initial engagement of at least one year which can be renewed.

[...]

The maximum duration of the combined engagements shall not exceed ten years. [...]

[...]

1A By way of derogation from paragraph 1 Member States may

- (a) require an initial engagement period of in excess of one year;
- (b) permit more than one renewal subject to the overall maximum duration of combined engagements set out at paragraph 1 sub paragraph 2 or as appropriate in paragraph (c) of this paragraph; and

- (c) prescribe a maximum duration of combined engagements set out at paragraph 1 sub paragraph 2 lower than that set out at paragraph 1 sub paragraph 2.
2. After the expiry of the maximum duration of the engagement referred to in paragraph 1 subparagraph 2 or in paragraph 1A(c) as appropriate, the statutory auditor or audit firm or any members of its network within the Union, where applicable, shall not undertake the statutory audit of the public-interest entity concerned until a period of at least four years has elapsed.
3. By way of derogation from paragraphs 1 and 2,
- (i) the maximum duration period referred to in paragraph 1 subparagraph 2 or paragraph 1A (c) may be renewed once only [...] for a maximum duration period of five years [...] where one or more of the requirements set out in subparagraphs (a) or (b), [...] is satisfied:
- (a) a public tendering process for the statutory audit is conducted, in accordance with paragraphs 2 to 6 of Article 32; or
- (b) where throughout the the continuous engagement of the maximum duration period referred to in paragraph 1 subparagraph 2 or paragraph 1A(c) more than one auditor or audit firm has been appointed
- (ii) Member States may prescribe a lower maximum duration period of additional engagement permitted in this paragraph than that set out in this paragraph.
- (iii) The maximum duration periods referred to in paragraph 1 subparagraph 2 or paragraph 1A(c) shall only be renewed if, upon a recommendation of the audit committee, the administrative or supervisory board in accordance with national law proposes to the general meeting of shareholders to renew the engagement and the proposal meets its approval.

- 3a After the expiry of the maximum engagement referred to in paragraph 1 subparagraph 2, paragraph 1A(c) , paragraph 3(i),or paragraph 3(ii) as appropriate, on an exceptional basis the Public Interest Entity may request the competent authority referred to in Article 35(1) to grant an extension to re-appoint the statutory auditor or audit firm for an additional engagement. In case of appointment of more than one statutory auditor or audit firm, this third engagement shall not exceed three years. In case of appointment of one statutory auditor or audit firm, this third engagement shall not exceed two years.
4. The key audit partner(s) responsible for carrying out a statutory audit shall cease his, her or their participation in the statutory audit of the audited entity after a period of seven years from the date of appointment has elapsed. He, she or they may participate in the statutory audit of the audited entity again after a period of at least three years.
- The statutory auditor or audit firm shall establish an appropriate gradual rotation mechanism with regard to the most senior personnel involved in the statutory audit, including at least the persons who are registered as statutory auditors. The gradual rotation mechanism shall be undertaken in phases on the basis of individuals rather than of a complete team. It shall be proportionate in view of the scale and the dimension of the activity of the statutory auditor or audit firm.
- The statutory auditor or audit firm shall be able to demonstrate to the competent authority that such mechanism is effectively applied and adapted to the scale and the dimension of the activity of the statutory auditor or audit firm.

CHAPTER II

QUALITY ASSURANCE, INVESTIGATION, MARKET MONITORING, ~~CONTINGENCY~~ ~~PLANNING~~ AND TRANSPARENCY OF COMPETENT AUTHORITIES TASKS

Article 40

Quality assurance

1. For the purposes of this Article:
 - (a) "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 41;
 - (b) "inspector" means a reviewer who meets the requirements set out in point (a) of the second subparagraph of paragraph 4 of this Article and is employed by a competent authority;
 - (c) "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.
2. The competent authorities designated under Article 35(1) shall establish an effective system of audit quality assurance.

The competent authority shall carry out quality assurance reviews of statutory auditors and audit firms that carry out statutory audits of public-interest entities at least every three years.
3. The competent authority shall be responsible for the quality assurance system and shall organise it in a manner that is independent of the reviewed statutory auditors and audit firms.

The competent authority shall have the following responsibilities which may not be delegated to any association or body affiliated with the accounting or audit profession:

 - (a) approval and amendment of the inspection methodologies, including inspection and follow-up manuals, reporting methodologies and periodic inspection programmes;

- (b) approval and amendment of inspection reports and follow up reports;
- (c) approval and assignment of inspectors for each inspection.

The competent authority shall allocate adequate resources to the quality assurance system.

4. The competent authority shall 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.

The competent authority shall comply with the following criteria when appointing inspectors:

- (a) inspectors shall have appropriate professional education and relevant experience in statutory audit and financial reporting combined with specific training on quality assurance reviews;
- (b) a person who is a practising statutory auditor or is employed or otherwise associated with a statutory auditor or an audit firm shall not be allowed to act as an inspector;
- (c) a person shall 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;
- (d) inspectors shall declare that there are no conflicts of interest between them and the statutory auditor and audit firm to be inspected.

By way of derogation from 1(b) of this Article, the competent authority may contract experts for carrying out specific inspections when the number of inspectors within the authority is insufficient. The competent authority may also be assisted by experts when this is essential for the proper conduct of an inspection. In such instances, the competent authorities and the experts shall comply with the requirements of this paragraph. Experts shall not be involved in the governance of, or employed by professional associations and bodies but may be members of such associations or bodies.

5. The scope of inspections shall cover:

- (a) an assessment of the design of the internal quality control system of the audit firm or of the statutory auditor;
- (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) of this paragraph, 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 27.

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

- (a~~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 of Directive 2006/43/EC and [Articles 5 to 10 of this Regulation], as well as relevant laws, regulations and administrative provisions of the Member State concerned;
- (b~~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~~c~~) compliance with the requirements set out in Article 9 on the audit fees charged.

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

The competent authorities shall also periodically review the methodologies used by statutory auditors and audit firms to carry out statutory audit.

Inspections shall be appropriate and proportionate in view of the scale and complexity of the activities of the reviewed audit firm or statutory auditor.

6. The findings and conclusions of inspections on which recommendations are based, including the findings and conclusions related to a transparency report, shall be communicated to and discussed with the inspected statutory auditor or audit firm before an inspection report is finalised.

Recommendations of inspections shall be implemented by the inspected statutory auditor or audit firm within a reasonable period set by the competent authority. Such period shall not exceed 12 months in the case of recommendations on the internal quality control system of the audit firm.

7. The inspection shall be the subject of a report which shall contain the main conclusions of the quality assurance review.

Article 41

Investigation

The competent authorities designated under Article 35(1) shall establish effective systems of investigation with a view to detecting, examining and [...] detering inadequate carrying out of the statutory audit of public-interest entities.

Where a competent authority contracts experts, as defined in Article 40, for carrying out specific assignments, the authority shall ensure that there are no conflicts of interest between these experts and the statutory auditor or audit firm under investigation.

These experts shall comply with the same requirements as those provided for at Article 40(4) of this Regulation.

Article 42

Market monitoring

1. The competent authorities designated under Article 35(1) or the competition authorities of the Member States, as appropriate, shall regularly monitor the developments in the market for providing statutory audit services to public-interest entities.

The competent authorities shall in particular assess the following:

- (a) the risks arising from high concentration, including the demise of any audit firm(s) with significant market share, the disruption in the provision of statutory audit services whether in a specific sector or across sectors, the further accumulation of risk in the market and the impact on the overall stability of the financial sector;
 - (b) the need to adopt measures to mitigate those risks.
2. By X X 20XX [2 years after the entry into force of the Regulation], and at least on a three-year basis thereafter, each competent authority or competition authority, whichever is appropriate, shall draw up a report on this issue and submit it to ESMA, EBA and EIOPA.

ESMA, EBA and EIOPA shall use those reports to draw up a joint report on the situation at Union level. The report shall be submitted to the Commission, the European Central Bank and the European Systemic Risk Board.

Article 44

Transparency of Competent Authorities

Competent authorities shall be transparent and shall at least publish:

- (a) annual activity reports regarding the tasks the competent authorities are required to carry out under this Regulation;
- (b) annual work programmes regarding the tasks the competent authorities are required to carry out under this Regulation;

- (c) a report on the overall results of the quality assurance system on an annual basis. This report shall include information on recommendations issued, follow-up on the recommendations, supervisory measures taken and penalties imposed. It shall also include quantitative information and other key performance information on financial resources and staffing, and the efficiency and effectiveness of the quality assurance system;
- (d) the report referred to in Article 40(7), which shall have regard to the specific need to protect the commercial interests of the audited entities and the statutory auditor and audit firm, including that of industrial and intellectual property.

Article 46 Regulation

Establishment of CEAOB

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- 1. Without prejudice to the organisation of national auditing oversight, the cooperation between competent authorities shall be organised within the framework of a Committee of European Auditing Oversight Bodies, hereinafter referred to as ‘CEAOB’.

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- 1a. The CEAOB shall be composed of high level representatives from the competent authorities referred to in Article 32 of Directive 2006/43/EC.

- 1b. The CEAOB shall adopt guidelines and recommendations, for the purposes of Articles XX [to be completed with the relevant articles]. [The competent authorities shall endeavour to follow CEAOB recommendations and guidelines upon their adoption.

or

The competent authorities shall consider such guidelines and recommendation before taking any decision under this Regulation.]

or

- 1b. The CEAOB shall provide advice to the Competent authorities in the cases provided for in this Regulation. The Competent authorities shall consider that advice before taking any final decision under this Regulation.

In order to facilitate the exercise of the tasks provided for in this Regulation, the CEAOB shall issue guidelines, as appropriate, on:

- (a) common standards on the content and presentation of the report referred to in Article 22;
- (b) common standards on the content and presentation of the report referred to in Article 23;
- (c) common standards on the oversight activity of the audit committee referred to in Article 24;
- (d) common standards and best practices on the content and presentation of the report referred to in Article 27;
- (e) common standards and best practices on the gradual rotation mechanism referred to in Article 33;
- (f) common standards and best practices regarding the dismissal of auditors, in particular on the existence of proper grounds for it, as referred to in Article 34;
- (g) enforcement practices and activities to be conducted by competent authorities under this Regulation;
- (h) common standards and best practices for conducting quality assurance reviews provided for in Article 40, taking into consideration, in particular:
 - (i) the different scale and dimension of activity of statutory auditors and audit firms and policies;
 - (ii) the commonality of quality standards, policies and procedures to which members of networks of statutory auditors and audit firms adhere;
- (i) common standards and best practices for conducting investigations provided for in Article 41;
- (j) procedures and modalities for cooperation with regard to quality assurance reviews and for joint investigations and inspections provided for in Article 49;
- (k) the operational functioning of the colleges provided for in Article 53, including on the modalities for determining the membership to the colleges, the selection of facilitators, the written arrangements for the operation of the colleges and the coordination arrangements between colleges.

1c. The CEAOB shall assume all existing and on-going tasks, as appropriate, of the European Group of Audit Oversight Bodies (EGAOB) created by Commission Decision 2005/909/EC.

2. The CEAOB shall be chaired by the Commission.
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3. The CEAOB may establish sub-groups on an ad hoc basis to examine specific issues under the terms of reference established by the CEAOB.
4. At the request of XX committee members, or on its own initiative, where this is considered useful and/or necessary, the chair of the CEAOB may invite experts, including practitioners, with specific competence on a subject on the agenda to participate in the CEAOB's or its sub-group's deliberations as observers.
5. The CEAOB's discussions shall not be public.
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6. The Secretariat of the CEAOB shall be provided by the Commission. The CEAOB and its sub-groups shall normally meet on Commission premises in accordance with the procedures and schedule established by it.
7. The CEAOB shall adopt its rules of procedure on the basis of the standard rules of procedure adopted by the Commission.
8. The Commission shall publish the guidelines and recommendations adopted by the CEAOB.
9. The Commission shall reimburse travel and, where appropriate, subsistence expenses for members of the CEAOB and experts invited in connection with the CEAOB's activities in accordance with Regulation 966/2012 and rules adopted pursuant to it, but shall not pay them for their duties carried out under this Regulation. Meeting expenses shall be reimbursed within the limits of the appropriations allocated to the department concerned under the annual procedure for allocating resources.

Article 70
Transitional provision

1. By derogation from Articles 32 and 33, the following requirements shall apply to contracts for the provision of statutory audit to public-interest entities which are in force at [date of entry into force of this Regulation]:
 - (a) any audit contract entered into before XX/XX/XXXX [*the date of adoption of the Commission proposal*] which is still in force on [*the date of entry into force of this Regulation*] shall remain applicable for a maximum period of four accounting years after [*the date of entry into force of this Regulation*];
 - (b) any audit contract entered into after XX/XX/XXX [*the adoption of the Commission proposal*] but before XX/XX/XXXX [*the date of entry into force of this Regulation*] and which is still in force shall remain applicable for a maximum period of five accounting years after XX/XX/XXXX [*the date of entry into force of this Regulation*];
 - (c) when an audit contract referred to in points (a) or (b) of this paragraph expires or is terminated, the public-interest entity may renew such contract once with the same audit statutory auditor or audit firm, without the provisions Article 31(3) being applicable. Such renewed contract shall be subject to the following maximum duration:
 - (i) 1 year: if the auditor has been providing services to the audited entity for a consecutive period exceeding 100 years;
 - (ii) 2 years: if the auditor has been providing services to the audited entity for a consecutive period between 51 and 100 years;
 - (iv) 3 years: if the auditor has been providing services to the audited entity for a consecutive period between 21 and 50 years;
 - (v) 4 years: if the auditor has been providing services to the audited entity for a consecutive period between 11 and 20 years;
 - (vi) 5 years: if the auditor has been providing services to the audited entity for a consecutive period not exceeding 10 years.

By derogation from the criteria set out in point (c), the audit contract may remain applicable until the end of the first accounting year ending after [*2 years after the entry into force of this Regulation*].

By derogation from points (a) to (c), when national rules establish a maximum duration of the contractual relationship between the statutory auditor or the audit firm and the audited entity which does not exceed 9 years and require the audited entity to select a different statutory auditor or audit firm when such maximum duration is reached, the audit contract may remain applicable until the end of that maximum duration period.

2. Article 33 shall apply to any audit contract entered into after [...] [*the date of the entry into force of this Regulation*] but before [...] [*2 years after the entry into force of this Regulation*].

Article 32(3) shall only apply to such contract after the expiration or termination of the first renewal of such contract.

Article 71a

Repeal of Commission Decision 2005/909/EC

Commission Decision 2005/909/EC is hereby repealed.
