



# EUROPEAN Update



JUNE 2003

Issue No. 2 / 2003

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LATEST NEWS:

SME: In its latest comment letter FEE welcomes the EC Green Paper entitled 'Entrepreneurship in Europe'

[www.fee.be/secretariat/Positionpaper.htm](http://www.fee.be/secretariat/Positionpaper.htm)

FEE Council meeting approves a wide range of new publications

See Page 4 for more details

## EC COMMUNICATIONS

The European Commission (EC) recently launched two major Communications: one on statutory audit; and the other on company law and corporate governance.

FEE supports the reform of corporate regulation and oversight of the audit profession in Europe, as outlined in the Communications.

FEE has responded with a policy paper outlining in detail the views of the European accounting profession to each issue raised by the EC. The paper also suggests possible next steps in the reform process.

For further information and links to the official EC documents, together with FEE's press release and related policy document:

[www.fee.be/european/eunews.htm](http://www.fee.be/european/eunews.htm)

## CORPORATE GOVERNANCE AND COMPANY LAW

*Mr. Johannes Guigard, Chairman of FEE's Company Law Task Force outlines the European accountancy profession's response to the EC Communication on Company Law and Corporate Governance*

The European Commission (EC) published two Communications on 21 May 2003: the first outlined ten priorities for harmonising and improving the quality of statutory audit throughout the EU; and the second was an action plan focused on company law and corporate governance.

By linking these two initiatives the EC has clearly signalled the relevance of company law and corporate governance to the work of the accountancy profession, thus widening the scope of issues on which FEE can be expected to contribute.

The Communications take

place against a backdrop of high profile financial scandals which have shaken consumer and investor confidence. It is clear that in the context of restoring confidence in financial markets, the role of all players in the financial reporting chain needs to come under scrutiny.

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## STATUTORY AUDIT REFORM

*Report on the new proposals on auditing, recently issued by the European Commission, which aim to drive the creation of a single EU capital market*

On 21 May 2003, the European Commission published simultaneously two major Communications outlining future plans for audit strategy and for company law and corporate governance.

Supporting the reforms, FEE immediately called for urgent progression of the European Commission's proposals, noting the need for

member states to implement reforms consistently.

The European Commission (EC) has stated that "the integration of European capital markets requires the quality of auditing in the EU to be reinforced further". The main driver for the Communication is the development of the single European capital market and continued efforts to

harmonise and improve the approximately two million statutory audits conducted annually in the EU.

The Communication on Statutory Audit outlines ten priorities necessary to improve and harmonise the quality of statutory audit across the EU. The EC's plan is divided into both short and medium term priorities.

### Oversight

The proposals note that for the auditing profession robust oversight in the public interest is necessary. Hence oversight is amongst the short term

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# SAFEGUARDING INVESTOR CONFIDENCE

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**"a well-developed company law framework will drive economic growth by facilitating business efficiency and enhancing the competitiveness of European financial markets."**

Johannes Guigard  
FEE Company Law Task Force Chairman

## References:

For links to the official EC documents, together with FEE's press release and related policy document:

<http://www.fee.be/european/eunews.htm>

FEE Discussion Paper on the Financial Reporting and Auditing Aspects Of Corporate Governance

<http://www.fee.be/publications/main.htm>  
(section: Capital Markets)

## Note !

Paper copies of FEE publications can be ordered from the FEE secretariat:

[Sylvie\\_Romancide@fee.be](mailto:Sylvie_Romancide@fee.be)

## Jaap Winter Group

FEE had previously participated in the consultation by the High Level Group of Company Law Experts, (the so called Jaap Winter Group), proposing a number of suggestions which were taken into consideration in the group's final report. The Winter Group report was published in November 2002. The Communication on company law and corporate governance is the EC's response to the report.

At the beginning of 2003, FEE set up its Company Law Task Force. The Task Force will enable FEE to make a detailed comment to the action plan for corporate governance and company law as outlined in the Communication of 21 May 2003 (there is a three month public consultation period).

FEE welcomed the Communication on the day it was published. There is a need to strengthen European corporate governance arrangements for listed companies so that they are equally effective in encouraging the provision of financial information of the highest quality to the capital markets. FEE supports the EC in believing that EU-wide consistency needs to be achieved on such elements as confirming the collective responsibility of directors for financial reporting and the function of audit committees in providing high quality financial information for investors. The proposed European Corporate Governance Forum could support convergence of best practice and FEE would be pleased to participate in the Forum.

Regarding company law the EC's corporate restructuring initiatives aim to allow European companies to do business more easily across national borders within the EU. In the short

term, the EC intends to present a new proposal for a Tenth Company Law Directive, facilitating mergers between companies from different member states. The action plan also foresees a proposal for a Fourteenth Company Law Directive on the transfer of a company's headquarters from one EU member state to another.

## Short Term Priorities

The proposal to amend the Second Company Law Directive, on the formation of public limited liability companies and the maintenance and alteration of their capital, is a short term priority of the EC. The proposal aims to promote business efficiency and competitiveness, whilst not reducing shareholder protection, and it may result in a partial relaxation of certain rules; for example those applicable to contributions in kind and acquisition of own shares.

In the medium term, an alternative regime not based on the concept of legal capital could be offered as an option to member states. The Commission will launch a study into the feasibility of an alternative based on a solvency test. FEE is calling for the study on the solvency test to be upgraded from a medium term priority, as the rules on distribution of profits in the 2nd Directive could become a problem when applying IFRS after 2005.

Furthermore, the EC believes that for groups of companies, more transparency is necessary. Initiatives aiming at improving the financial and non-financial information disclosure are priorities for the short term.

FEE has committed to undertake proactive work in the Company Law area. The Task Force will also

cooperate and coordinate related activity with other working parties in FEE; for example, with the Corporate Governance Subgroup, who have just finalised a discussion paper on the financial reporting and auditing aspects of corporate governance.

## Independent Directors

Focusing on good corporate governance, areas where action could be taken include increasing the role and authority of independent directors; tightening the definition of 'independent' director; and adding new audit committee qualification requirements. In addition, shareholders could be given more opportunity to monitor and participate in the governance of their companies; hence new control and enforcement mechanisms may be necessary.

In conclusion, the Communication is a welcome initiative. FEE will work to support the realisation of the action plan. The European accountancy profession is keen to demonstrate its integrity, expertise and relevance by contributing appropriate solutions in the public interest. A strengthening of corporate governance systems, in the broadest sense, will be positively received by Europe's capital markets, and will help to increase investor confidence.

## NEXT STEPS:

The official FEE response to the consultation on the EC Communication of 21 May 2003 on Company Law and Corporate Governance will be available from:

<http://www.fee.be/secretariat/Positionpaper.htm>

# PUBLIC SECTOR ACCOUNTABILITY

*New call for all public sector organisations to publish annual management reports, both in the interests of good corporate governance and to allow greater awareness of the process of government*

The latest FEE publication recommends that all public sector organisations publish an annual management report in addition to the annual audited financial statements of the organisation. Even where there is no legal obligation to prepare such a report, it should be prepared in the interests of good corporate governance, the paper concludes.

The annual management report is an instrument of accountability, and together with the annual financial statements, conveys information needed by the different stakeholders. It presents, the overall position of the organisation for which operational, technological, legal and economic perspectives may also be significant, in addition to financial aspects.

The discussion paper makes suggestions about the financial and other related information that should be included in the annual management report. Such information includes a commentary about the financial position of the organisation, in comparison with expectations as set out in the budget. The paper also suggests that a range of indicators and measures are necessary to identify the efficiency and effectiveness of the organisation. The report should also include a statement about the management of risk and the internal control processes that have been introduced. It should comment on the effectiveness of those controls and the process for review.

## EC COMMUNICATION ON STATUTORY AUDIT

*(Continued from page 1)*

priorities. The EC recognises that oversight is best organised at member state level, with a European level co-ordination of the national systems. Common EU principles will be developed on the appropriate composition and duties of public oversight arrangements. This will increase trust in the effectiveness of European audits. FEE strongly supports the establishment of an effective EU co-ordination mechanism; it is important, however, that it does not simply become a further administrative layer.

### ISAs

The EC's proposal to require the use of International Standards on Auditing (ISAs) for all audits by 2005, is a positive development. FEE has been calling for Europe to move to ISAs for some time, and is ready to assist in the necessary preparatory steps.

### 8th Company Law Directive

The EC will modernise the 8th Company Law Directive (84/253/EEC) to ensure a comprehensive, principles-based Directive applicable to all statutory audits. The modernised Directive will include principles on: public oversight; external quality assurance; auditor independence; code of ethics; auditing standards; disciplinary sanctions; and the appointment and dismissal of statutory auditors. FEE will make concrete proposals on each of these issues.

### EU Regulatory Infrastructure

A new Audit Regulatory Committee will

be established and the present EU Committee on Auditing, will be renamed the Audit Advisory Committee. FEE welcomes the EC's intention to continue the present EU Committee on Auditing, as a discussion forum between regulators and the audit profession.

### Medium Term Priorities

A number of medium term priorities have been targeted. Corporate Governance is included amongst these; the EC plans to strengthen audit committees and internal control. The Audit Advisory Committee, will address issues concerning the appointment, dismissal and remuneration of statutory auditors, as well as communication between the statutory auditor and the company being audited.

Following the Sarbanes-Oxley Act, reporting on internal control is now an obligation in the US. The necessity to go the same route is being considered in Europe. FEE Council has already decided to set up a subgroup of the Auditing Working Party in order to make proposals in this regard.

### Auditor Liability

On auditor liability, FEE is calling for the issue to be studied as a priority as there is a strong public interest in reform. Auditor liability should reflect the different responsibilities for financial reporting of management and auditors. It is essential that audit liability reasonably relates to the consequences of unsatisfactory audit performance. FEE therefore supports the

European Commission's intention to study this issue and would like to see it progressed urgently.

### Conclusion

Reform is necessary and all players in the financial reporting supply chain should play their part in restoring confidence in capital markets.

To this end, FEE will soon publish two highly relevant and timely papers, one on the financial reporting and auditing aspects of corporate governance and the other on European coordination of public oversight.

By so doing, the European accounting profession is aiming to stimulate an informed debate amongst all market participants. Broad acceptance is the best guarantee of successful reform, and wider involvement will ensure that the reforms serve the public interest.

### NEXT STEPS:

**Building on the momentum generated by the EC Communication on Statutory Audit, of 21 May 2003, FEE will publish a new discussion paper which makes recommendations regarding public oversight of the European auditing profession.**

**It will be available from:**

<http://www.fee.be/publications/main.htm>

"Public Sector Annual Management Reports on the activities for the financial year"

- is available from the FEE member body, Chartered Institute of Public Finance and Accountancy (CIPFA): [www.cipfa.org.uk](http://www.cipfa.org.uk)

- and from FEE at: [www.fee.be/publications/main.htm](http://www.fee.be/publications/main.htm)

For links to the official EC documents, together with FEE's press release and related policy document:

[www.fee.be/european/eunews.htm](http://www.fee.be/european/eunews.htm)



## COMPETITION IN PROFESSIONAL SERVICES

### *Report on the latest developments in the European Commission's internal market strategy for services*

Professional services were highlighted as a key component of the 'Internal Market Strategy for Services', launched at the Lisbon European Council in March 2000. The European Commission (EC) subsequently identified a comprehensive inventory of barriers to cross-border services. In January 2003 a study was conducted on behalf of the Directorate General Competition comparing the varying levels of regulation for the liberal professions, in each member state.

The study concludes that consumers are adequately protected in those countries where there is a lower level of regulation of professional services. It suggests that although countries

with a lower degree of regulation generally have lower revenues per professional, such countries typically have a proportionally higher number of practitioners, and thus generate higher overall turnover than countries with more regulation. It considers reduced regulation to be a spur to overall wealth creation.

Based on this study, which has been heavily criticised by many European representatives of the liberal professions, the EC has now issued a working document on the effect of regulation in the liberal professions and has launched an accompanying questionnaire.

The Directorate General Competition intends to assess whether government or

professional body rules and regulations serve the legitimate purpose of the protection of the public interest or whether they are providing barriers to competition.

FEE has encouraged its members bodies to respond to the questionnaire. The role of the liberal professions in society is not comparable with that of other business services. Liberalisation measures must not (inadvertently) undermine the high quality of services provided.

FEE also commented directly on issues of common interest at EU level. The specific situation of statutory audit was highlighted, where contrary to what was advocated in the study, regulation can be expected to increase rather than decrease. In addition, the danger of a competition-based rationale lowering the qualitative education requirements was also emphasised.

The EC Report on the economic impact of regulation in the field of liberal professions is available from:

<http://europa.eu.int/comm/competition/publications/publications/>

The Commission Services Working Document 'Regulation in Liberal Professions and its Effects' is available from:

[http://europa.eu.int/comm/competition/general\\_info/invitation/en.pdf](http://europa.eu.int/comm/competition/general_info/invitation/en.pdf)

### FEE COUNCIL: 25 JUNE 2003

FEE Council had a very busy agenda when it met on 25 June 2003. Amongst the items under discussion were a range of new FEE documents and comment letters. The below documents have been approved and will be published during the Summer. They provide a good illustration of the broad scope of activities in which the European accounting profession is active.

FEE Working Party	Publication
Capital Markets Advisory Group	Discussion Paper European Enforcement Coordination
Company Law Task Force	FEE reaction to the Communication on Company Law and Corporate Governance
Corporate Governance Subgroup	Discussion Paper on the Financial Reporting and Auditing Aspects of Corporate Governance
Ethics Working Party	A Conceptual Approach to Ethics in the Financial Reporting Chain Position on Auditor Independence
European Public Oversight Task Force	Discussion Paper European Co-Ordination of Public Oversight
Direct Taxation Working Party	Position Paper on Taxation of Corporate Reorganisations
Public Sector Committee	Public Sector Annual Management Reports on activities for the financial year
SME/SMP Working Party	FEE reaction on Green Paper Entrepreneurship in Europe

FEE publications are available from: [www.fee.be/publications/main.htm](http://www.fee.be/publications/main.htm)

### EUROPEAN Update

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