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Federal Audit Oversight Authority (FAOA)



Activity Report 2006–2007

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**Bridges as symbols of transition
from the old to the new law**

Photos by Hansueli Trachsel

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Foreword by the Chairman and Executive Director

2007 was a milestone in Swiss audit law. What began with the setting up of a “Company Law” reflection group by the Federal Department of Justice and Police (FDJP) in 1993 was taken to an important interim conclusion: On 1 September 2007 the new Audit Oversight Act (*Revisionsaufsichtsgesetz – RAG; SR 221.302*), came into force. It is the formal basis for the activities of the Federal Audit Oversight Authority (*Eidg. Revisionsaufsichtsbehörde – RAB*), hereinafter also referred to as the FAOA, and governs in particular the authorization of individuals and companies to provide statutorily prescribed audit services, the oversight of the auditors of public companies and international cooperation in the area of audit regulation. The material part of the reform of audit law approved by Parliament on 16 December 2005, namely the revised provisions relating to the statutory audit requirement and auditors under the Code of Obligations (*Obligationenrecht*) and under the Civil Code (*Zivilgesetzbuch*), came into force four months later, on 1 January 2008. A new definition of the statutory audit requirement for all legal forms thereby became fact.

The impetus for a comprehensive redrafting of the provisions relating not only to the statutory audit requirement and auditors but also to accounting rules came from financial scandals at listed companies, spectacular collapses of large companies and a number of other events in the world of business at home and abroad which revealed various deficiencies in the rules in force at that time. But Switzerland also needed to act because of international developments such as the implementation of the Sarbanes-Oxley Act (SOX) of 2002 in the United States and the 8th European Union Directive on statutory audits of consolidated and unconsolidated financial statements (2006/43/EG) of 2006.

The auditing of consolidated and unconsolidated financial statements is a very technical task, especially when it involves larger and listed companies, which can only be entrusted to experts with appropriate educational qualifications and practical training. The so called “layman” audit, which had long been regarded as problematic, had, however, been abolished by the company law reform of 1991 only in form and not in substance. Proper bookkeeping and accounting rules are, however, vital for assessing the financial position of a company. Only if the financial statements are audited reliably and credibly can all those involved and other interested parties, starting with the company itself through its shareholders, lenders and suppliers right through to the general public, form an objective view of the companies in question.

The recently introduced registration procedure for all individuals and firms, that wish to provide statutory audit services, will formally ensure that only experi-

enced and appropriately trained persons scrutinize bookkeeping and accounting. The tighter regulations governing the independence of auditors enhance the reliability of the accounting process and help to prevent conflicts of interest. Auditors of public companies are also subject to particularly strict oversight.

The new legal structure means radical changes for the audit industry and will require considerable resources. Ultimately all those involved, however, will benefit from high-quality audit services. Confidence in the auditors will be strengthened and protection of investors, minority shareholders and creditors increased. Audit firms, for their part, will be protected by the new registration procedure from unqualified competitors. Finally, public companies' audit firms will profit from considerable simplifications in the international environment.

The new audit legislation does not mean just a tightening of previous rules, it also brings considerable simplifications for small and medium-sized enterprises (SMEs). For such enterprises the audit serves primarily the private interests of the shareholders, creditors and employees. For that reason only a limited audit is required for such companies. Compared to a full audit, this permits simplifications in the scope and depth of the audit and in the professional requirements for the auditors. Very small companies with fewer than ten full-time employees can even do without an audit altogether (opting out).

With the revised provisions relating to the statutory audit requirement and auditors under company law and with the new Audit Oversight Act, Switzerland has now been provided with modern audit legislation, which also takes account of international developments. With the registration and public oversight of auditors, Switzerland is, however, also entering uncharted territory. It is crucial that compliance with the new legislation be enforced and monitored by the authorities. A newly-created, independent, public-law institution has been entrusted with the implementation of the new Audit Oversight Act, the Federal Audit Oversight Authority (FAOA). Following a 10 month start-up phase, it commenced operations on 1 September 2007. In the following four months the FAOA was occupied mainly with issuing provisional licenses. Thousands of individuals and audit firms took advantage of the opportunity offered by the transitional provisions of the Audit Oversight Act to obtain a provisional license. The provisional registration procedure is meant to ensure a smooth transition from the old system to the new legislation. Following what was initially a merely cursory examination of applications, in the majority of cases the FAOA was also able to grant the required provisional license.

The registration and public oversight of auditors is not, however, purely a Swiss phenomenon. National public oversight bodies exist in many countries and are being set up in others. The audit of both the consolidated and unconsolidated financial statement of an international public company is a cross-border activity in which audit teams from a number of countries are frequently involved. An effective public oversight is possible, therefore, only in close cooperation with the national public oversight bodies in question. The objective is to create an international network and to ensure comparable public oversight in the various countries. For this reason the FAOA participated in the creation of the International Forum of Independent Audit Regulators (IFIAR) and established its first contacts with foreign regulators. The discussions on the mutual recognition of regulatory bodies concentrated in the first instance on Switzerland's two most important partners, the EU and the USA.

Further important tasks lie ahead for the FAOA in 2008. Firstly, the provisional licenses that have been issued will now have to be gradually converted into definitive ones. Secondly, public oversight of public companies' audit firms is scheduled to commence in the second quarter. In addition to these activities, talks with foreign counterparts in respect of mutual recognition are continuing, as is the establishment of an effective administrative and legal assistance system.



Hans Peter Walter



Frank Schneider

Berne, February 29, 2008

Establishment and Start-up Phase

The organizational provisions of the Audit Oversight Act were brought into force by the Federal Council earlier than expected, on 1 November 2006, in order to facilitate the establishment of the Oversight Authority. A project group was set up to oversee the establishment of the FAOA even before the Board of Directors had been appointed by the Federal Council. At the same time the search for suitable candidates for the position of the Executive Director began. Once an appropriate internal structure had been decided, the search for suitable office premises successfully completed and the necessary fixtures purchased, the FAOA's main preoccupation in the first half of 2007 was to prepare for the operational stage from September 2007 onwards. The first employment contracts with future FAOA employees were signed in spring 2007. By the time the Audit Oversight Act came into force, the headcount had grown steadily to approximately 12 full-time employees (headcount as of 31.12.2007: 14 full-time). The Code of Conduct adopted by the Board of Directors guarantees that all FAOA employees exercise their duties independently and free of conflicts of interest.

In the initial stages the Registration and Support Department was mainly involved in providing the necessary infrastructure, with the main emphasis on IT and staff recruitment. Since registration applications are filed online via the FAOA's portal, the creation of a simple and clear registration process was crucial. A registration portal was therefore created, through which the applications for the various types of registration could be recorded. With a guide explaining the registration process, help-texts and legal references, an efficient process was achieved and the filing of applications facilitated.

The Oversight Department was primarily concerned with preparing for the commencement of inspections of state regulated audit firms. While an FAOA oversight strategy was being devised, the FAOA visited various public oversight bodies in other countries in order to be able to benefit from their experience on the inspection processes. The Ordinance of the FAOA on the Oversight of Audit Firms under state oversight was drawn up, in close collaboration with the Legal Department, on the basis of the FAOA oversight strategy. Inspection activities are scheduled to commence in the second quarter of 2008.

Initially, the Legal Department was heavily involved in the issuance of the Audit Oversight Act implementing legislation and drafting the Audit Oversight Ordinance (Revisionsaufsichtsverordnung – RAV; SR 221.302.3). The hearings and consultations on this were prepared and attended by the FAOA. In addition, Circular 1/07 was created, setting out in more detail the conditions for registra-



Bridge "Neubrücke" between Berne and Stuckishaus

tion. The decision models for the provisional and full registration procedures were also drawn up, in order to guarantee the most efficient assessment of applications possible. The discussions with foreign counterparts on the conditions for mutual recognition and for the provision of administrative and legal assistance were also continued.

Operational Phase from 1 September 2007

On 22 August 2007 the Federal Council decided to bring the Audit Oversight Act and the implementing legislation into force with effect from 1 September 2007. The FAOA also commenced its operational activities at the same time as the Audit Oversight Act and the implementing legislation also came into force on 1 September 2007.

In the first few days after the Act came into force several hundred applications were registered on the FAOA Internet platform. The first provisional licenses and a number of definitive licenses for certified public accountants were issued from mid-September 2007. Initially the number of applications was below expectations, however. In late November 2007, therefore, a press release was issued, drawing attention to the year-end deadline.

The majority of the completed applications met the formal requirements. The details and documents required were listed in a Circular and a guide led applicants through the filing process. Questions of broad interest were added to the FAOA's website as FAQs (frequently asked questions). In numerous presentations, held together with various professional associations, in all the linguistic regions of Switzerland, individuals directly affected by the new legal order were informed on the current status quo in law and practice. Articles in the professional press also provided continuous coverage on major changes.

In the first few weeks after the enactment of the new legislation, a considerable amount of time was spent in dealing with individual queries from auditors. Among other things, this meant clarifying undefined legal concepts in the Audit Oversight Act and Ordinance and making use of discretionary powers granted to the FAOA by the Act to decide on certain issues of principle.

Organization

As a public-law institution, the FAOA is a legal entity in its own right. It is funded solely out of fees and charges payable by registered individuals and audit firms and is thus self-supporting. The FAOA maintains its own accounts outside the Federal budget and is consequently not a burden to it. This organizational structure permits an independent, purposeful and cost-efficient oversight of the audit industry. Administratively, the FAOA is attached to the Federal Department of Justice and Police (FDJP) and is based in Berne. It is under the supervision of the Federal Council and has to report on its activities every year both to the Federal Council and to Parliament. For efficiency and cost reasons the first reporting period was exceptionally extended to 14 months, including the start-up phase.

The objective of the FAOA is to ensure the proper provision and quality of audit services. A broad outline of the organization of the FAOA is to be found in the Audit Oversight Act (cf. Art. 28 ff. RAG). The FAOA has three executive bodies: the Board of Directors, the Executive Board and the Auditor.

The FAOA Board of Directors, appointed by the Federal Council, consists of the following persons:



Chairman of the Board of Directors:
Hans Peter Walter
Dr. h.c., Professor of private and commercial law at the University of Berne



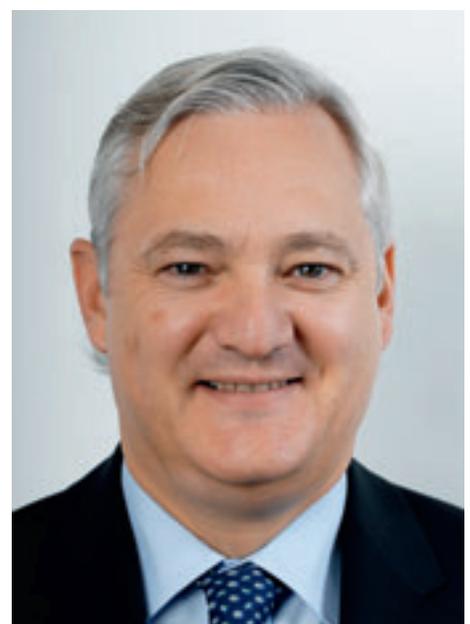
Vice Chairman of the Board of Directors:
Thomas Rufer
Graduate of University of Applied Science in Business Administration and Swiss Certified Accountant



Member of the Board of Directors:
Eugen Haltiner
Dr. oec., President of the Swiss Federal Banking Commission



Member of the Board of Directors:
Alfred Stettler
Prof. emer., Dr. rer. pol., HEC Lausanne, member of the Swiss GAAP FER Technical Committee



Member of the Board of Directors:
Peter R. Voser
Graduate of University of Applied Science in Business Administration, CFO of Royal Dutch Shell

The Executive Board consists of the Executive Director and the Heads of the Legal Department and the Registration & Support Department. The Executive Director is the highest executive representative of the FAOA and fulfils all the duties that are not required by law to be performed by the Board of Directors.

The FAOA's Auditor is the Swiss Federal Audit Office.

The FAOA Executive Board consists of the following persons:



Frank Schneider
Accountant (Director and Head of Oversight
in a dual capacity)



Reto Sanwald
lic. iur., Attorney (Head of Legal)



Jürg Bloesch
Attorney (Head of Registration & Support)

Staff and Finances

The staff of the FAOA comprises a broad range of specialists in various technical fields who work together on an interdisciplinary basis and includes Certified Public Accountants, lawyers and individuals with commercial experience. The headcount was increased steadily from spring 2007, in order to drive forward the preparation for the operational phase. At the same time, with the aid of outside specialists, the register of auditors was set up and tested and other IT infrastructures put in place. At the start of the operational phase on 1 September 2007 there were 12 full-time employees, whereof five in the Registration & Support and three each in the Legal and Oversight departments. A team assistant also relieves the Executive Director of certain organizational matters.

The FAOA stayed within its budget and in the first few months its staff requirements and operating costs were well below the Federal Council's estimates (cf. Message, Federal Gazette 2004, page 4096 ff.). In particular there were considerable economies on personnel expenditure since a number of accountants will not be recruited until the second quarter of 2008. The government loan granted for the setting up of the FAOA (cf. Art. 36, para. 2 of the Federal Oversight Act) was therefore more than adequate due to careful planning and strict cost management. Of the 3.2 million Swiss francs granted, only 2.1 million Swiss francs were used. Since October 2007 the FAOA has been financing itself entirely from registration fees. The government loan of 2.1 million Swiss francs was repaid prior to maturity on 30 November 2007. From 2008 onwards the Oversight Authority will be funded primarily by inspection and oversight fees from the audit firms under state oversight.

The FAOA's accounts are prepared in accordance with the Public Sector Accounting Standards issued by the International Public Sector Accounting Standards Board (IPSAS).

The Registration System

By the end of the provisional registration procedure on 31 December 2007 the FAOA had received 9,587 registration applications. Thereof 6,371 were submitted by individuals and 3,216 by audit firms (incl. sole proprietorships). The FAOA received more than 3,000 applications in December 2007, the last possible month for provisional registration. As previously mentioned, by the end of 2007 the FAOA had been able to examine all applications received by 30 November 2007 and – where possible – grant a provisional license. The applications received from individuals as of 31 December 2007 were processed by mid-January 2008 and those received from companies by 31 January 2008.

The majority of applications fulfilled the criteria for an initial summary examination, as a result of which a provisional license was issued. A number of registration applications were withdrawn by the applicants or had to be rejected by the FAOA as they did not meet the requirements. In such cases the applicants lacked either a recognized educational qualification (cf. Art. 4, para. 2 of the Audit Oversight Act), sufficient practical experience or supervised practical experience.

As of 29 February 2008, 85 individuals and 46 audit firms had withdrawn their applications. In addition, the FAOA had rejected 17 applications on formal grounds (17 individuals and 0 audit firms).

License applications as of 31.12.2007

Type of registration	Auditor	Audit experts	Total
Individuals	1,544	4,827	6,371
Sole proprietorships	264	425	689
Audit firms	654	1,825	2,479
Audit firms under state oversight	0	48	48
Total	2,462	7,125	9,587

Clarifications of the educational qualifications pursuant to the Audit Oversight Act were time-consuming. Although the list of recognized educational courses in the Act is to be regarded as definitive, various problems became apparent. Questions relating, for example, to the comparability of educational courses and foreign degrees were responded to in collaboration with the Federal Office for Professional Education and Technology (OPET). Assessing the comparability of foreign degrees and titles was particularly problematic, since there is no center of excellence at the federal level for foreign university degrees.

E-Government

All the possibilities of e-government are used by the FAOA and the registration application is processed entirely electronically right through to the delivery of the signed document. The register of licensed auditors is kept only in electronic form and published on the Internet. This increases user-friendliness and enables auditors to amend their own data (for example, a change of address). The FAOA also benefits from this system because it can offer its electronic services at a lower cost. Furthermore, third parties can easily obtain an overview of all licensed auditors and audit firms, simplifying their selection of an auditor and increasing legal security.

The electronic registration system has proved its worth and it is only possible to register, fill in the application and to pay the registration fees electronically. For

this purpose, the FAOA benefited from the experience of the Federal Office of Private Insurance (FOPI), which had already opted for a similar system for the recording and registration of insurance brokers. Based on such experience it became possible to create an efficient, rapid and low-cost registration procedure which meets the demands of both applicants and the FAOA.

Correcting applications which had been filled incorrectly proved considerably time-consuming. Where material errors had been made when inputting data electronically, the applications had to be released manually for correction.

Because the FAOA wishes to remain a lean and efficient authority, all IT operations have been outsourced and are now managed by specialists that also work for other Federal Agencies. For this reason the FAOA can do without an expensive and underutilized internal IT department.

Issue of Definitive Licenses

The provisional registration procedure came to an end on 31 December 2007. Provisional licenses were issued on the basis of an initial summary examination. Only applications which manifestly failed to meet the statutory requirements were rejected. For the purpose of a complete verification, the registration applications will now be gradually subjected to a closer examination and if necessary additional documents demanded. This will ensure that when registration applications are being fully assessed, all the documents are up to date and the decision is taken in the knowledge of all relevant information and facts.

The documents relating to individuals are being fully assessed first, in order to verify in a second stage whether audit firms fulfill the registration conditions (for example, whether the relationship between registered and non-registered audit employees is adequate). New registration applications received under the normal procedure (i.e. with effect from 1 January 2008) are, however, being given priority treatment, since under the new regulations of the Code of Obligations and Civil Code such applicants may not provide audit services until they have been duly registered.

It is expected that it will take approximately two years for the provisional registrations to be converted into definitive decisions. This relatively long time-span is justified in respect of complex circumstances. For example, when assessing the comparability of foreign educational qualifications, the FAOA is dependent on the assistance of other agencies and organizations.

In the provisional registration procedure the information on practical experience is based on self-declaration by the applicants. Evidence is not demanded until the full assessment of applications.

In the absence of any other reasons for rejection, Swiss Certified Accountants were registered immediately and without having to provide any evidence of practical training, because these persons have already acquired the necessary practical experience in the course of their education.

For persons whose practical experience does not satisfy the statutory requirements, the legislators left a back-door open in the form of the hardship clause of Art. 43, para. 6 of the Audit Oversight Act. Such individuals may in principle be registered if they can furnish evidence of having provided proper audit services based on many years' practical experience. The Federal Council, in its Message on the Audit Oversight Act, did, however, request that this exception be applied restrictively. What the Federal Council particularly had in mind was that a person might have the necessary practical experience but no evidence to prove it. The hardship clause cannot compensate for a lack of educational qualifications or missing qualified professional experience (f. Federal Gazette 2004, page 4093 ff.). This does not mean, however, that application of Art. 43, para. 6 of the Federal Audit Oversight Act is excluded in all other cases. When applicants cannot provide proof of the necessary practical training, the FAOA automatically checks whether they can be regarded as hardship cases. In order that Art. 43, para. 6 of the Federal Audit Oversight Act can be considered, in particular a long period of practical experience has to be made plausible and, if necessary, the FAOA will request relevant documents.

Module System

Some public oversight bodies prescribe a specific registration for audits required under specific laws (for example banking and insurance). Now that the legislators have created a registration procedure for all individuals and firms that carry out audits in accordance with the Audit Oversight Act, the question now arises as to the relationship with these special-law registrations.

The legislator has acknowledged this problem and has committed the registration bodies to coordinate their activities in order to avoid duplications (cf. Art. 22 of the Audit Oversight Act). The Federal Council is implementing these requirements by creating what is known as the "module system" (cf. the Federal



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Council's response to Interpellation 06.3795 Germann of 28 February 2007). Accordingly, in future the FAOA decides on registrations pursuant to the Audit Oversight Act (so called primary registrations). The other public oversight bodies will take these primary registrations into account and decide on the special-law registrations in their own areas of jurisdiction more expediently and efficiently (so called modules). The registration conditions and documents to be filed will thus be harmonized with the primary registrations. In the case of special-law registrations, it needs to be determined, therefore, which additional conditions have to be met and documents filed. If the FAOA withdraws an auditor's primary license, the special-law public oversight bodies also cancel any registrations that they have issued. The FAOA will in future therefore hold an important position in the field of Swiss Financial Market oversight.

Since the harmonization of the crucial regulations will take some time, the system will not become effective until 1 September 2009 (cf. Art. 21 in conjunction with Art. 52, para. 3 of the Audit Oversight Ordinance). The FAOA and the other bodies involved have, however, already made significant progress: the legal foundations of the Federal Office for Social Insurance (auditing of pension funds), the Federal Office of Public Health (auditing of health insurance funds), the Federal Gaming Commission (auditing of casinos), the Swiss Federal Banking Commission (auditing of investment funds), the Federal Office of Private Insurance (auditing of insurance companies), the Money Laundering Control Authority (auditing of financial intermediaries directly subject to monitoring by the Authority) and the Federal Office for Housing (auditing of housing cooperatives) have already been brought definitively into line with the new provisions of the Audit Oversight Act; they came into force on 1 September 2007 or 1 January 2008.

Talks between the FAOA and the remaining special-law public oversight bodies as to how their future cooperation should be organized, have already begun. It should be considered that financial market regulation in Switzerland is being radically overhauled. The new Financial Market Supervision Act (*Finanzmarktaufsichtsgesetz – FINMAG*), which stipulates the formation of the Federal Financial Market Supervisory Authority (*Eidg. Finanzmarktaufsicht – FINMA*), is expected to come into force on 1 January 2009. The new statutory provisions and their effects are already being incorporated as far as possible in the planning of the public oversight bodies' joint activities.

Oversight Activity

Public companies within the meaning of Art. 727, para. 1, subpara. 1 of the Code of Obligations are deemed to be companies which:

- a) Have equity securities listed on an exchange;
- b) Have bonds outstanding;
- c) Contribute at least 20 percent of assets or turnover to the consolidated financial statements of a company which falls within the categories above.

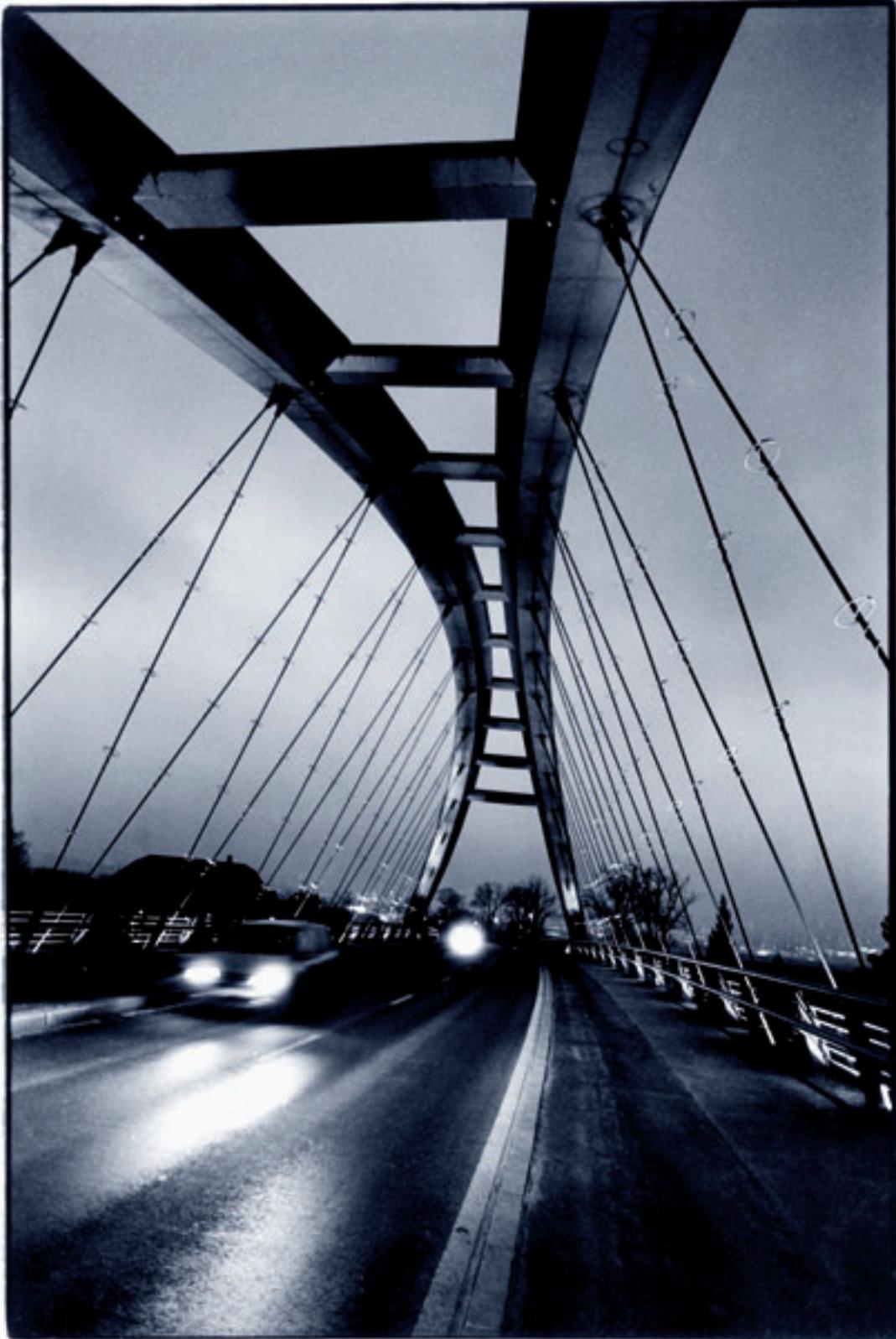
Audit firms that provide audit services for public companies (audit firms under state oversight) and audit firms that submitted their registration voluntarily have been subject to state regulation by the FAOA since 1 January 2008.

As of 31 December 2007, 30 audit firms had been provisionally registered as audit firms under state oversight. Out of these, 11 submitted their registration voluntarily.

The FAOA has devised an internal strategy which defines the supervisory activities of the FAOA on the basis of legal requirements and international practice. The Federal Audit Oversight Authority's supervisory strategy is based on the so-called "supervisory model". This states that the quality of audit services is to be enhanced primarily in collaboration with the audit firms under state oversight. In the majority of cases the inspection of an audit firm is therefore a routine examination and not a formal investigation. In the opinion of the FAOA the objective of enhancing the quality of audit services can be achieved more efficiently through this cooperative approach than through confrontational measures. But this should not obscure the fact that the FAOA has appropriate means at its disposal in order to restore conditions to proper order unilaterally as well.

The process of an inspection will be governed not only by the Audit Oversight Act and by the Ordinance issued by the Federal Council but also by the Ordinance of the FAOA on the Oversight of Audit Firms ("*Verordnung über die Beaufsichtigung von Revisionsunternehmen*", also known as the "*Aufsichtsverordnung RAB*"). The Ordinance is expected to come into force on 1 April 2008.

The inspection of audit firms under state oversight covers both formal and material aspects of an examination. In addition to the registration conditions and processes relating to independence, the inspection will first verify the existence of an appropriate and functioning internal quality control system (so called "firm review"). Assessing the monitoring activities of the audit firm is of particular importance. In a second stage an inspection of the working papers in respect of an audit of the financial statement of public companies is carried out, in order to determine whether the quality assurance criteria have actually been observed (so called "file review").



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Inspections: Review of Firmwide Processes (Firm Review)

The FAOA coordinates its oversight activity with the activities of the existing special-law public oversight bodies (especially the Federal Banking Commission) and the SWX Swiss Exchange. This cooperation reduces the cost for the audit firms under state oversight and increases efficiency of regulation generally.

According to the statutory provisions, audit firms under state oversight are to be inspected at least once every three years. In the event of any suspicion of infringements of the statutory obligations, the FAOA can carry out an appropriate inspection immediately (cf. Art. 16, para. 1 of the Audit Oversight Act).

The audit firms to be inspected are selected methodically on the basis of internationally accepted risk factors and other criteria such as the market capitalization of the public company being audited.

Because of the market position of the largest international audit networks operating in Switzerland (Big 4) and the market capitalization of the public companies audited by them, it is envisaged that they will be inspected at shorter intervals than the three-year cycle.

ISQC1 and ISA 220 (revised): Quality Control

ISQC 1 requires the member firms of IFAC to introduce documented measures which establish quality control over financial statement audits/reviews and assurance and other related services engagements. ISA 220 (revised) sets out specific requirements with regard to quality control on the audit.

The firmwide requirements are summarized in the introduction to ISQC1 as follows: The firm's system of quality control should include policies and procedures addressing each of the following elements:

- a) Leadership responsibilities for quality within the firm;
- b) Ethical requirements;
- c) Acceptance and continuance of client relationships and specific engagements;
- d) Human resources;
- e) Engagement performance;
- f) Monitoring;

The quality control policies and procedures should be documented and communicated to the firm's personnel.

In connection with the inspection of an audit firm's internal processes (firm review), the following are the main areas that are covered:

- a) Inspection of the internal quality control system;
- b) Examination of the registration documents;
- c) Tests of processes relating to independence.

The requirements that the internal quality control system must meet are based on the accounting standards used. For example, if an audit firm under state oversight audits financial statements in accordance with International Financial Reporting Standards (IFRS), the IAASB rules on the Internal System of Quality Control (ISQC 1 and ISA 220) are to be followed (see box).

The firm's internal monitoring system that is required by the standards of the profession is a key component of an internal quality control system. This area is therefore regularly reviewed, the main items examined being:

- a) The monitoring procedure;
- b) The composition and qualifications of the monitoring teams;
- c) The criteria applied to the selection of the working papers that are checked;

- d) The number of working papers checked in a business year;
- e) The results of the individual monitoring activities;
- f) The documentation of the reporting to engagement partners and to responsible persons within the audit firm;
- g) The measures taken to rectify any deficiencies identified.

Inspections: Review of Working Documents (File Review)

The review of working papers assesses whether the audit assignment has been properly performed. For this purpose, a risk-based selection of the working papers to be reviewed is of great importance, since in this area monitoring activities are carried out only on a sample basis. (cf. Art. 16, para. 2, subpara c of the Audit Oversight Act). The selection is based primarily on an in-depth risk analysis of the public companies audited.

For audit firms that have submitted to regulation voluntarily (and therefore do not provide audit services for public companies), the selection is made on the basis of the ordinary audits carried out by the company.

The FAOA does not perform an “audit of the audit”. Rather, the review is limited to the main risk areas, as for example:

- Audit areas with higher risk (based on review of the financial statements of the audited public company);
- Consideration of the internal control system (planning of the audit, audit risk assessment and the planning and execution of the audit procedures);
- Qualifications of the audit team;
- The auditor’s responsibility to consider fraud in an audit of financial statements (ISA / PS 240);
- Enlisting the assistance of internal and external specialists and network firms (ISA / PS 600, 610 and 620 on using the work of another auditor, considering the work of internal auditing and using the work of an expert);
- Communications of audit matters with those charged with governance (ISA / PS 260);
- Audit Documentation (ISA / PS 230).

Inspections: Reporting by the FAOA

The FAOA produces a draft report on the inspection, its findings on the areas inspected and any deficiencies identified. The audit firm is given an opportunity to comment on this draft and to propose measures to improve any deficiencies identified. These are then checked by the FAOA for their suitability.

The final inspection report contains the list of measures agreed in order to restore conditions to proper order. It is addressed to the audit firm's highest executive or administrative body, which will be responsible for implementing the measures. Deficiencies are to be rectified within an appropriate period of time but in any event within twelve months. If necessary, the FAOA checks on the effectiveness of the measures agreed once the deadline has expired.

The preceding does not exclude that the FAOA, if necessary, conducts proceedings and issues acts of disposal.

Standards for the Audit of Public Companies

The FAOA lays down the standards to be applied by audit firms under state oversight when providing audit services to public companies (cf. Art. 28 of the Audit Oversight Ordinance), and makes reference to nationally and internationally accepted standards. If there are no or inadequate audit standards available, the FAOA can issue its own standards or add to or partially annul existing standards.

The Federal Council has delegated the competence to lay down audit standards to the FAOA. The latter plans to set out the audit standards to be applied in the separate Ordinance of the FAOA on the Oversight of Audit Firms (*"Aufsichtsverordnung RAB"*). These standards will largely correspond to existing practice. At 31 December 2007 this Oversight Ordinance had been 6 weeks in the consultation stage and it is expected to come into force on 1 April 2008.

In connection with the laying down of standards, the FAOA has also analyzed the draft version of the Internal Control System Audit Standard (PS IKS) recommended by the Swiss Institute of Certified Accountants (*Treuhand-Kammer*).

Verifying the existence of the internal control system pursuant to Art. 728a, para. 1 of the Code of Obligations

The new provisions of the Code of Obligations in respect of auditing that came into force on 1 January 2008 stipulate in Art. 728a, para. 1, subpara 3 Code of Obligations, that the auditors shall verify whether an internal control system exists. Furthermore, para. 2 of the same Article stipulates that the auditors shall take the internal control system into account when conducting their audit and determining the scope of the audit.

The auditing of the Internal Control System (ICS) is, however, not new for auditors. For instance, the Swiss Audit Handbook 1998 (SAH 1998) stated in Section 3.21, page 108: *“The modern audit approach must be risk-oriented and system-oriented. The main focus of the audit will normally be on indirect test methods – i.e. on tests of controls and analytical tests. The substantive audit approach, especially the traditional testing of transactions, is limited to those areas which cannot be tested indirectly or in which these indirect tests allow no conclusive assessment . . .”*

What is understood by the tests of controls is a verification of the ICS. SAH 1998, Section 3.321, page 168: *“When employing the tests of controls approach, the auditor forms an impression of the quality and reliability of the internal controls and control environment and thus obtains the audit evidence of the reliability of the system (organization, information flows, work processes)”. This audit procedure is explained further in SAH 1998, Section 3.24, page 130: “The auditor shall test the effectiveness of those controls on which he intends to rely . . .”*

If, on the basis of his risk analysis and of the overview of the ICS, the auditor has decided to proceed largely on a tests of controls approach, i.e. to verify the effectiveness of the ICS, confirmation of the existence of the ICS can then be given directly on the basis of the results of the ordinary audit. No further audit procedures are necessary.

In connection with the verification of the existence of the ICS, special-law provisions also have to be taken into account. For instance, Federal Banking Commission Circular FBC-C 05/1 “Auditing” states in marginal note 12: *“The audit firm must perform appropriate tests of controls to ascertain the adequacy and effectiveness of the institution’s internal control system and risk management. Auditing the internal control system is an important element of both the financial and the regulatory audit. The results of the tests of controls of the internal control system influence the audit firm’s choice of the type and scope of the tests of details on their substantive procedures.”* These more detailed special-law provisions, mean that confirmation of the existence of the ICS can also be given based on the results of the tests of controls.

As mentioned above, the auditor decides which audit strategy to adopt. In medium and small audits it may be more efficient and expedient to opt for a substantive approach. In that case no, or only limited, tests of controls are performed and special audits have to be carried out in order to confirm the existence of the ICS. The Swiss Institute of Certified Accountants’ Audit Standard



"Altenbergsteg" beneath the bridge of "Kornhaus" in Berne

PS 890 – *Verifying the Existence of the Internal Control System* – explains the audit procedures required for the auditor to be able to confirm the existence of the ICS as required by the Act.

It is obvious that an ICS exists only if the company has introduced it and is using it. Consequently a mere check of the ICS is not sufficient but must be supplemented by questioning, observing and testing. The testing can also take the form of a walk-through test. The auditor decides on the testing method, or combination of methods, to be applied and will take into account his knowledge of the business and the results of the substantive procedures.

The FAOA's main objective is to ensure a high quality audit service. The FAOA believes that, as far as audit standards are concerned, this goal should be achieved primarily by implementing internationally accepted IAASB standards. ISA 315 sets out in detail how the ICS is to be incorporated into the audit of the annual financial statements. The standard is binding for all audits of companies whose accounts are prepared in accordance with IFRS. It would be desirable if ISA 315 would form part of the Swiss Auditing Standards as soon as possible and thus be applicable for all ordinary audits.

The FAOA has accepted these auditing standards conditional upon the Internal Control System Audit Standard issued by the Swiss Institute of Certified Accountants being completely revised when ISA 315 is incorporated into the Swiss Auditing Standards.

Cooperation with Swiss Authorities and Stock Exchanges

The Audit Oversight Act stipulates that the FAOA and the special law public oversight bodies exchange with each other all information and documentation necessary to enforce their legislation. They shall coordinate their supervisory activities in order to avoid duplication. The various public oversight bodies must also inform each other of pending investigations and decisions which might be of material relevance for their regulatory activity (Art. 22 of the Audit Oversight Act). The Audit Oversight Ordinance, for example, provides explicitly for the possibility of joint inspections of state-regulated audit firms (Art. 32 of the Audit Oversight Ordinance).

It is not only in the area of public oversight that there is a risk of duplication. There is also considerable synergy potential between the FAOA and other public oversight bodies as far as registration is concerned (cf. section 8 Module System, page 14 ff.).

There is also a need for coordination in the cooperation between the FAOA and the Swiss stock exchanges. The guiding principles for such coordination are once again contained within the Act itself (cf. Art. 23 of the Audit Oversight Act). It is therefore clear that as far as audit oversight and the imposing of sanctions on audit firms is concerned, the FAOA has the leading role. The stock exchanges, however, have an important role to play when foreign-based audit firms are involved, because foreign firms cannot have sanctions imposed upon them by the FAOA. Foreign audit firms acting as auditors of a company listed on a Swiss stock exchange can, however, be compelled by the Swiss stock exchange to comply with the Audit Oversight Act indirectly. The Stock Exchange and Securities Trading Act (*Börsengesetz – BEHG, SR 954.1*), in Article 8, as amended, now stipulates that the admission of a listing of equity securities and bonds must be made dependent upon compliance with Articles 7 and 8 of the Audit Oversight Act. The Swiss stock exchanges SWX Swiss Exchange (SWX) and BX Berne eXchange (BX) have amended their listing rules accordingly and may impose sanctions on issuers whose auditors disregard the provisions of Swiss law.

Membership of the IFIAR

As a result of globalization, national barriers are falling all around the world. This development will not spare the regulation of audit firms either. The FAOA has therefore been striving for close international cooperation from an early stage. It participated in the creation of the International Forum of Independent Audit Regulators (IFIAR). As of 31 December 2007 the association had 22 member countries. The IFIAR has set itself three objectives:

- The exchange of know-how and experience between audit regulators;
- The promotion of international cooperation;
- The creation of a contact point for other international organizations with an interest in the audit field.

The FAOA is keen to play an active role within the IFIAR – including gaining the international recognition to which it aspires. In the meetings that have been held to date the Swiss representatives have been able to establish valuable contacts and present the Swiss public oversight system.



Bridges "Schwarzwasserbrücken" for road and railway

International Recognition of the FAOA

Audits of large international public companies are generally carried out by international audit networks (Big 4). In line with the international nature of the audit business, the regulation of audit firms must also have an international dimension. The various national bodies therefore need to harmonize their public oversight and quality assurance systems.

The legislators have given the FAOA a flexible framework for providing administrative and legal assistance. Not only does the legislation take due account of the objective of internationally accepted and internationally oriented regulation, it also retains the principles of traditional administrative and legal assistance (Art. 26 and 27 of the Audit Oversight Act). These two objectives can pull in somewhat different directions and may not always be compatible.

In the forefront of the discussions on international cooperation in the field of audit regulation is the question as to whether and to what extent an audit regulator, that also needs to inspect audit firms headquartered in other countries, can rely on an inspection by the regulatory authority of the foreign audit firm's home country. The question arises not only in the context of auditors of Swiss companies that are traded on foreign stock exchanges but in particular for auditors of foreign companies that are listed on a Swiss stock exchange.

As far as the FAOA is concerned, for legal but also for practical reasons (language, mentality), the quality of audit services will be improved most efficiently if the inspections are carried out by the relevant national regulator. For that reason inspectors should as a matter of principle not be deployed abroad. This will prevent multiple inspections, ease the burden on audit firms and permit a sensible and efficient use of resources.

The FAOA has already held its first discussions on the mutual recognition of audit regulators. For the time being the negotiations are concentrating on its counterparts in the USA and EU. Both the US audit oversight authority (PCAOB) and the EU Commission as well as various public oversight bodies of the EU Member States have been following the start-up of the Swiss Federal Audit Oversight Authority with great interest. The foreign counterpart bodies have been periodically briefed informally on the progress of the start-up of the FAOA and briefed on the architecture of the Swiss public oversight system. The negotiations have not yet, however, produced any concrete results. Since all the Authorities and countries involved are entering uncharted waters, the recognition process cannot be expected to come to an early conclusion.

Both the USA and the EU have, however, given early indications of how they propose to handle cooperation with third countries:

- In a speech delivered on 27 November 2007 in Brussels, setting out the basic principles, the Chairman of the PCAOB declared his belief in the principle of full reliance, i.e. recognition of comparable foreign public oversight systems as a matter of principle. However, he sees the implementation of full reliance as the goal of a transition process, during which bilateral agreements would be created and in particular joint inspections by the PCAOB together with the relevant national public oversight body would also be carried out. Details may be found in a policy statement published by the PCAOB on 5 December 2007.
- The 8th EU Directive (2006/43/EC) on stand-alone and consolidated financial statements came into force on 29 June 2006 and must be implemented by Member States within two years. Like the Swiss regulations, the home country principle that is enshrined in the Directive provides for registration and public oversight of audit firms by their country of origin or the country in which they have their registered office, provided the respective public oversight bodies have mutually recognized each other. If the respective systems can be regarded as comparable, reliance can therefore in principle be placed on registration and public oversight by the home country. The EU has already undertaken a number of examinations of the Swiss system. The EU Commission is also intending to issue a policy statement in the coming weeks, setting out how it envisages the non-member country recognition procedure.

Detailed negotiations on mutual recognition will start later in 2008, once the policy statements that have been issued have been analyzed and the FAOA has been in operation for a number of months.



Appendix: Key Financial Data (unaudited)

Abridged Income Statement

for the period of
1 November 2006 to 31 December 2007

Revenues	CHF
Registration charges for individuals	5,165,600
Registration charges for audit firms	3,910,500
Commission for Internet payments	-390,114
Repayments of registration charges	-42,150
Accrual of charges ¹	-4,970,720
Total Revenues	3,673,116
Costs	
Personnel expenses	2,020,289
General & administrative expenses	698,008
Finance cost	28,320
Depreciation	76,499
Accumulation of Reserves according to Art. 35 para. 3 of the Audit Oversight Act	850,000
Total Costs	3,673,116

¹ The collected registration charges are dissolved over a period of 5 years.

Compensation of the Board of Directors and Management

Board of Directors	in thousand CHF	
	2007	2006 ¹
Fee, Chairman of the Board of Directors	110	18
Fee, Vice Chairman of the Board of Directors	75	13
Fee, other Members of the Board of Directors	90	15
Social Security Contributions	64	11
Total fees paid to the Board of Directors	339	57
Director and Executive Board ²		
Salary, Director	230	0
Other benefits, Director	14	0
Salary, other Members of the Executive Board	226	0
Other benefits to other Members of the Executive Board	14	0
Social Security Contributions	57	0
Total compensation paid to management	541	0

¹ The Board of Directors commenced its duties on 1 November 2006.

² The Director commenced his duties on 1 January 2007, the other members of the Executive Board during 2007.

As of 1 January 2008 the salaries of the employees were, where applicable, increased on an individual basis and adjusted with an effective inflation rate of 1% [0%].

Appendix: Abbreviations

BEHG	Stock Exchange and Securities Trading Act
BX	BX Berne eXchange
EU	European Union
FDJP	Federal Department of Justice and Police
FAOA	Federal Audit Oversight Authority
FAQ	Frequently Asked Questions
FINMA	Federal Financial Market Supervisory Authority
FINMAG	Financial Market Supervision Act
FOPI	Federal Office of Private Insurance
IAASB	International Auditing and Assurance Standards Board
ICS	Internal Control System
IFAC	International Federation of Accountants
IFIAR	International Forum of Independent Audit Regulators
IFRS	International Financial Reporting Standards
IPSAS	International Public Sector Accounting Standards
ISA	International Standards on Auditing
ISQC 1	International Standard on Quality Control No. 1
OPET	Federal Office for Professional Education and Technology
PCAOB	U.S. Public Company Accounting Oversight Board
PS	Audit Standard of the Swiss Institute of Certified Accountants (Treuhand-Kammer)
SAH	Swiss Audit Handbook
SFBC	Swiss Federal Banking Commission
SME	Small and medium-sized enterprises
SOX	Sarbanes-Oxley Act
SWX	SWX Swiss Exchange
USA	United States of America

