IMPACT OF THE EU AUDIT REFORM ON SUPERVISORY BOARDS AND AUDIT COMMITTEES OF 'FIVEFOLD COMPANIES'

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IMPACT OF THE AUDIT REFORM

Contrary to what the title of the latest phase of reform might lead one to suppose, the changes to statutory audits do not only affect statutory auditors but they were also intended to sharpen the responsibility of supervisory boards and audit committees in their monitoring and oversight of the statutory audit. With this in mind, existing obligations were made more specific and to a certain extent extended.

OBLIGATION TO ESTABLISH AN AUDIT COMMITTEE – WHAT'S NEW?

The criteria for being obliged to establish an audit committee are largely unchanged. Public-interest entities (quoted companies, credit institutions and insurance undertakings) as well as companies that exceed one of the euro-denominated limited-company size thresholds by a factor of five (so-called fivefold or XL companies) must establish an audit committee, unless certain exceptions apply.

The exemption conditions are now a little broader:

- In future, 'fivefold companies' need not have an audit committee if their Supervisory Board has no more than four members. However, this is subject to the condition that one of the members of the Supervisory Board is a financial expert who, together with the Chairman of the Supervisory Board, is independent within the meaning of section 92(4a)(1) of the [Austrian] Joint-Stock Companies Act (*Aktiengesetz* – abbreviated to AktG from now on) or section 30g(4a) of the [Austrian] Limited-Liability Companies Act (*GmbHgesetz* – abbreviated to GmbHG from now on) and that the full Supervisory Board carries out all the duties of an audit committee.

- The existing availability of exempting wholly owned subsidiaries from the requirement to have an audit committee is altered to extend to 75% subsidiaries.

NEW METHOD FOR CALCULATING THE SIZE CATEGORIES OF JOINT-STOCK COMPANIES

It should particularly be borne in mind that there has already, by virtue of the [Austrian] Accounting Act (Amendment) Act 2014 (*Rechnungslegungs-Änderungsgesetz*), been a **change for joint-stock companies** holding shares in subsidiaries in the way that the thresholds are calculated to qualify as a 'fivefold company'. The newly inserted article 221(4a) of the Commercial Code (*Unternehmensgesetzbuch*) provides that the thresholds for size categorisation are now to be determined on a consolidated (aggregate) basis and not on a stand-alone basis as previously. Parent companies may consequently already have become obliged to establish an audit committee with effect from 2016, unless an exception applies.

COMPOSITION OF THE AUDIT COMMITTEE – WHAT'S NEW?

Compared to the previous legislation on audit committees and their composition, section 92(4a)(2) AktG and section 30g(4a) GmbHG contain the requirement that all members of the Committee must be familiar with the sector in which the undertaking concerned operates. This condition will be interpreted to mean that at least one member of the Audit Committee must have relevant sector experience.

As far as credit institutions and insurance undertakings are concerned, a majority of members must now be independent.

WHAT NEW DUTIES DO SUPERVISORY BOARDS AND AUDIT COMMITTEES HAVE?

The statutory list of duties incumbent on audit committees has been lengthened and now comprises (changes are marked in bold and will be explained in more detail below):

- oversight of accounting procedures **as well as the making of recommendations or proposals to ensure their reliability**;

- oversight of the effectiveness of the company's internal-control system, where applicable of its internal-audit system, and of its risk-management system;

- oversight of the statutory audit and/or the statutory audit of the consolidated financial statements **taking into account the findings and conclusions of the reports published by**

the Statutory Auditors Oversight Board (APAB) (Inspection Reports);

- review and oversight of the independence of the statutory auditor, especially with regard to additional services provided to the company under audit;
- **preparation of a report to the Supervisory Board on the outcome of the statutory audit and a statement on how the statutory audit has contributed to the reliability of the company's financial reporting and the part played by the Audit Committee in this connection;**
- audit of the annual and/or consolidated financial statements and preparations for their approval or taking note thereof, the recommended appropriation of profits, the management report and/or consolidated management report, the (consolidated) corporate governance report and preparation of the report to the Supervisory Board on the outcome of the audit;
- **implementation of the procedure for appointing the statutory auditor having regard to the appropriateness of the audit fee and the submission of a recommendation to the Supervisory Board.**

The new duties in detail:

■ Oversight of accounting procedures as well as the making of recommendations or proposals to ensure their reliability

In addition to the obligation to oversee accounting procedures, the Audit Committee now has the express obligation to make recommendations or proposals to ensure their reliability. It is therefore essential to check that the company's Executive Board or management have established accounting systems, whether these systems are fit for purpose and whether they guarantee the correctness and completeness of the accounting records. Should shortcomings in the system's fitness for purpose or effectiveness be detected and improvements proposed, the Audit Committee must then check that these shortcomings have been remedied and the recommendations for improvements have been implemented.

■ Oversight of the statutory audit and/or the statutory audit of the consolidated financial statements taking into account the findings and conclusions of the reports published by the Statutory Auditors Oversight Board (APAB)

In future, when exercising oversight of the statutory audit, regard must be had to the reports published by the newly established Statutory Auditors Oversight Board. In this way, it can be ensured that in exercising their oversight functions, audit committees will take into account the findings that the Statutory Auditors Oversight Board has made as a result of its own oversight function from its quality audits and inspections.

■ Preparation of a report to the Supervisory Board on the outcome of the statutory audit and a statement on how the statutory audit has contributed to the reliability of financial reporting and the part played by the Audit Committee in this connection

The Audit Committee is now charged with not only reporting to the Supervisory Board on the outcome of the statutory audit but also with providing it with a statement on

- how the statutory audit has contributed to the reliability of the company's financial reporting and
- what role the Audit Committee has played in this process.

This will have the consequence that the Audit Committee must concern itself yet more closely with the performance of the audit and the significant audit issues. The specific contents and scope of this report will depend on the size of the undertaking and the complexity of the issues relating to the accounting system.

■ Implementation of the procedure for appointing the statutory auditor having regard to the size of the fee and the submission of a recommendation to the Supervisory Board

The Audit Committee is already charged under existing legislation with making a recommendation to the Supervisory Board on the appointment of the statutory auditor.

It has been made clear that in making its recommendation the Audit Committee must also ensure that the audit fee is commensurate with the auditor's task and the foreseeable scope of the audit, and that the fee structure allows one to expect proper performance of the audit.

THE NEW STRUCTURE OF AUDIT REPORTING – WHAT HAS CHANGED?

■ The restructured audit report

The new revised rules for the new audit report are aimed at a greater degree of transparency and improved informative value. This is to be achieved by a significant enlargement of reporting on the statutory audit in the proper meaning of the word, covering the following important aspects:

- The audit opinion will in future feature prominently at the beginning.
- The section entitled 'Responsibility of the management and the Audit Committee' is being enlarged with the addition of a note that the management (the legal representatives) must form a judgment as to the going concern assumption and on the adequacy of the accounting principles underlying the going concern basis. A second new item is a note on the Audit Committee's responsibility for oversight of accounting procedures.
- The section entitled 'Statutory auditor's responsibility for the audit of the annual financial statements' is significantly more detailed than previously.
- In the event that the enterprise prepares a management report, this needs to be reviewed by the auditor. The audit report must state whether discrepancies have been found between the management report and the audited financial statements.

■ Additional report to the Audit Committee

Alongside the audit report, the statutory auditor of a 'fivefold company' must also prepare a report to the Audit Committee. Where the company is exempt from the requirement to have an audit committee, this additional report must be addressed to the Supervisory Board and the Audit Committee (or an equivalent organ) of the parent company.

This additional report must first be prepared with respect to audits relating to financial years beginning after 16 June 2016 (thus, in the case of calendar-year ends, first for the financial year 2017).

Among the contents of this additional report are the following:

- **General information:** the auditors involved; certificate of independence; a statement as to whether all necessary documentation was made available.
- **Audit planning and performance:** the audit scope and timetable; identification of those parts of the financial statements that were subject to a systems audit; a quantification of materiality thresholds; the nature, frequency, dates and extent of communication with management, the Audit Committee and the Supervisory Board.
- **Audit outcome:** identification and explanations in the event that any doubt exists as to the going concern assumption; an explanation of any significant deficiencies detected in the accounting-related ICS; information on misstatements and infringements; information on significant difficulties or other oversight issues relating to the audit.
- **Other information relating to the financial statements:** information on and an assessment of the valuation methods for various positions and any changes in the same.

WHAT EFFECT WILL THESE DEVELOPMENTS HAVE ON THE SPECIFIC RELATIONSHIP BETWEEN THE STATUTORY AUDITOR AND THE SUPERVISORY BOARD?

The Supervisory Board's additional duties with respect to the statutory audit will in future result in a yet more intensive exchange of information between the statutory auditor and the Audit Committee.

Efficient two-way communication is important in order to support:

- the statutory auditor and the supervisory body in understanding audit-related issues and developing a constructive working relationship;

- the statutory auditor in obtaining information relevant to the audit from the supervisory body;
- the supervisory body in properly exercising its responsibility for oversight of accounting procedures.

The statutory auditor should consequently attend both:

- the Audit Committee meeting dealing with (preparations for) the audit of the annual and/or consolidated financial statements and
- the Audit Committee meeting dealing with preparations for the approval of the annual and/or consolidated financial statements

and report on the audit.

At these meetings, the statutory auditor must in future report during the course of the audit not only on numerous issues such as the planned scope and timetable of the audit but also on any identified risks.

We should also recommend that the way in which the two-sided communication during the audit between the Audit Committee and the statutory auditor is to take place should be clearly established.

For questions on this subject, contact your BDO expert

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