

The CEAOB has published an analysis on the requirements for audit committees contained in both the Audit Regulation (Regulation (EU) No 537/2014) and Directive (Directive 2006/43/EC). The Market Monitoring Sub-group analysed the results of a questionnaire sent to audit committees across European member states, the report and its results are set out below.

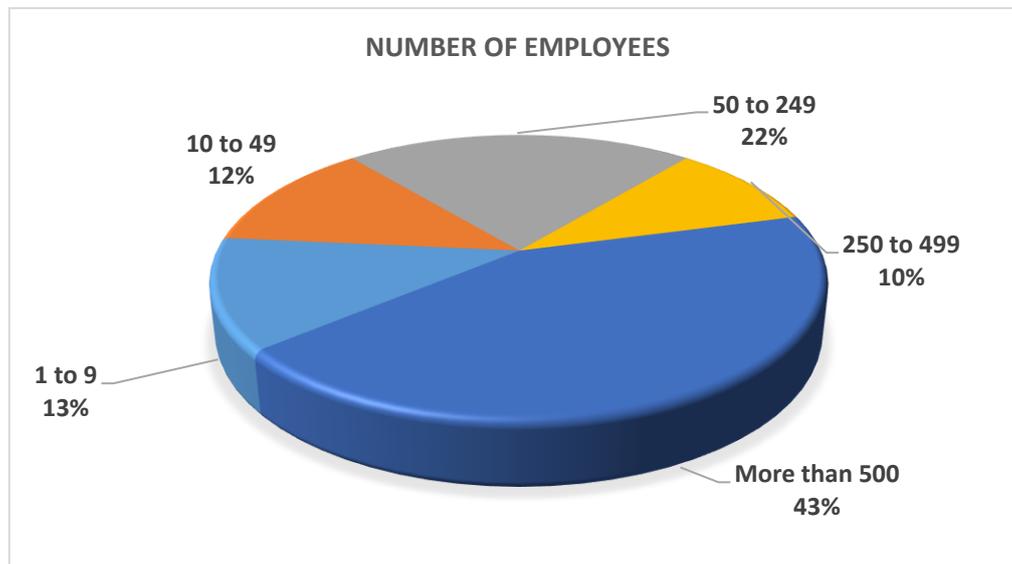
Date of Issuance: 18 December 2020

Overview

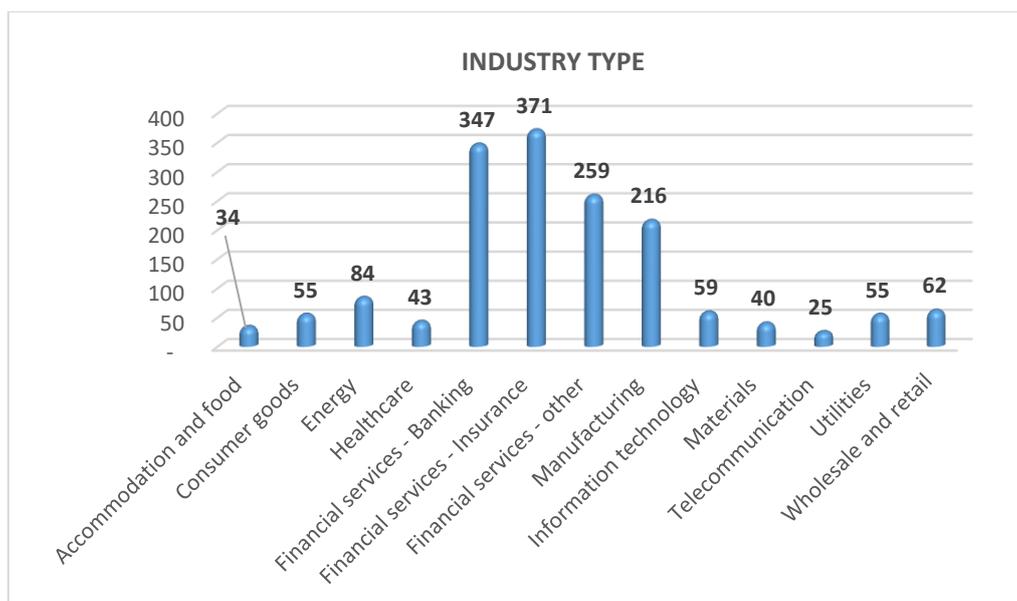
Between November 2018 and April 2019 a questionnaire was sent to a sample of audit committees in member states across Europe. This questionnaire was developed by the CEAOB to gather information on the application of the requirements for audit committees contained in both the Audit Regulation (Regulation (EU) No 537/2014) and Directive (Directive 2006/43/EC) (together the 'Regulations'). The objective was also to help National Competent Authorities ("NCAs") understand how audit committees were operating following the introduction of the audit rules as well as the practical difficulties they faced in carrying out their tasks.

1695 audit committees' responses were gathered, in 26 member states¹.

The following charts give a breakdown by number of employees and industry (please note for the industry graph some public interest entities sampled fell outside the descriptors which accounts for the difference in number of PIEs (1695 vs 1651)):



¹ 2 member states did not provide data in respect of audit committee questionnaires



The information collected in this questionnaire was collated, aggregated, anonymised and sent on to the European Commission who use the information in the preparation of their second market monitoring report at EU level.

This report, prepared by the market monitoring sub-group of the CEAOB, sets out more details about the data collected.

The questionnaire was divided into the following sections:

- Audit committee composition and skills
- Interaction with the administrative or supervisory body
- Independence including the prior approval of permitted non-audit services
- Auditor selection process
- Oversight of the audit function
- Oversight of the financial reporting process
- Oversight of internal quality control and risk management systems

The questionnaire was set out as a series of questions relating to specific requirements of both the Audit Regulation and Directive, where respondents could respond either 'Yes', 'Yes, partly', 'No' or 'Not applicable'. Where audit committee members were responding 'No' to a particular question it was generally indicative of a failure to apply an aspect of the Regulations, however as no other information was obtained from the Audit Committees, we are not able to conclude without further investigation, if it is actually a failure to apply an aspect of the Regulations. Respondents were asked to provide their answers with respect to a specific reference period. The reference period was defined as the interval of time (usually twelve months) between the annual general meeting at which the most recent statutory accounts have been approved and the annual general meeting at which the accounts for the previous financial year were approved.



Limitations of the analysis:

Given that the audit committee questionnaire was completed by audit committee chairs it is essentially a self-assessment and as such certain precautions must be taken when interpreting the data. It should also be noted that no additional work was performed to corroborate the responses given. The audit committees' responses to the questions posed are, to a certain extent, a measure of their compliance (or non-compliance) with legal requirements and resulting data must be examined in this context. Any resulting findings or conclusions must also be viewed in this context.

Summary Findings

The responses provided by the audit committees indicated a broad application of the requirements of both the Audit Regulation and Directive (ARD). However a number of areas were highlighted where there were indications of either non-compliance with the ARD or a lack of understanding around the application of the ARD. The chart below summarises the findings of this analysis. Low levels of indicators of non-application of the ARD (items marked green) were classified 2 or less identified instances where the percentage of 'yes' responses was less than 80% and these identified instances were also indicative of non-application of the ARD. Areas classified as having medium levels of non-application (items marked orange) had multiple instances (more than 2) of 'yes' responses less than 80%, where those instances were also indicative of non-application of regulation.

Section	Low or Medium level of occurrence of non-application of regulation	Relevant Section
Audit Committee Independence	Low	1
Monitoring of fees paid to statutory auditors	Low	3
Non-examination of requests for the provision of non-audit services by Audit Committees	Low	3
Audit Tenders – Invitation to Tender	Medium	4
Audit Tenders – non-discriminatory process	Low	4
Audit oversight – auditor meetings	Low	5

It cannot be definitively stated that these can be identified as areas of non-compliance, nevertheless the analysis warrants further investigation especially in the area of audit tendering.

Next steps:

Using the above findings as a basis, the market monitoring sub-group will draft a guidance note around the areas of potential non-application identified. The sub-group encourages National Competent Authorities to continue to engage with audit committees at local level using this analysis as an aid to understand if there are deficiencies in application of the ARD or if there are other contributory factors.

1. Audit Committee Composition and skills

Chart 1

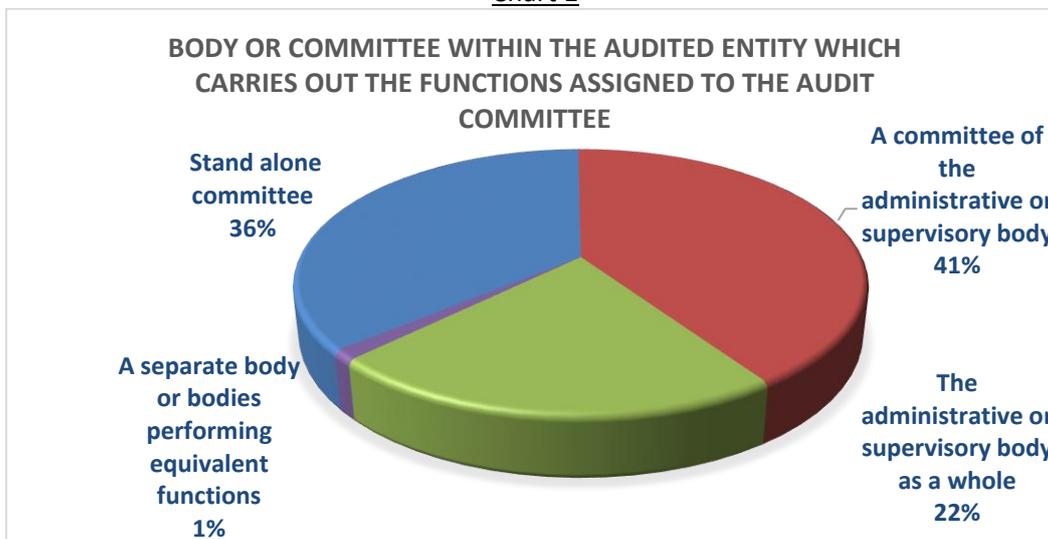


Chart 1 is a reflection of the diversity of administrative structures across Europe, as well and the tiered leadership structure that is in place in certain jurisdictions.

96% of audit committees confirmed that at least one member of that body/committee had competence in accounting and/or auditing.

Over 90% of audit committees questioned confirmed that members as a whole, had experience relevant to the sector in which the audited entity is operating. 8% of the audit committees indicated that a majority of its members were not independent of the audited entity. Some audit committees may have used exemptions set out in local legislation around independence requirements but the data may also indicate non-compliance. In addition it should be noted that the Audit Directive does not provide a specific definition for “independence” in this context and therefore subject to differing interpretations across the various member states.

2. Interaction with the administrative or supervisory body

Chart 2

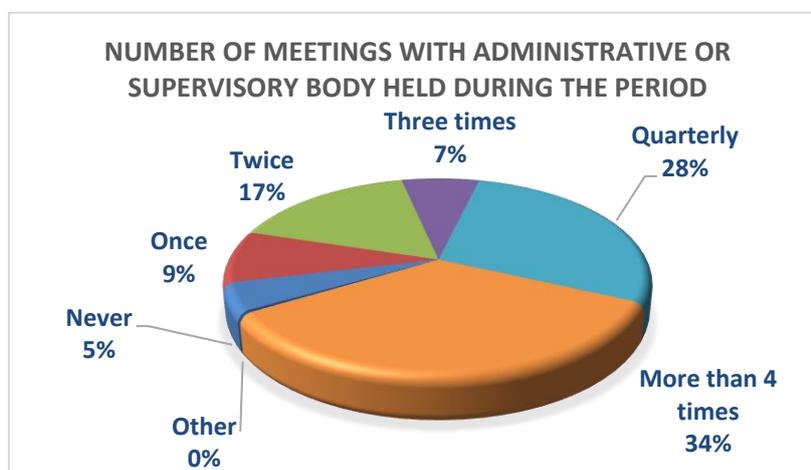
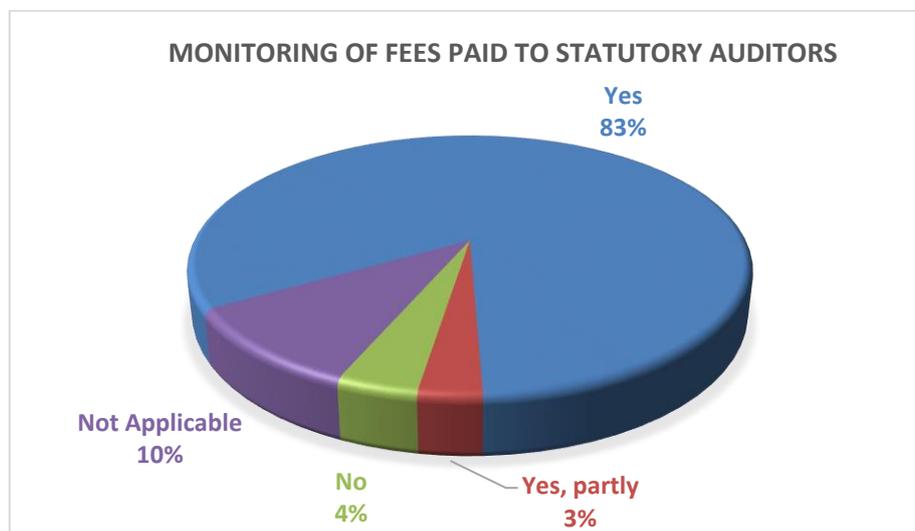


Chart 2 indicates the number of meetings held with the administrative/supervisory body during the period. 5% of audit committees had never a meeting with the supervisory body, whereas 63% of the audit committees (irrespective of size or sector) had a meeting with the supervisory board/body four or more times during the reference period.

83% of the respondents indicated that the audit committee explains its role in the statutory audit to the administrative or supervisory body of the entity. 88% informed the administrative or supervisory body of the outcome of the statutory audit and 81% explained to the administrative or supervisory body how the statutory audit contributed to the integrity of the financial reporting.

3. Independence including the prior approval of permitted non-audit services

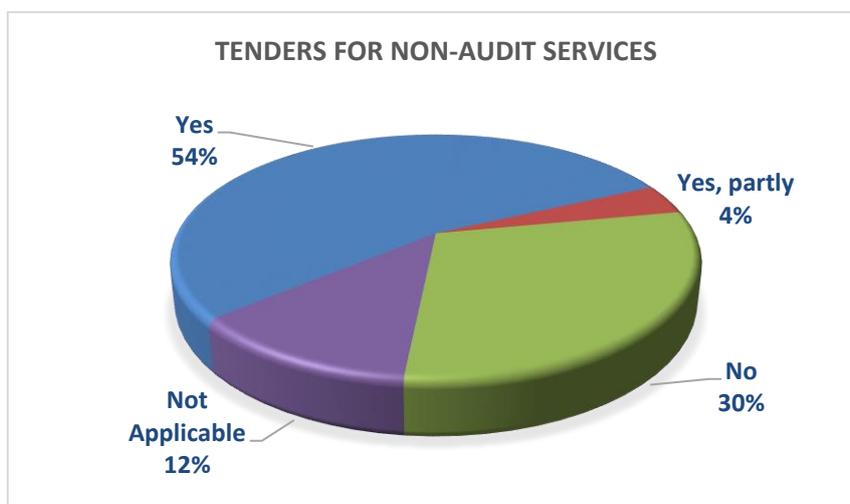
Chart 3.1



When asked whether audit committees monitored the amount of fees paid to the statutory auditor (or the audit firm) in order to ensure future compliance with the permitted non-audit services fee cap of 70%, in so much as we can surmise there appears to be a large degree of compliance however 4% of those surveyed that did not monitor fees paid to the statutory auditor.

95% of those surveyed confirmed that the audit committee received a written representation from the statutory auditor (or the audit firm) confirming that the statutory auditor, the audit firm and partners, senior managers and managers, conducting the statutory audit were independent of the entity. In only 76% of the cases, the statutory auditor and the audit committee discussed the threats to independence as well as safeguards applied to mitigate those threats.

Chart 3.2



54% of the respondents stated that the statutory auditors (audit firms) submitted tenders for the provision of non-audit services to the audited entity during the period. In 92% of the cases, the audit committee examined those services before their performance by the audit firm. The remaining 8% of audit committee respondents who stated that the requests for the provision of non-audit services by their statutory auditor were not examined by the audit committee may be indicative of a breach in regulation or refer to the practice of pre-approving non-audit services. Regardless of the rationale for non-examination of requests for non-audit services, it does not absolve audit committees of their obligations around approval of non-audit services to avoid any potential threats to independence.

After examination of the services proposed, only 4% of the audit committees withheld approval of any of the provision of those services during the reference period.

4. Auditor selection process

33% of audit committees surveyed went through the process of selecting a new statutory auditor or reappointing a previous statutory auditor after a tendering process was performed within the defined period. The data suggested that audit committees were aware of a number of the regulatory requirements around auditor selection, including:

- that the audit committee assume responsibility with regard to the selection procedure
- that tender documents contain sufficient information to allow invited statutory auditors (or audit firms) to understand the business of the entity
- that tender documents contain transparent non-discriminatory selection criteria that was used by the entity to evaluate the proposals made by statutory auditors (or audit firms)

A number of areas were also highlighted that require further investigation as to why there appears to be more mixed response in terms of application of the requirements, these areas are set out below.

Chart 4.1

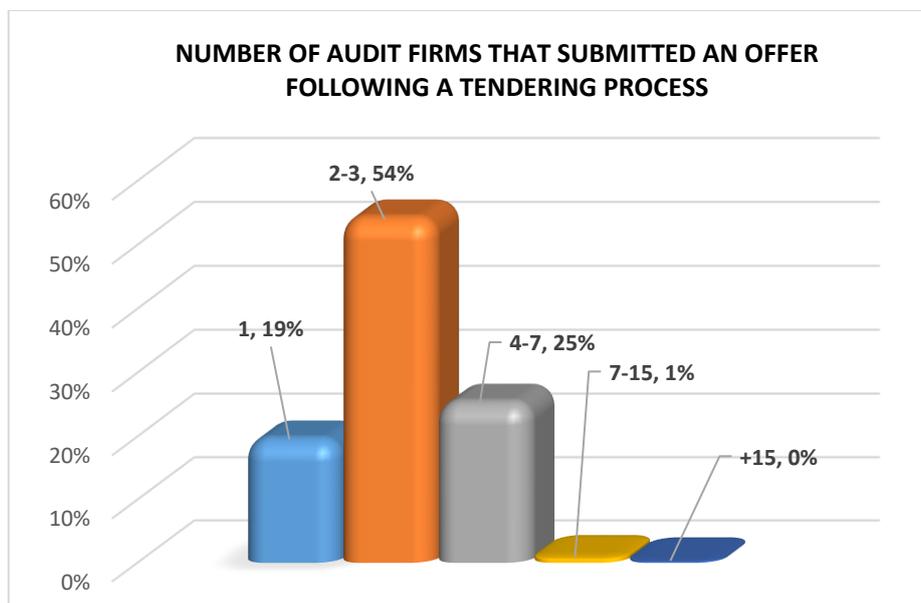


For those who organised a tender, 16% issued an invitation to tender to only one audit firm which is not technically in compliance with the Audit Regulation given that Art 16.2 of the Audit Regulation requires at least two candidates to be invited to participate in the tender process. There may be extenuating circumstances as to why only one invitation to tender may be issued, such as lack of suitable candidates in the market. This situation also raises wider questions on a potential lack of competition in the audit market which falls outside the scope of this analysis.

75% of the PIEs that proceeded to tender during the reference period invited between 2 to 7 audit firms to participate.

Respondents were then asked how many statutory auditors (or audit firms) finally submitted an offer following the tendering process.

Chart 4.2



The above graph displays the percentage response rate (number of tenders received) broken down by the number of tender invitations issued. Figures show a high correlation between the number of audit firms invited to participate to a tender and the number of audit firms that finally submitted a tender following the tendering exercise. The response rate decreases when the number of audit firms invited, increases.

The audit Regulation requires that a tender process allow for the participation in the selection procedure of firms which received less than 15% of total fees from public-interest entities in the Member State in the previous calendar year. Only 56% of audit committees (which had a tender process within the reference period) responded that this criterion was applied indicating a potentially high level of non-compliance and/or lack of understanding of the requirements of the Regulation.

When asked if the audit committee identified in its recommendation to the administrative or supervisory body at least two candidates for appointment only 58% indicated they had done so.

5. Oversight of the audit function

Chart 5

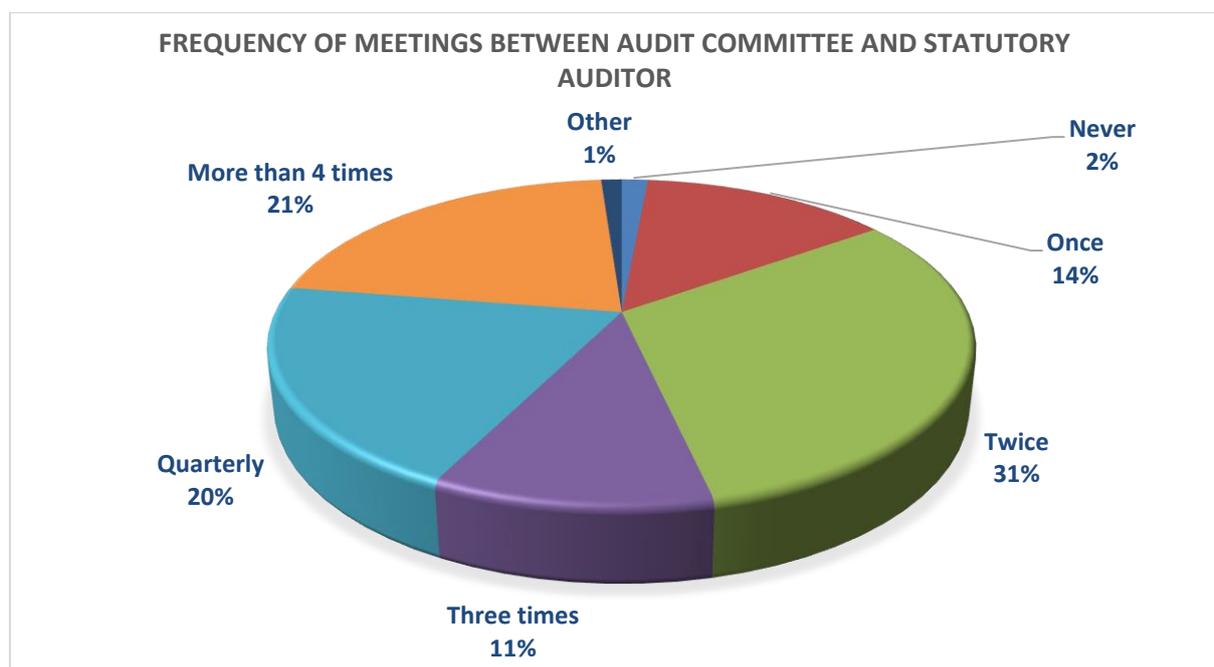


Chart 5 shows the frequency of meetings between the audit committee and the statutory auditor in the reference period. The varying levels of interaction between the audit committee and statutory could be attributed to a number of factors, such as the size and complexity of the entity or the industry type of the entity.

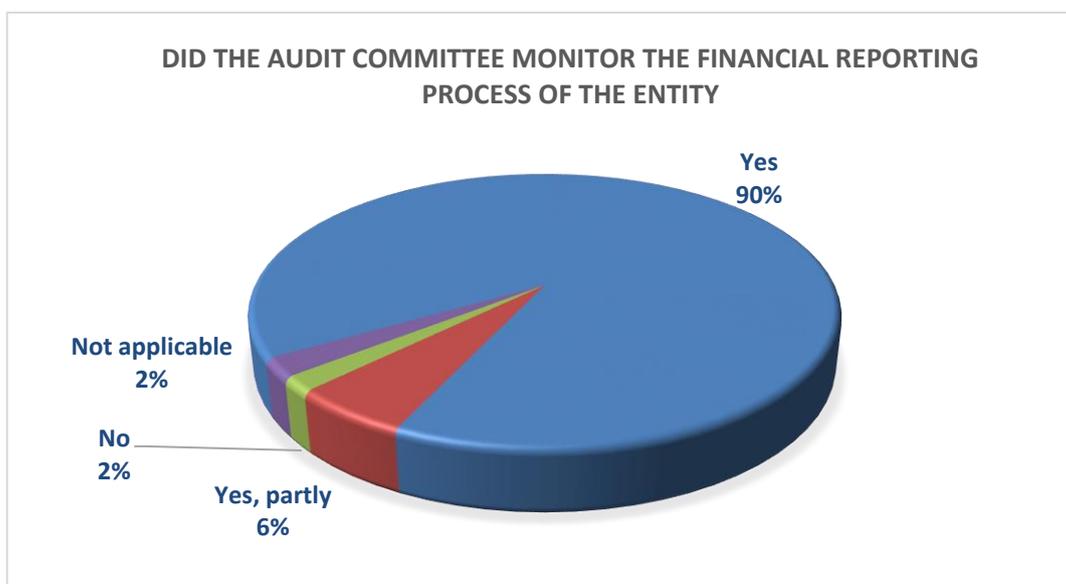
However, 2% of respondents did indicate that they did not meet the statutory auditor within the period. 3% indicated the audit committee did not monitor the performance of the statutory audit of the annual and consolidated financial statements of the entity which raises questions on how the

audit committee adequately discharged their regulatory obligations. When asked if the audit committee considered the findings (if any) and conclusions made by national competent authorities during their last inspection of the statutory auditor (or audit firm) 61% respondents gave a response of not applicable. This can be attributed to a number of reasons, the entity was not inspected in the period, the findings may not have been shared with the audit committee (information made available to the audit committee) or legal impediments to regulators sharing inspection findings with audit committees.

4% of the audit committees did not discuss with the statutory auditor key matters arising from the statutory audit, in particular significant deficiencies in the entity's, in the entity's internal financial control system and/or in the accounting system.

6. Oversight of internal quality control and risk management systems

Chart 6



For the period under review the vast majority of audit committees stated that they monitored the financial reporting process and the effectiveness of the entity's internal quality control and risk management systems. However, only 48% of audit committees submitted recommendations or proposals to ensure the integrity of the financial reporting process. This is not necessarily indicative of an underlying issue, with some audit committees stating that there were no recommendations to be brought forward in respect of the integrity of the financial reporting process.

89% of them monitor the effectiveness of the entity's internal quality control and risk management systems and, where applicable, its internal audit regarding the financial reporting of the audited entity.