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Comparative Study at European Level

on the Criteria that Determine the Obligation to Audit the Financial Statements and the Organizational Structure of the Statutory Audit Oversight Body

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Abstract

In recent years, the accountancy profession has been significantly influenced by the amendment of EU directives in the field of accounting and statutory audit.

An important change was determined by the Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings.

Another amendment which significantly impacts the statutory audit is Directive 2014/56/EU amending Directive 2006/43/EC on the statutory audit of annual financial statements and consolidated financial statements, together with Regulation (EU) no. 537/2014 of the European Parliament and of the Council on specific requirements regarding the statutory audit of public interest entities.

The present study analyzes how the provisions of the mentioned European directives were introduced in the legislation of the EU Member States.

The author' findings highlight the diversity of attitudes towards the establishment of criteria that determine the obligation for entities to have their financial statements audited. We also indicated the organizational format of the audit oversight bodies accompanied by a few necessary comments.

Keywords: *statutory audit, oversight body of the statutory audit, audit profession*

JEL Classification: *M42*

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1. Preliminary

In recent years, the accountancy profession has been significantly influenced by the amendment of EU directives in the field of accounting and statutory audit.

An important change was determined by the Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings. This directive established new criteria regarding the identification of different categories of entities, respectively micro-entities, small entities, medium and large entities, as well as for the recognition of groups of entities.

Another amendment which significantly impacts the statutory audit is Directive 2014/56/EU amending Directive 2006/43/EC on the statutory audit of annual financial statements and consolidated financial statements, together with Regulation (EU) no. 537/2014 of the European Parliament and of the Council on specific requirements regarding the statutory audit of public interest entities.

These legal acts have fundamentally changed the way in which the auditor profession is exercised and the status of the audit firms and of the public oversight authority of the statutory auditors.

2. Research method

Our study has as initial reference basis some statistics published by European bodies interested in both the manner and degree of implementation of the provisions of Directive 2014/56/EU amending Directive 2006/43/EC on the legal audit of annual financial statements and the consolidated financial statements, together with Regulation (EU) no. 537/2014 of the European Parliament and of the Council regarding specific requirements on the statutory audit of public interest entities, as well as the different attitudes of the Member States in regards to the establishment of entities that have the obligation to have the financial statements audited.

As the significant reforms in the field of statutory audit had as a reference point the legal acts published in 2014, we prioritized studying the specialized literature and the published documents regarding these reforms that appeared after this date.

When necessary, we consulted the sites of the oversight bodies and accountancy related bodies, if references and more detailed information on these bodies was not presented only in the language of the respective country, but also in English.

3. Brief history

Globally, the obligation for an entity to have its financial statements audited is influenced by different factors. The economic system, in general, the information needs at certain times, the legal system, the attitude of the state towards businesses, the way of financing businesses, the fiscal system, tradition, and many other particular aspects have determined different rules among different regions and countries.

In the USA, only public companies[1] must have audited financial statements (those companies that are of public interest). Other companies do not have this obligation, but good practices and contractual provisions can establish that the financial statements must be audited. Furthermore, in the case of companies applying for loans, banks or even shareholders who do not permanently participate in the company's activities may request an auditor's intervention.

The obligation to audit is not recent in Europe. Directive 78/660/EEC on annual accounts of different types of companies, widely known as "The Fourth Directive", introduced, starting with the year it came into force – 1978, in section 11 – called "Auditing" – the obligation to audit the annual accounts by persons authorized by national law.

Regarding the possibility for small companies to draw-up abridged balance sheets, in the same section of the Directive (section 11) it was provided the possibility of Member States to exempt these categories of undertakings from the obligation to audit the financial statements.

The Directive also established the three criteria that define the limits of this exemption (which are, at the same time, criteria for delimiting the categories of entities), respectively the balance sheet, the net turnover and the average number of employees. This has remained unchanged so far. Even if the criteria have not changed, their values varied over the years, so that before the last directive they were set at the following

[1] The term "public" has different meanings in the continental European countries compared to Anglo-Saxon countries. In Europe, this term generally refers to state institutions, the state/government budget, while in the Anglo-Saxon countries this term is related to the public interest.

values: total assets – 4,400,000 euros; net turnover – 8,800,000 euros; the average number of employees – 50. In 2012, the criteria for the recognition of micro-entities were published (Directive 2013/34/EU): total assets – 350,000 euros; net turnover – 700,000 euros; average number of employees – 10.

4. The current situation

Directive 2013/32/EU has also caused a change of attitude. Before this Directive, the position of the European Union was to exempt certain types of undertakings from the obligation to have audited financial statements ("audit exemption thresholds") – generally, the entities considered small. In other words, all entities were required to have their financial statements audited, with the Member States having the option to establish provisions in their national law so that entities that did not reach the thresholds of two of the three criteria provided by the directive would not be required to audit.

The provisions in force indicate another attitude, that is to require the Member States to ensure that the financial statements of public interest entities and of medium and large entities are audited. As a result, small entities and micro-entities are not required to have their financial statements audited. The Directive also establishes a simplified financial reporting regime.

In accordance with the current provisions, the limits of the three criteria, which establish the threshold of delimitation between small and medium-sized entities and, implicitly, the obligation to audit the financial statements are the following: total assets 4,000,000 euros; net turnover 8,000,000 euros; average number of employees 50.

Member States may set limits different from those provided in the directive only by increasing them, in compliance with the maximum limit of 6,000,000 euros for total assets and 12,000,000 euros for net turnover.

Even if the directive does not explicitly mention this, Member States may set lower limits for the thresholds, so that all small entities or only part of them, have the obligation to audit the financial statements. The argument presented at point 43 of the explanatory memorandum regarding the Directive 2013/34/EU states: *"This Directive should not prevent Member States from imposing an audit on their small undertakings, taking into account the specific conditions and needs of small undertakings and the users of their financial statements."*

Different reactions, from this point of view, are based on different attitudes towards small and medium-sized entities in each country, depending on their place in the economy, the importance of the information provided by them for the public interest and many other particular aspects. For example, in Romania, small and medium-sized entities in industry, construction, trade, and services make up 57.4% of the turnover and occupy 64.8% of the workforce in this sector (National Institute of Statistics, 2018). Only a small part of the small entities falls under the obligation to audit.

Furthermore, the Member States that have not adopted the euro, as in the case of Romania, can increase or reduce the limits mentioned in euros when they are converted into local currency, in order to round up the national values, within a limit of 5% variation.

Considering these European references, we want to highlight the different attitudes of the Member States towards this Directive. The transposition deadline was set on July 20, 2015, so that the provisions can be applied from January 1, 2016, or during 2016 at the latest. Most Member States have transposed the new directive within the stipulated term. This is the case of Romania, which published the new Accounting Arrangements regarding the individual annual financial statements and the consolidated annual financial statements in December 2014, through the order of the Minister competent to public financial matters no. 1802/2014, with applicability from January 1, 2015. At the time, the classification of entities complied with the reference in the directive by mentioning the values in euros, but, in the following year, 2015, the value references in euros were converted into the local currency, RON.

Next, we will analyze the reactions of the Member States regarding the implementation of the provisions of the Directive 2013/34/EU on the obligation of auditing the financial statements (**Tables no. 1 and no. 2**).

Most of the Member States have maintained or reduced the values of the three criteria which oblige the audit. Others increased them or established different obligations for intervention, audit or revision, depending on the value of the criteria. It is worth mentioning the case of Cyprus, where the values of the three criteria have been reduced to zero since September 2016.

Table no. 1. Countries where the threshold level is equal to or lower than the one provided for in the directive, in increasing order of the value of the criteria

Country	Total assets	Turnover	Number of employees
Cyprus	0	0	0
Malta	46.600	93.000	2
Finland	100.000	200.000	3
Sweden	150.000	300.000	3
Hungary	-	965.000	50
Denmark	537.000	1.075.000	12
Latvia	800.000	1.600.000	50
Estonia	800.000	1.600.000	24
	2.000.000	4.000.000	50
Slovakia	1.000.000	2.000.000	30
Bulgaria	1.000.000	2.000.000	50
France	1.000.000	2.000.000	20
	1.550.000	3.100.000	50
Iceland	1.400.000	2.800.000	50
Czech Republic	1.500.000	3.000.000	50
Portugal	1.500.000	3.000.000	50
Lithuania	1.800.000	3.500.000	50
Italy	2.000.000	2.000.000	10
Croatia	2.000.000	4.000.000	25
Norway	2.500.000	645.000	10
Poland	2.500.000	5.000.000	50
Spain	2.850.000	5.700.000	50
Romania	3.500.000	7.000.000	50
Slovenia	4.000.000	8.000.000	50
Greece	4.000.000	8.000.000	50

Source: Table made with data from *Accountancy Europe*, Audit exemption thresholds in Europe, Survey results, February 2019, www.accountancyeurope.eu/publications/audit-exemption-thresholds-in-europe/

Romania has set limits for the two criteria in the national currency, respectively RON 16,000,000 for total assets and RON 32,000,000 for turnover, which leads to values in euros slightly lower than those provided in the directive.

Table no. 2. Countries where the threshold level is higher than the one provided for in the directive, in increasing order of the value of the criteria

Country	Total assets	Turnover	Number of employees
Luxembourg	4.400.000	8.800.000	50
Belgium	4.500.000	9.000.000	50
Austria	5.000.000	10.000.000	50
Denmark	6.000.000	12.000.000	50
The Netherlands	6.000.000	12.000.000	50
Germany	6.000.000	12.000.000	50
Ireland	6.000.000	12.000.000	50
Great Britain	6.541.000	13.082.000	50
Switzerland	18.203.000	36.405.000	250

Source: Table made with data from *Accountancy Europe*, Audit exemption thresholds in Europe, Survey results, February 2019, www.accountancyeurope.eu/publications/audit-exemption-thresholds-in-europe/

For the correct interpretation of the information from the **Tables no. 1 and no. 2**, some clarifications are needed.

Some Member States have provisions regarding the obligation to audit the financial statements included in the tax legislation. For example, Malta, which has the lowest values for the three criteria, has not made exceptions for the obligation to audit when there are tax purposes.

In France, different thresholds are established for different legal forms of entities. Lower thresholds are set for simplified joint-stock companies that are not part of a group. Higher thresholds are set for limited-liability companies and jointly owned companies. There are no exceptions for public limited-liability companies and limited partnerships with a share capital. In Norway, limited-liability companies are exempted from the obligation to audit if they do not exceed all three established criteria. In Portugal, exceptions do not apply to public limited-liability companies (Accountancy Europe, 2019).

Different thresholds are set in Denmark and Estonia, which allows entities to use different types of insurance. Thus, in Denmark, entities that exceed two out of three lower threshold values may choose to review or audit the financial statements, and those that exceed two out of three higher threshold values are required to have the financial statements audited. In Estonia, the option is not provided, i.e. entities that exceed two out of three lower threshold values are required to have the financial statements revised, and those that exceed two out of three values of the higher thresholds are required to have the financial statements audited (Accountancy Europe, 2019).

These different attitudes are nuanced when we consider the number of entities audited. In Belgium, for example, only 6% of the approximately 400,000 companies are required to have their financial statements audited. The other entities may voluntarily opt for auditing. In Denmark, increasing the value of the thresholds has caused many companies to give up auditing. In Germany, the number of small entities that voluntarily opt for audit is very small. An interesting example of business education is the United Kingdom, where after reducing the thresholds, 63% of companies continued to have their financial statements audited, even though they had become exempt (EFAA, 2019).

The thresholds can be changed when a country considers it necessary. For example, in January 2018, the Finnish Ministry of Affairs submitted the proposal to increase the thresholds, for total assets from 100,000 euros to 350,000 euros, for the turnover from 200,000 euros to 700,000 euros and for the number of employees from 3 to 10. Freedom and responsibility in business were some of the arguments put forward. It is interesting to note that several respondents commented against increasing the thresholds (Haapamaki, 2018).

In 2010, Sweden repealed the mandatory audit requirements for small limited liability companies. In 2017, *The Swedish National Audit Office*, an independent Parliamentary agency responsible for auditing government institutions, released a report stating that repealing the audit obligation for small entities led to higher costs than benefits and increased the number of risks to the economy (Blomme, 2019).

5. Oversight bodies of the statutory audit

The need for public oversight of the statutory audit has become more apparent around 2000, following several financial scandals, most of them in the USA, culminating in the ENRON financial scandal. Subsequently, in July 2002, President George Bush enacted the Sarbanes-Oxley Law (SOX), named after the two initiators who set up the *Public Company Accounting Oversight Board* – PCAOB, a governmental body vested with overseeing the audit of public undertakings for the purposes of investor and public interest protection by preparing informative, accurate and independent audit reports.

This law is of particular importance because it signifies the end of the self-regulation of the accounting profession. This happens almost 150 years after the establishment of the first associative forms of the accounting professionals, in the United Kingdom, in the middle of the 19th century.

The Member States of the European Union had the obligation to set up oversight bodies starting with January 1, 2006. After becoming an EU member, Romania also had the same obligation. In July 2008, the *Public Oversight Board of the Statutory Audit Activity* (Consiliul de Supraveghere Publică a Activității de Audit Statutar – CSPAAS) was established. In 2017, after a few reforms, the *Public Oversight Authority of Statutory Audit Activity* (Autoritatea de Supraveghere Publică a Activității de Audit Statutar – ASPAAS), a government body, was established in Romania.

Legal references regarding public oversight bodies are provided in the Directive 2006/43/EC on statutory audit of the annual financial statements and the consolidated financial statements, amended by Directive 2014/56/EU, and in the Regulation no. 537/2014 on specific requirements regarding the statutory audit of public interest entities.

The public supervisory bodies are ultimately responsible for overseeing the following activities:

- authorization and registration of statutory auditors and audit firms;
- adoption of standards in the field of professional ethics, quality control of audit firms and audit activity;
- continuous training of auditors;
- quality assurance systems;
- systems for investigation and disciplinary sanctions.

Under certain conditions, some of these tasks may be appointed to other professional bodies and authorities, the supervisory body having final responsibility in these cases.

In the case of the auditors of public-interest entities, quality assurance verification activities cannot be delegated.

According to a study published in February 2019 (*Accountancy Europe*, 2019), many of the 28 Member States have shown confidence in professional bodies and have delegated several tasks to them. Thus, in the case of auditors of public-interest entities, the following tasks were delegated totally or partially: the education (continuous professional training) – in 20 countries, the registration of auditors and the quality control in 14 countries. Regarding auditors of entities that are not of public interest, we have the following situation: registration of auditors – in 15 countries, publication of standards – in 13 countries, education – in 21 countries, quality assurance – in 17 countries and disciplinary sanctions – in 11 countries. In this case, professional bodies are of great importance and participate in increasing the quality of the audit.

At the European level, in order to ensure the cooperation of the supervisory bodies for the purposes of unitary attitudes and practices, the *Committee of European Auditing Oversight Bodies* – CEAOB was established. For the same purpose, in 2006 the *International Forum of Independent Audit Regulators* (IFIAR) was set up.

The Member States reacted differently to the organization of the supervisory body. Some established this body within the government, others established a private organization and others appointed the supervision to other existing bodies (CFRR, 2016). In most countries, the funding of these bodies comes wholly or mostly from the audit profession (*Accountancy Europe*, 2018).

Thus, most countries have set up or reformed the oversight body under the government: Austria, Cyprus, Finland, Germany, Hungary, Lithuania, Malta, Poland, Romania, Spain, Sweden. This option also involves financing the body, partially or totally from the government budget. In some cases, the supervisory body is financed both from the government budget and from the contribution of the auditors, usually through professional bodies. This is the case for Austria, Germany, Hungary, Malta, Romania. Lithuania and Poland are financed exclusively from the government. There are also cases of government bodies receiving funding only from auditors or professional bodies: Finland, Spain, Sweden.

Nevertheless, the particular legal issues in each country create a diversity in terms of statuses of these supervisory bodies. For example, in Spain, supervision is exercised by *Instituto de Contabilidad e Auditoria de Cuentas* (Institute of Accounting and Accounts Auditing), which is an independent body attached to the Ministry of Economy and Taxes, financed from the auditors' contribution. In Lithuania, there is *The Authority of Audit, Accounting, Property Valuation and Insolvency Management*, organized within the Ministry of Finance, fully financed from the state budget. In Poland, the duties of the oversight body, *Audit Oversight Commission*, are exercised with the support of a department within the Ministry of Finance, Accounting and Auditing Department.

In Germany, the *Auditor Oversight Body* is financed approximately 70% with the money paid by the auditors for inspections and the difference is covered by the federal budget. Inspection fees are set by the Federal Ministry for Economic Affairs and Energy, without the involvement of the accounting profession (IFIAR, 2019).

Others entrusted the supervision to an independent body: Bulgaria, Croatia, Czech Republic, France, Greece, Ireland, Slovakia, Slovenia, the United Kingdom. It is interesting to note that in some cases, even if the body is independent, funding is provided

exclusively by the state budget – in Bulgaria, Croatia, Czech Republic, Slovenia. In other countries, financing is exclusively private – in France and Greece. Mixed financing, both from the government budget and from the auditors can be seen in Ireland; in Slovakia financing is provided by the government budget and the listed companies. In the UK, funding is provided by listed companies and auditors.

For example, in 2018, the French oversight body received 14,669,457 euros in fees from auditors. It has 9,037 auditors who performed statutory audit missions and also has 15 members in the council. The Czech supervisory body, financed from the government budget, collected CZK 2.1 million (approx. 82,500 euros) in 2017 and it declares 1,225 natural person members, 353 audit firms and 151 public interest entities.

In Bulgaria, supervision is exercised by the *Commission for Public Oversight of Statutory Auditors*, an independent body, but fully funded from the state budget. However, in addition to supervising the statutory audit, this commission evaluates the performance of the audit committees and the level of market concentration.

Several countries have included oversight within an existing regulatory body: Belgium, Denmark, Italy, Luxembourg, the Netherlands, Portugal. In Belgium, the *Belgian Audit Oversight College* – BAOC is part of the *Financial Services and Markets Authority*, the capital market oversight body.

In Denmark, public supervising is exercised by the *Danish Business Authority*, a body that aims to create a predictable and responsible business environment, having the legal attribution to administer and make any changes to the company law or the accounting law. Any audit firm that audits the financial statements of companies trading securities on the Danish capital market must be registered at this authority.

In Italy, Luxembourg, the Netherlands, and Portugal public oversight of the statutory audit is exercised by the capital market oversight body.

We can find a variety of forms of organization of the supervisory bodies, as well as differences in terms of the number of entities of public interest audited and the number of auditors.

The identification of public interest entities (PIEs) refers in the European Union, from the point of view of our study, to the definition in Directive 2014/56/EU, which amended point no. 13 of Article 2 of Directive 2006/43/EC, which provides as follows:

"public-interest entities" means:

(a) entities governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC;

(b) credit institutions as defined in point 1 of Article 3(1) of Directive 2013/36/EU of the European Parliament and of the Council (**), other than those referred to in Article 2 of that Directive; 27.5.2014 L 158/202 the Official Journal of the European Union;

(c) insurance undertakings within the meaning of Article 2(1) of Directive 91/674/EEC; or

(d) entities designated by Member States as public-interest entities, for instance undertakings that are of significant public relevance because of the nature of their business, their size or the number of their employees;"

The number of public interest entities in each member country of the European Union varies depending on the possibility for Member States to designate certain entities as public interest entities, in addition to those expressly established by the Directive.

According to the *Accountancy Europe* study (2019), 12 countries have adopted the reference definition from the European level, while other 18 countries have expanded the definition with national provisions.

This has caused the number of public interest entities to differ significantly. For example, according to a study from 2017 (*Accountancy Europe*, 2017), Germany has adopted the European definition and declares 1,150 public interest entities, and France, which has expanded the definition, declares 1,796 such entities.

In Romania, the characteristics of public interest entities are established by Law no. 162/2017 regarding the statutory audit of the annual financial statements and the consolidated annual financial statements, which at point 12 of Article 2 provides:

"public interest entities" means:

a) undertakings whose transferable securities are admitted to trading on a regulated market;

b) credit institutions;

c) insurance, insurance-reinsurance, and reinsurance undertakings;

d) non-banking financial institutions, defined according to the legal regulations, registered in

the General Register; payment institutions and institutions issuing electronic money, defined in accordance with the law, which provide loans related to payment services and whose activity is limited to the provision of payment services, respectively issuing electronic money and providing payment services; privately administered pension funds, optional pension funds and their administrators; financial investment services companies, investment management companies, collective investment undertakings, central securities, clearing houses, central counterparties and market/system operators authorized/endorsed by the Financial Supervisory Authority; national companies; companies wholly or mostly state-owned; autonomous companies;"

In terms of the number of auditors, the differences are specific and much bigger. We take into account the fact that the number of auditors in a country is determined by the tradition of the accounting profession, its organization, its reforms directly related to the global changes, the vision of the professional body of the statutory auditors and the oversight body. Also, the number of auditors of public interest entities in each country is influenced by the registration and development of multinational audit firms or their national representatives, which, in many countries, are the majority in this market. For example, in Germany, where listed entities, banks and insurance entities total 1,111 entities, the segment occupied by the Big Four alone in this market is 5,462 million euros (IFIAR, 2019). According to a recent study, the degree of concentration on the market of auditing of public interest entities in Europe of the Big Four decreased from 2013 to 2017 from 91.21% to 89.79% (IPOL, 2019).

Conclusions

A first conclusion is that there is a great diversity among the Member States of the European Union, both in terms of the segment of entities that are required to have the annual financial statements audited, as well as in the way of organizing the audit oversight body.

The attitudes of the Member States are different because each one has its own characteristics. What made Cyprus request the audit of the financial statements of all entities, regardless of their size? Maybe this country learned a lot from the major financial crisis of 2012-2013. What determines the Bulgarians to set audit thresholds lower than half the level established by Romania? We should take into account that Bulgaria and Romania are given as examples when discussing corruption and they are not yet part of the Schengen area.

Furthermore, specific aspects, different in each country, are of significant importance: the role and status of the professional bodies of the accounting profession; the number of professional accountants and their legal powers; how much do the users of the financial statements need to increase their confidence in the information provided by them; the attitude of the State towards the business environment and the accounting profession.

These particular aspects lead to a different implementation of European directives in each Member State.

The oversight authorities are also significantly different. We are not referring only to their organizational structure. There are significant differences between their budgets and funding sources, between the number of members in the body council and the number of employees. The number of supervisory duties and their degree of delegation to other professional bodies also leads to many contrasts.

These differences make one believe that there is no "universal recipe" for the organization and functioning of the supervisory bodies.

The differences highlighted in our study lead to many other differences when the rules are applied in the business environment and in professional practice. The development of digital technologies, the diversification of the communication methods, particular characteristics at the national level, create a diverse, challenging world, in which we have to constantly adapt and redefine our status.

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