FI Supervision

Audit Supervision of Public-Interest Entities

No 2

25 april 2018

25 april 2018
Ref. 18-3414

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FI Supervision

Finansinspektionen publishes regular supervision reports in a numbered report series. The supervision reports are part of FI's communication. The reports describe the investigations and other supervision carried out by FI. Through these reports, FI presents its observations and assessments as well as its expectations in various matters. This information can support firms in their operations.

Summary

Pursuant to the Supervision of Public-Interest Entities (Audit) Act (2016:429), Finansinspektionen (FI) is responsible for conducting certain audit supervision activities. FI has conducted an investigation into this supervisory area in 2017. This report provides an overview of the investigation's results and describes FI's view on how the regulations can be applied.

The aim of the investigation was to review whether public-interest entities (PIEs) have established an audit committee or have decided that the board of directors will perform the duties of such a committee, and whether at least one member of the committee or the board has the stipulated accounting or auditing expertise. FI noted that the firms investigated are complying in a satisfactory manner with the requirement to establish an audit committee or to have given the duties of the committee to the board of directors. However, FI would like to underline the fact that the legislative history of the amendment to the Swedish Companies Act (2005:551), which was implemented due to the EU directive concerning auditors and audit[1], states that the establishment of an audit committee, or allowing the entire board of directors to perform the duties of the committee, should be decided on by the board.

FI is able to ascertain that the firms investigated have generally interpreted the act's requirement for expertise in accounting or auditing as a requirement for an education within economics, combined with experience from working in a senior management position. It is FI's understanding that this requirement can be met through either relevant education or through relevant professional experience. In cases where the expertise is founded in education alone, without supplementary relevant professional experience, FI believes that it is preferable if this education is at university level and specialised in areas related to accounting or auditing. The legislative history states that experience of company management can provide sufficient insight into accounting and auditing issues to meet this requirement. FI believes that experience of working at an accounting firm is also an example of relevant professional experience. Furthermore, FI is of the opinion that the stipulated expertise is held by those who have the ability to contribute to what the audit committee is intended to contribute to as specified in the applicable acts and directives.

The investigation did not result in FI intervening in or issuing sanctions against any firm. Instead, FI will be continually monitoring developments relating to how PIEs will be applying and complying with the applicable provisions.

1 Govt Bill 2008/09:135, p. 115.

Audit Supervision Investigation

FI has conducted an investigation, the aim of which was to review whether public-interest entities (PIEs) have established an audit committee or have decided that the board of directors will perform the duties of such a committee, and whether at least one member of the committee or the board has the stipulated accounting or auditing expertise.

SUPERVISION OF PUBLIC-INTEREST ENTITIES

As of 17 June 2016, FI is responsible for conducting certain audit supervision pursuant to the Supervision of Public-Interest Entities (Audit) Act (2016:429). In accordance with Section 5 of this act, FI may intervene if a PIE does not establish an audit committee or give the board of directors responsibility for handling the duties of such a committee. FI also has the right to intervene if these firms do not ensure that at least one member of the committee/board has the stipulated accounting or auditing expertise. FI may also intervene if the firm does not choose an auditor in accordance with the Audit Regulation, does not rotate its auditor in accordance with the applicable legislation or dismisses its auditor prematurely without good cause.

Section 2, point 9 of the Auditors Act (2001:883) set out which firms are PIEs. Swedish PIEs are firms domiciled in Sweden that fulfil any of the criteria below.

- Firms that have transferable securities admitted to trading on a regulated market (listed companies).
- Firms that are authorised to conduct business in accordance with the Banking and Financing Business Act (2004:297) (banks and credit market companies).
- Firms that are authorised in accordance with both Chapter 2, Section 2, first paragraph, points 2 and 8 of the Securities Market Act (2007:528) (investment firms).[2]
- Firms that are authorised to conduct business in accordance with the Insurance Business Act (2010:2043) (insurance companies), aside from those firms that have been granted an exemption pursuant to Chapter 1, Section 19 or 20 of this act. It can be noted here that mutual benefit societies are not affected as they are not encompassed by the Insurance Business Act.

2 Chapter 2, Section 2 states that “An investment firm may, having been authorised by Finansinspektionen, as an aspect of its business […] 2. issue customers with credit so that the customer, through the investment firm, will be able to conduct a transaction in one or more financial instruments, […] 8. receive customers’ funds into accounts in order to facilitate the investment business.” Please note that both of these authorisations are required in order to become a PIE on this ground.

FI HAS CONDUCTED AN INVESTIGATION

FI conducted an investigation in 2017, the aim of which was to review whether PIEs had established an audit committee or had decided that the board of directors was to perform the duties of the committee. FI also investigated whether at least one member of the committee or the board has the stipulated accounting or auditing expertise. The requirements appear in Chapter 3, Section 4a of the Savings Bank Act (1987:619), Chapter 6, Section 7 of the Cooperative Societies' Act (1987:667), Chapter 6, Section 4a of the Members' Banks Act (1995:1570) or Chapter 8, Section 49a of the Swedish Companies Act (2005:551). This is the first investigation that FI has conducted as a consequence of these provisions.

The investigation was conducted with the help of a questionnaire that was sent out in May 2017 to 30 PIEs, and which asked the firms to answer questions about how they are complying with the current legal requirements. FI also asked the firms to enclose certain documents with their responses to the questionnaire. The firms that were included in the investigation consisted of 15 that are PIEs only because they are listed companies, four insurance companies, six banks, four credit market companies and one investment firm. At the time the selection was made, the firms included in the investigation accounted for around five per cent of the total number of Swedish PIEs. This number has now increased for reasons including the fact that additional companies have become listed on regulated markets. The investigation included firms that represent all the different types of PIE.

Practice at the Firms

All of the firms investigated had either chosen to establish an audit committee or decided that the entire board of directors was to perform the duties of the committee. The legal requirement for at least one member of the board to have expertise in accounting or auditing has been interpreted by the firms investigated as a requirement for an education within economics, combined with experience of working in a senior management position.

Of the 30 firms investigated, 23 had chosen to establish an audit committee. Among these were all 15 of the listed companies included in the investigation, one of the four insurance companies, five of the six banks, one of the four credit market companies and the investment firm.

All the firms investigated stated that at least one (1) person on the board or the committee had the stipulated accounting or auditing expertise. Several firms stated that two or three people had the stipulated expertise. Various combinations of education and/or professional experience were stated as grounds for this. Of the firms investigated, 25 listed an education in the form of a bachelor's or master's degree in economics or an MBA. Five firms did not list an education, only professional experience, in all cases in a senior management position. Two firms listed no professional experience, only an education in the form of a master's degree in economics. There were no striking differences between the different types of PIE in terms of what was listed as grounds for the stipulated expertise.

Practice at the firms investigated can be summed up as that a bachelor's or master's degree in economics from a university, regardless of specialisation, or an MBA and/or professional experience in a senior management position, for example as a CEO, head of group, CFO or COO is seen as sufficient grounds to meet the requirement for accounting or auditing expertise.

Conclusions

FI's assessment is that the firms investigated are complying in a satisfactory manner with the requirement to establish an audit committee or to task the board of directors with the duties of the committee. It is FI's understanding that it is possible to comply with the requirement for expertise through relevant education and/or through relevant professional experience. FI is also of the opinion that the stipulated expertise is held by those who have the ability to contribute to that which the audit committee is intended to contribute to.

ESTABLISHMENT OF AN AUDIT COMMITTEE

From the investigation, FI draws the conclusion that the firms investigated are complying in a satisfactory manner with the requirement to establish an audit committee or to task the board of directors with the duties of the committee. In this context, it has to be noted that listed companies were already encompassed by a statutory requirement to have an audit committee, with the potential to allow the entire board of directors to perform the duties of the committee. In addition, prior to the introduction of the legal requirement, the *Swedish Code of Corporate Governance*[3] already contained a requirement that listed companies establish an audit committee. Because only a limited number of firms have been included in the investigation, FI cannot express an opinion on the general level of regulatory compliance among Swedish PIEs.

As a complement to the questionnaire, FI asked for minutes from the board meeting at which the decision was made to establish an audit committee or to task the entire board with the duties of the committee, as well as information concerning which member or members were regarded as having the stipulated accounting or auditing expertise. Some firms responded to the questionnaire by stating that there was no legal requirement for a decision by the board, but that an audit committee had been established. Chapter 8, Section 49 a of the Swedish Companies Act states that the board of directors of a listed company shall have an audit committee and that the company may decide that the board will not have an audit committee, provided that the board instead performs the duties of the committee. According to the legislative history of this provision, the audit committee should consist of board members who are appointed by the board itself.[4] This also states that the board should determine whether or not the audit committee is to consist of the entire board. FI believes that the legislative history indicates that the board reasonably should make a decision to establish an audit committee or to allow the entire board to perform the duties of the committee. However, FI cannot see any

3 The Swedish Code of Corporate Governance is a form of self-regulation that is applied in accordance with the principle of comply or explain.

4 Govt Bill 2008/09:135, p. 115.

obstacles to this decision being made instead by the general meeting of shareholders or an equivalent body.

ACCOUNTING OR AUDITING EXPERTISE

With regard to the requirement for at least one board member to have expertise in accounting or auditing, FI concludes that the firms investigated have generally interpreted the act's requirement as a requirement for education within economics, combined with experience from working in a senior management position. However, it is not entirely clear what constitutes accounting or auditing experience. Room for interpretation has been left here in both the act and its legislative history.[5] Consequently, if FI is to be able to determine what sufficient expertise entails, a qualitative assessment of the level of expertise of individual board members is required. FI describes below its view of what may be of significance to whether the requirement for expertise can be deemed to have been met.

Education and/or professional experience

The legislative history to the implementation of the Audit Directive of 2006 states that the implications of the requirement for expertise must be determined in the light of the circumstances in each individual firm. It says there that a greater requirement for expertise should be placed the more complex the firm's operations are, if this complexity is reflected in the firm's accounts and internal control. It also appears that no requirements are placed in terms of formal education within accounting or auditing.[6] Accordingly, it is FI's understanding that it is possible to comply with the requirement for expertise through relevant education and/or through relevant professional experience.

In cases where the expertise is founded in education alone, without supplementary relevant professional experience, FI believes that it is preferable if this education is at university level and specialised in areas related to accounting or auditing. In cases where the expertise is founded in professional experience alone, the legislative history states that experience of corporate management can provide sufficient insight into accounting and auditing issues in order to meet this requirement. This also states that those who have held the position of CEO should, as a rule, meet the requirement.[7] In the light of this, FI believes that professional experience such as serving as CEO or CFO for a not insignificant period in a firm of a corresponding complexity, size and operations to the firm in which their expertise is to be assessed normally constitutes sufficient grounds to meet the

5 Govt Bill 2015-16:162 uses the term 'accounting or auditing expertise' but no further information is provided about what this entails. The same applies to Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts (see Art. 13, point 1).

6 Govt Bill 2008/09:135, pp. 155–156. When the legislative history was written, only listed companies were covered. However, FI is of the opinion that there is no reason to differentiate here between financial and non-financial firms.

7 Govt Bill 2008/09:135, p. 156.

requirement for expertise. Especially given that the accounting requirements for financial firms differ from those of non-financial firms, FI is of the opinion that it is important that the experience that constitutes the grounds for this expertise is also relevant in this respect.

FI is of the opinion that work at, for example, an accounting firm can also constitute relevant professional experience. However, the statutory requirements concerning auditors' independence constitute a barrier to those who are practising auditors being members of an audit committee. This is evident from the Swedish Supervisory Board of Public Accountants' case F 1/08 (Ref. 2008-603), which is an advance decision that an auditor may not be a member of an audit committee because this is considered to be an ancillary activity that may harm confidence in the impartiality and independence of the auditor (see Section 25 of the Auditors Act).

The ability to contribute to the duties of the committee

When assessing what constitutes sufficient accounting or auditing expertise, FI believes that company law provides some guidance about which duties the committee is to perform. FI is of the opinion that the stipulated expertise is held by those who have the ability to contribute to that which the audit committee is intended to contribute to. For a listed limited liability entity, Chapter 8, section 49b of the Swedish Companies Act states that the audit committee, without this having an impact on the board's other responsibilities and duties, shall perform the following duties:

1. monitoring the firm's financial reporting and issuing recommendations and proposals to ensure the reliability of the reporting,
2. with reference to the financial reporting, monitoring the effectiveness of the firm's internal control, internal audit and risk management,
3. keeping itself informed about the audit of the annual report and consolidated accounts and about the conclusions of the Swedish Inspectorate of Auditors' quality control.
4. informing the board about the results of the audit and about the way in which the audit contributed to the reliability of the financial reporting and about which function the committee has had,
5. scrutinising and monitoring the impartiality and independence of the auditor, in particular noting whether the auditor is providing the firm with services other than auditing, and
6. assisting in drawing up proposals for the general meeting of shareholders' decision concerning choice of auditor.

Equivalent legislation for other legal forms of business entity that can be PIEs is found in Chapter 3, section 4b of the Savings Bank Act, Chapter 6, section 7a of the Cooperative Societies' Act and Chapter 6, section 4b of the Members' Banks Act.

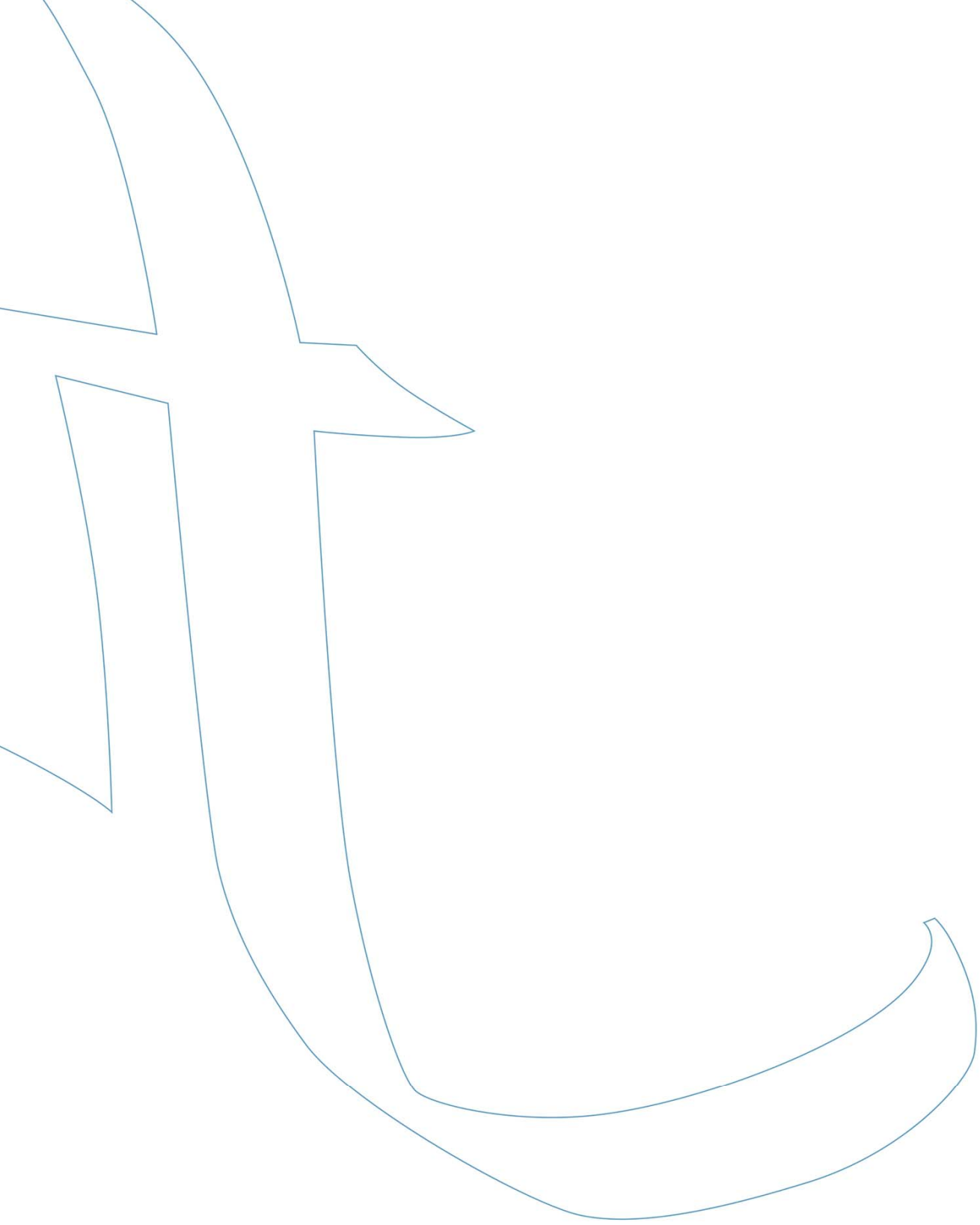
FI is also of the opinion that some guidance is provided in recital 24 of Directive 2006/43/EC[8], which states that audit committees help to minimise financial, operational and compliance risks and enhance the quality of financial reporting. As regards this directive, FI is also of the opinion that the stipulated expertise is held by those who are able to contribute to that which the committee, in accordance with this recital, is intended to contribute to.

FINAL THOUGHTS AND FOLLOW-UP OF THE INVESTIGATION

The investigation described here have included a number of firms and aim to paint a general picture of the application of specific regulations and to identify shortcomings at individual firms. The investigation did not lead to FI intervening in or issuing sanctions against any firm. Instead, FI will be continually monitoring developments relating to how PIEs will be applying and complying with the applicable provisions.

In this report, FI has conveyed its view of what may be of significance to compliance with the legal requirement for accounting or auditing expertise. In order to determine whether an individual has sufficient expertise in accounting or auditing, FI will always need to conduct a qualitative assessment of the individual case.

8 Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on markets in financial instruments amending Council Directives 78/660/EEC and 83/349/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 84/253/EEC.



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