European Commission Green Paper on audit policy - the European Union legislative process – 9 December 2011

The European Commission (EC) has proposed two pieces of legislation that affect the audit profession and the audit market. The first is a proposed Directive that would concern all audits, while the provisions in the proposed Regulation would apply to the audits of Public Interest Entities (PIEs). PIEs are listed companies and certain other public interest organizations such as unlisted credit institutions. The more extreme provisions being proposed by the EC are contained in the Regulation.

The proposals of 30 November would in some ways amend and in other ways build upon the 8th Company Law Directive on Statutory Audits (2006).

What is the difference between a Directive and a Regulation?

Directives have to be implemented by all 27 European Union (EU) Member States into their national laws within two years of the time the Directive is formally adopted. Directives allow a degree of flexibility as to how they should be implemented by the Member States. This makes it easier to get Member State approval.

A Regulation has no such flexibility and becomes law as soon as it is adopted by the EU Council and must be implemented as of the effective date. This lack of flexibility makes it more difficult to get Member State approval.

Where are we in the process and what comes next?

The EC proposed legislation on 30 November followed an internal EC consultation and a debate among the 27 EU Commissioners of the Directorates General (DG) on the proposals made by Internal Market DG of which Michel Barnier is the Commissioner.

Following the EC’s publication of the proposed legislation, parallel processes will commence in the European Council and the European Parliament.

In late 2011 or early 2012, the Council will establish an Expert Working Group comprising representatives from each of the 27 EU Member States. They will work through the proposed legislation, article by article, agreeing amendments as they go. Their goal will be to reach a common position by the middle of 2012 on a revised text.

At the same time the European Parliament will begin its own discussions. We expect the European Parliament’s Legal Affairs Committee (JURI) to take the lead with input from the Economic & Monetary Affairs Committee (ECON). This was the case with the Parliament’s own initiative report on the Green Paper adopted in early September 2011. However, it is likely that other committees such as the Internal Market Committee (IMCO) and Trade & Industry Committee (ITRE) will also wish to make their views known.

EU law also requires that the European Economic & Social Committee (EESC) give their views on the draft legislation. The EESC is a forum that represents the views of employer and employee organizations from across the EU. While their views are not binding, they are influential in the European Parliament.

Both the European Parliament and the EESC issued reports on the original Green Paper proposals. Both of them pushed back on many of the more radical EC proposals.
How long will it be before any legislation is finalized?

For legislation to be adopted by the EU, the EC, European Parliament and European Council all need to be in agreement. To understand in more detail how the three institutions seek to reach that agreement, please click here.

It is a lengthy process. The chart below shows the average length it takes to pass EU legislation.

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<tbody>
<tr>
<td>First reading</td>
<td>14 months</td>
<td>15 months</td>
<td>2 months/48 months</td>
</tr>
<tr>
<td>Second reading</td>
<td>25 months</td>
<td>31 months</td>
<td>12 months/108 months</td>
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<tr>
<td>Conciliation</td>
<td>32 months</td>
<td>44 months</td>
<td>29 months/159 months</td>
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There is a significant degree of opposition to many of the EC’s more radical proposals. This increases the probability that it will go to a Second Reading in the European Parliament. There will be plenty of opportunities to see further changes during this process. It is a marathon and not a sprint.

European Parliament

There are 736 Members of the European Parliament, but far fewer MEPs on the key committees of JURI and ECON.

As a whole, the European Parliament pushed back on many of the EC’s ideas, measures like mandatory joint audit and mandatory audit firm rotation were left on the table providing the EC could justify them based on a rigorous cost/benefit analysis (impact assessment). The EC eliminated the mandatory joint audit requirement prior to proposing the legislation on 30 November.

European Council

The European Council comprises Ministers from each of the 27 EU Member States. There are numerous configurations of the Council depending on the issues the Council is debating. In this case it is likely (but not certain) that the Economic and Financial Affairs Council (ECOFIN) (finance ministers) will oversee any draft legislation.

Each EU Member State has a number of votes in the Council that reflects its relative size (based on population, GDP, etc). The largest EU Member States (France, Germany, Italy, and the UK) each have 29 votes. By comparison, Malta, the smallest EU Member State, has just 3 votes. In all there are a total of 345 votes across the 27 Member States.

In order for legislation to be adopted, a simple majority of the EU Member States must support it (i.e., a minimum of 14 countries) and a total of 255 votes must be cast in favor (i.e., around 74% of all available votes). Put another way, it takes just 90 votes to block legislation from being adopted.

Our own analysis of EU Member State responses to the Green Paper indicates a significant degree of opposition to many of the more radical measures. With the degree of opposition we have witnessed and are continuing to witness, we do not believe it likely that the ECs legislative proposals could get adopted in their current form.

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