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Federal Audit Oversight Authority FAOA

# Activity Report 2010

 Eidgenössische Revisionsaufsichtsbehörde RAB

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## Foreword

In accordance with legal provisions (Art. 16 AOA), the Federal Audit Oversight Authority (FAOA) carries out its oversight activities at the state-regulated audit firms at least once every three years. At the end of 2010 the first cycle came to an end, which gives reason to make an overall review and to provide a summary of the main activities of the authority and of the outlook for the near future.

A major part of the activities of the FAOA over the last three years consisted of the implementation of a licensing system for the individuals and firms who provide legally-prescribed audit services. Up to 31 December 2010, 12,452 individuals and firms had submitted an application for a licence as auditor, audit expert or state-regulated audit firm. 1,253 applications were withdrawn while being processed. Of the 11,199 applications not withdrawn, 10,748 were licensed provisionally or fully by the end of 2010. 270 applicants were rejected<sup>1</sup>. The remaining 181 applications are currently pending or in the process of re-classification. The rejection rate thus amounted to around 2.5%. Around 70% of the licences granted to individuals relate to the small and medium-sized enterprise area, for audit firms it is actually more than 95%.

The licensing process primarily aims to professionalise the provision of audit services and stem the previously widespread «layman audit». It is thus unsurprising that a certain number of applications failed to meet all of the legal licensing conditions (education, professional experience, impeccable character) and could not be accepted. However, against this background the rejection rate was, if anything, at the lower end of expectations.

Meaningful external financial reporting by public companies is essential to trust in the capital markets. The **oversight** of audit firms that audit, or plan to audit, the entity and consolidated financial statements of public companies therefore assumes an important role from an economic point of view. Currently, 21 (prior year: 28) audit firms are subject to mandatory or voluntary FAOA oversight. These firms employ around 3,600 people in the audit area.

The first inspection cycle ended in 2010. Although oversight has been exercised for only three years and the measures agreed with audit firms are yet to be completely effective, significant progress could be noted in the wake of the inspections. The FAOA sees particular room for further improvement in the area of professional scepticism and in the strict compliance with independence requirements. Additional potential for improvement exists in the anti-fraud area. Here, existing auditing standards should generally be applied with more force and with audit procedures better tailored to the individual case.

The FAOA also sees potential for improving its own processes. Hence, also in 2011 it will further develop and optimise its oversight processes to satisfy the needs of its various stakeholders within the limits of the statutory provisions.

The **international recognition** of its work is a particular focus of attention for the FAOA. Only if the oversight authority of the FAOA is recognised internationally can Swiss public companies raise capital on foreign stock exchanges without disadvantage. Relationships with the EU and the USA stand in the foreground, their capital markets being essential to Swiss companies. On 5 February 2010 the EU Commission provided Switzerland with an attestation as to the so-called «adequacy» of the administrative assistance apparatus. With this the EU gave a green light to the oversight authorities of its member states to negotiate over cooperation with the FAOA. In addition, in its decision of 19 January 2011 the EU recognised the «equivalence» of the oversight system for auditors and audit firms in Switzerland, and accordingly also the FAOA. Negotiations towards a Statement of Protocol between the FAOA and the Federal Financial Market Supervisory Authority (FINMA) on the one side and the US audit oversight authority (PCAOB) on the other have been taking place since the end of 2008 and are nearing completion. General agreement could be reached between the negotiating delegate teams. Formal signature is pending

<sup>1</sup> Additionally, contrary to their applications 38 licence applicants were licensed as auditor rather than audit expert. A total of 308 applications were therefore rejected. See section 1.3 for details.

but should take place in the first half of 2011. Provided signature does take place the first joint inspection between the PCAOB, the FAOA and FINMA is expected to be performed in the first half of 2011.

**Looking to the future**, it is notable that the causes of the financial and economic crisis are being analysed worldwide and means are being sought to avoid, or at least cushion, the effects of such events in the future. The auditors followed the financial institutions and rating agencies in coming into the focus of the discussions last year. At the national level, given that the crisis occurred mainly in the finance sector, FINMA has announced that it will optimise its inspection procedures further. The FAOA supports this approach. The division of company and oversight law inspections at the financial institutions, which has been discussed against this background, makes sense in the view of the FAOA. Only so can the oversight of audit firms be unified and international cooperation with foreign audit oversight authorities be simplified.

At the international level, the EU Commission's Green Paper of October 2010 has caused lively debate recently. The FAOA will follow the international discourse with interest. It is imperative, however, that premature conclusions concerning the crisis and rash impulsive actions are avoided. The aim should rather be to enforce existing regulations forcefully and consistently. The inspection of state-regulated audit firms by the FAOA contributes significantly to safeguarding and raising the quality of audit services.

In connection with licence applications and the inspection of state-regulated audit firms, the FAOA finds repeatedly that legal and professional independence requirements have not been observed adequately. In 2010 the FAOA again had to object to various breaches, some serious. There is a need for further action here and the FAOA will seek discussions with the professional organisations in this regard. To avoid loss of public faith in the profession it is important that appropriate measures are identified.

«The international recognition of its work is a particular focus of attention for the FAOA.»

In the licensing area the FAOA will enter quieter waters upon completing the final review of provisional licences. In 2011 the main task will be to process new incoming applications in order to issue the respective first-time licences. The renewal of existing audit firm licences will begin only as from the end of 2012. In the future the inspection of state-regulated audit firms, together with related questions concerning international cooperation, will form the main activity of the FAOA.

14 February 2011



Prof. Hans Peter Walter  
Chairman of the Board of Directors



Frank-Oliver Schneider  
Chief Executive Director



# 1 Licensing

## 1.1 Provisional licences

Those who submitted their licence application to the FAOA between 1 September 2007 and 31 December 2007 were licensed using a two-stage process: At the first stage a summary check was made as to whether licensing requirements were met. Only in obvious cases were applications rejected at this stage of the process. The remaining applications were only checked in detail at the second stage to determine whether they met the licensing requirements (Art. 43 AOA and Art. 47 AOO).

Almost all the remaining ca. 10% of licence applications originally accepted on a provisional basis were assessed definitively in 2010. The licensing process was thus basically completed in the reporting year. At the end of 2010, a total of 10,528 individuals and firms held the full FAOA licence.

A few applications could nevertheless not be assessed finally. As at 31 December 2010 around 220 individuals and audit firms were licensed on a provisional basis as before. This had various causes:

- A portion of the applications are subject to appeal before the Federal Administrative Court (FAC) and the Federal Supreme Court<sup>2</sup> and can therefore be finalised, or at least taken further, only when the respective court reaches a decision.
- Another portion of the applications depend indirectly upon the outcome of such appeals. A case where the licensing of an audit firm depends upon the licensing of the owner comes to mind. It can also be that the courts have to determine the licensed status or competence of an individual responsible for supervision. It follows that applications from auditors claiming professional experience under the oversight of this individual cannot be finalised. Furthermore, the FAOA is expecting the FAC to make precedent rulings as regards one or the other question, each of which will be applicable to other pending applications. Depending on the circumstances, the processing of the affected applications is suspended until the precedent ruling is made.
- In part, the need for an extraordinary amount of clarification also led to longer processing time. In-

dividuals with foreign educational qualifications, whose equivalence to one or more Swiss diplomas has to be checked (Art. 4 para. 2 indent d AOA), come to mind. It is not uncommon for the FAOA to be dependent upon information and documentation from abroad, which can lead to considerably extended processing times.

The FAOA is endeavouring to reach final decisions on the remaining provisionally licensed individuals and firms as soon as possible. As explained, however, the FAOA has either no or limited influence on the timing of the final assessment in many cases.

The completion of the final checks on provisional licences has also affected the number of FAOA staff. As expected, the workload in the licensing area reduced significantly following the processing of the majority of licence applications. Staff numbers are therefore reducing (see Appendix 1).

## 1.2 New licence applications

As all provisionally approved licence applications have, with very few exceptions, been decided upon finally<sup>3</sup>, the transition from old to new law is basically completed.

The FAOA continues to receive many new licence applications. An increase in licence applications is particularly noticeable upon the completion of examinations qualifying for a licence under the AOA. In the reporting year a total of 744 new applications for licences were submitted. In 2008 and 2009 it was 1,886 and 1,088 respectively.

With the expiry on 31 August 2009 of the transitional provisions concerning the requirements of individuals qualified to supervise (Art. 43, para. 4 and 5 AOA), professional experience can now be acquired solely under the oversight of individuals who themselves hold the required licence. For professional experience acquired before the above-mentioned date, the less stringent requirements regarding individuals qualified to supervise still apply.

<sup>2</sup> Cf. Adjudications of both courts in 2010 - section 4.

<sup>3</sup> Cf. Section 1.1.

### 1.3 Statistics

The statistics regarding licensed individuals and audit firms as at 31 December 2010 are as follows:

Type of licence	Auditor	Audit expert	Total 31.12.2010	Total 31.12.2009
Individuals	29	72	101	627
Sole proprietorships	4	9	13	106
Audit firms	36	64	100	679
State-regulated audit firms	0	6	6	22
<b>Total provisional licences</b>	<b>69</b>	<b>151</b>	<b>220</b>	<b>1 434</b>
Individuals	2 031	5 121	7 152	6 357
Sole proprietorships	372	441	813	670
Audit firms	797	1 751	2 548	1 910
State-regulated audit firms	0	15	15	6
<b>Total full licences</b>	<b>3 200</b>	<b>7 328</b>	<b>10 528</b>	<b>8 943</b>
<b>Total licences</b>	<b>3 269</b>	<b>7 479</b>	<b>10 748</b>	<b>10 377</b>



As per 31 December 2010, the statistics regarding the application processes which resulted in a negative outcome for the applicant are as follows<sup>4</sup>:

Individuals Type of decision	Deficiency	Case category	Number	%	
Non-receipt of application	Duty to assist	No documentation submitted	5	2	
Application rejected	Duty to assist	Incomplete application	46	19	
	Swiss education	Qualification not as per Art. 4 para. 2 indent a–c AOA	44	18	
	Professional experience	Insufficient supervised professional experience	33	0	
		Lack of professional experience in audit	28	25	
	Character		Infringement of independence	9	0
			Convictions under civil or criminal law	7	0
			Audit without a licence	3	0
			Financial situation	2	0
			Deficient auditing	1	10
	Applicants with foreign education		Qualification not as per Art. 4 para. 2 indent d AOA	6	0
			Lack of reciprocity	9	0
Lack of knowledge of Swiss law			5	8	
Rejection as audit expert, but licensed as auditor	Professional experience	Insufficient professional experience or, as the case may be, supervised professional experience	38	16	
Licence withdrawal	Character	Infringement of independence	4	0	
		Audit without a licence	1	0	
		Bankruptcy and concealment of convictions under civil law	1	2	
<b>Total decisions against individuals</b>			<b>242</b>	<b>100</b>	

<sup>4</sup> Pending appeals not included. Determining factor is therefore the status of the licensing process within the Register of Auditors as per the end of 2010.

Audit firms Type of decision	Deficiency	Case category	Number	%
Non-receipt of application	–	–	–	–
Application rejected	Duty to assist	Incomplete application	4	6
	Quality assurance system	No documentation submitted	1	1.5
	Quorum not achieved	Non-compliance with Art. 6 AOA	53	80
Rejection as audit expert, but licensed as auditor	Quorum not achieved	Non-compliance with Art. 6 AOA	7	11
Licence withdrawal	Quorum not achieved	Non-compliance with Art. 6 AOA	1	1.5
<b>Total decisions against audit firms</b>			<b>66<sup>5</sup></b>	<b>100</b>
<b>Overall total of negative decisions</b>			<b>308</b>	

Depending on the circumstances it may prove unreasonable to reject a licence application or withdraw a licence on the grounds of a character-related breach of standards. In such cases, the FAOA can also issue the fallible individual with only a warning. To the end of 2010 the FAOA had identified 90 such breaches<sup>6</sup>. In 62 proceedings, that is in approximately 70% of cases, the FAOA issued a warning. In the other, approximately 30% of proceedings (28 cases), the licence application was rejected or the licence was withdrawn for a limited or unlimited time period. In half of the cases referred to (45) the FAOA's action was prompted by breaches of auditor independence.

## 1.4 Applicants with foreign educational qualifications

### 1.4.1 Equivalence of educational qualifications

The processing of applications from individuals with foreign educational qualifications was one of the more complex licensing activities of the FAOA during the reporting year<sup>7</sup>. In 2007 and 2008 many of these individuals were granted a provisional licence provided that their qualifications were, at first sight, comparable with recognised Swiss qualifications. Furthermore, the question of reciprocity could not be answered definitively as part of the summary checks performed. During the reporting year the FAOA has, in a second step, checked in detail whether all licensing requirements have been met and whether a full licence can be granted.

The FAOA decides whether a foreign educational course is equivalent to a Swiss one according to administrative discretion. However, this discretion relates solely to the question of whether the foreign educational qualification is equivalent to one of the Swiss qualifications listed as part of a definitive catalogue within the law. It follows that the list of recognised qualifications is also definitive in international terms. To date the FAOA has judged the following qualifications to be equivalent (position as at 31 December 2010):

<sup>5</sup> 50 cases related to sole proprietorships where the owner did not hold the appropriate licence. The licensing processes for the owner and respective sole proprietorship are amalgamated and dealt with together.

<sup>6</sup> No statistics are available regarding the number of cases in which applicants abstained from commencing activities or asked for the licensing process to be discontinued.

<sup>7</sup> Foreign licence applicants who hold a foreign educational qualification equivalent to a recognised Swiss qualification (Cf. Art. 4 para. 1 indent a to c AOA), have appropriate professional experience and can demonstrate the necessary knowledge of Swiss law, satisfy the educational and professional experience conditions, in so far as this is provided for in a state treaty with the country of origin or the country of origin grants reciprocity (Art. 4 para. 2 indent d AOA).

Australia	Graduate Diploma
Germany	Bestellungsurkunde Wirtschaftsprüfer
France	Diplôme d'études supérieures comptables et financières und Diplôme d'expertise comptable
Great Britain	Chartered/Certified Accountant
Italy	Dottore commercialista
India	Chartered Accountant
Netherlands	Registeraccountant
Norway	Studiet i revisjon (registered auditor, state authorised auditor)
Austria	Bestellungsurkunde Wirtschaftsprüfer
Sweden	Approved / Authorised public accountant

#### 1.4.2 Required knowledge of Swiss law

Alongside equivalent educational qualifications and adequate professional experience, the licence applicant must evidence having the knowledge of Swiss law necessary to audit a Swiss company. Following a change to the AOO, since 1 December 2010 applicants can produce this evidence more simply. They are no longer required to complete an FAOA-approved training course. The necessary knowledge of Swiss law can now be evidenced solely by passing an examination whose regulations are recognised by the FAOA. The examination can be taken in all the official languages of the Confederation and, if requested, in English (Cf. Art. 6 and 34 AOO).

The FAOA will ask provisional licence holders who have yet to evidence the necessary knowledge of Swiss law to sit the exams at the first examination date in 2011.

#### 1.4.3 Reciprocity with respect to Swiss educational qualifications

Reciprocity constitutes a further important licensing requirement. The holder of a foreign diploma can be licensed in Switzerland only if the holder of an equivalent Swiss diploma would also be licensed in that person's home country. Reciprocity can be created by state treaty. At the present time treaties exist with the EU and EFTA member states<sup>8</sup>. These agreements ensure that the reciprocity licensing condition is met, provided that the licence applicant is actually licensed in an EU or EFTA country or would fulfil the conditions for such a licence. No state treaties exist with other countries, as far as is known.

Reciprocity does not necessarily require the existence of a relevant state treaty however. In order for a diploma obtained in a country without a state treaty with Switzerland to be recognised, Art. 4, para. 2, letter d AOA requires only that the country of origin grants reciprocity. Reference is thereby made to so-called substantive reciprocity, which need not necessarily be assured through state treaty but can also be assured through lower levels of law or through legal precedence<sup>9</sup>.

The principle of reciprocity is a general basic principle of international law that allows a country to make its behaviour dependent on the behaviour of another country, where the other country behaves towards it in the same way in the same situation (BGE 109 Ib 168, E. 5). In the present case this relates to the freedom of professionals to access the audit services market. The relationship of foreigners' rights and obligations as regards access to the audit market must be comparable between the two countries. The reciprocity requirement aims to ensure that those holding Swiss educational qualifications have the possibility to establish themselves abroad. In contrast to the other licensing conditions of the AOA, the requirement for reciprocity is of an economic rather than trade regulation character. Given this objective, it is sufficient when the responsible foreign authority actually licences auditors with Swiss diplomas under certain conditions, on a case by case basis and according to their own discretion.

<sup>8</sup> Freedom of movement agreement with the EU of 21 June 1999, SR 0.142.112.681, und EFTA-Agreement of 4 January 1960, SR 0.632.31

<sup>9</sup> Cf. Federal Council message of 23 June 2004, BBl 2004, 4082 f., on cross-border oversight activities.

## 1.5 Audit firms

### 1.5.1 Joiners and leavers

In assessing whether reciprocity exists the question is not whether a Swiss diploma holder has access to the audit market, as such, but rather whether they are permitted to act as lead auditor and sign audit reports. In Switzerland it is possible for individuals without an FAOA licence to assist on audit mandates in a less responsible capacity. They cannot, however, act as lead auditor or sign an audit report, as this requires a licence from the oversight authority (Art. 6 para. 1 indent c. AOA in conjunction with Art. 728b para. 2 section 3 and Art. 729b para. 2 CO).

Except in the case of EU and EFTA states the question of reciprocity has been considered only where it has arisen specifically as part of a licence application. Investigations to date have shown that Australia and India grant reciprocity to Swiss certified accountants. In contrast, educational qualifications obtained in the USA and Canada cannot be recognised due to lack of reciprocity. Investigations are continuing with respect to reciprocity with Argentina, Algeria, Belgium, Mexico, Peru, the Philippines, Portugal and Russia.

The following options are currently available to a licence applicant holding an educational qualification from a country which does not grant reciprocity to nevertheless possibly obtain a licence:

- Simplified access to the Swiss certified accountant examination: Detailed information regarding the conditions and modalities are shown on the website of Educaris AG<sup>10</sup>.
- Obtaining membership of the Association of Chartered Certified Accountants (ACCA)<sup>11</sup> or the Institute of Chartered Accountants in England and Wales (ICAEW)<sup>12</sup>: Membership is conditional upon passing all necessary examinations and any additional examinations necessary to obtain so-called «signing rights» in the EU. Where Mutual Recognition Agreements with the ACCA or ICAEW allow for simplified access these are also recognised. It is not necessary to be actually registered in the relevant EU country. Lack of professional experience in the EU country can be compensated for through appropriate professional experience in Switzerland. Since the ACCA and ICAEW diplomas are foreign qualifications the other requirements of Art. 4 para. 2 indent d AOA, and in particular evidence of knowledge of Swiss law<sup>13</sup>, must also be met.

An audit firm can be licensed as an audit expert or auditor if it fulfils certain organisational requirements (Art. 6 para. 1 indent a–c AOA): The majority of the members of the highest supervisory or governing body (for a limited company this is, as far as it exists, the Board of Directors) and of the executive body (for a limited company this is, as far it exists, the Executive Board) must hold the relevant licence. In addition, one fifth of the individuals providing audit services must hold the relevant licence. Finally, all lead auditors or, as the case may be, firm owners must hold the appropriate licence.

It follows that when licence holders join or leave this can have a direct impact on the licence of the audit firm. Under certain circumstances the licensing requirements may no longer be met or the type of licence may be incorrect. Personnel changes can also affect the quality assurance system (Art. 6 para. 1 indent d AOA): The functioning of such a system is based on the premise that at least two individuals hold the same licence as the audit firm itself. Where this requirement is no longer met the audit firm must subscribe to a system of external quality assurance assessment on or before 31 August 2013<sup>14</sup>. On the other hand, where an audit firm has had only one member of staff to date but appoints another member of staff with the same or superior type of licence, the firm must start operating and documenting an internal quality assurance system.

Should an audit firm no longer meet the above requirements the FAOA can withdraw its licence for a limited or unlimited period. If it is possible to restore compliance a warning of possible licence withdrawal is to be made (Art.17 para. 1 AOA).

In order that the FAOA can carry out its duties efficiently and in timely manner it is vital that licensed individuals and firms update their register entries on a continual basis<sup>15</sup>.

<sup>10</sup> [www.educaris.ch/dynasite.cfm?dsamid=92321](http://www.educaris.ch/dynasite.cfm?dsamid=92321)

<sup>11</sup> [www.accaglobal.com](http://www.accaglobal.com)

<sup>12</sup> [www.icaew.com](http://www.icaew.com)

<sup>13</sup> Section 1.4.2.

<sup>14</sup> So-called «Peer Review», Cf. Art. 9 and 49 AOO as well as FAOA Activity Report 2009, section 2.10.

<sup>15</sup> Cf. also section 1.6.

### 1.5.2 Restructuring

The licence of an audit firm under the AOA represents a regulatory authorisation which is granted ad personam to an audit firm on the basis of its specific structure. Therefore, it is generally not possible to transfer a licence from one audit firm to another. In certain cases, however, the need to transfer a licence from one audit firm to another may be justified. In particular, this could arise in the context of restructuring and thus include mergers, demergers, conversions and asset transfers.

In each case the transfer of a licence requires the prior approval of the FAOA. The approval of the licence transferred ensures that when the relevant entry is made in the Commercial Register the licence is also transferred to the transferee firm. Time gaps or other transitional problems can thereby be avoided and it is ensured that audit services can be provided without interruption<sup>16</sup>.

There is no right to transfer a licence. In particular, the FAOA will not approve a transfer if this represents an attempt to sell the licence. It is forbidden to trade FAOA licences. In particular, it is not possible to use such means to reduce the waiting that accrues with new applications. Thus, for example, a licence can be transferred as part of an asset transfer only where the transferring audit firm transfers its entire audit activities, be it the whole firm or part of the firm.

The approval to transfer a licence to another audit firm naturally assumes that the recipient firm also fulfils the licensing requirements of Art. 6 AOA. As mentioned, the approval of the FAOA is generally to be obtained in advance as there is otherwise a danger that the licence cannot be transferred on time. The information and documentation required to check the transfer can vary from case to case; basically, however, it is the same as the information and documentation required for a new application, with additional relevant information regarding the (planned) restructuring.

If the firm receiving the licence fulfils all licensing requirements the respective register entry must be amended by the licence holder. After this, the FAOA transfers the licence to the applicable firm under its existing register number and records this in the public Register of Auditors. At the same time the former licence of the transferring firm is removed and the respective entry in the Register of Auditors deleted. There can be variations to this procedure in special cases. This could apply, for example, where a sole proprietorship converts to a corporate body, or where a simultaneous change to the type of licence is planned.

Whether, and to what extent, fees are charged for a licence transfer depends on the related work. Any such fees are charged to the transferee firm.

<sup>16</sup> Regarding the consequences of an audit without a licence see section 1.7.

## 1.6 Reporting and disclosure requirements

The experience of the FAOA suggests that the maintenance of the Register of Auditors by licensed individuals and audit firms could often be improved. It is observed repeatedly that the data entered is not kept up to date subsequent to licensing. This can lead to problems, for instance, where an individual changes their e-mail address, street address or employer as the FAOA may no longer be able to contact them. The new contact details must be obtained in other ways. If it is not possible to do this at reasonable cost the licence holder must accept any possible disadvantages that arise.

Similar problems arise with audit firms. Outdated contact details make it difficult for the FAOA to deliver important information regarding licence renewal<sup>17</sup>. The problem may additionally arise that current staff numbers or changes to the composition of management bodies are not communicated on a timely basis<sup>18</sup>.

It should be remembered that licensed individuals and firms are subject to various reporting and notification requirements (Art. 15 para. 3 AOA, Art. 13 para. 1 AOO). State-regulated audit firms are subject to a further-reaching reporting requirement (Art. 14 para. 2 AOA). Changes in circumstances relevant to oversight are to be notified to the FAOA within 10 working days by way of an electronic entry in the relevant licence application. Contravention of reporting and notification duties is punishable by law (Art. 39 AOA, Art. 45 AOO)<sup>19</sup>.

The FAOA tests whether data is current based on its own findings and third party reports. A complete test of the relevant information will be made at the time of licence renewal, following the end of the initial five year licensing period<sup>20</sup>.

<sup>17</sup> Cf. section 1.9.

<sup>18</sup> Cf. section 1.5.1.

<sup>19</sup> Contraventions of reporting and notification duties can be subject to a fine of up to 100'000 Swiss Francs and represent contraventions of audit law. Alongside possible consequences under criminal law, repeated or, as the case may be, serious contraventions of audit law can also have consequences under administrative law and, for individuals, can affect the assessment as to whether that individual assures the proper conduct of audit activities. Contravention of reporting and notification duties by audit firms likewise calls into question whether the firm's quality assurance system meets legal requirements and operates effectively.

<sup>20</sup> Cf. section 1.9.



## 1.7 Auditing without a licence

### 1.7.1 Consequences under criminal, administrative and civil law

Although the new audit law has been in force since 1 September 2007 and 1 January 2008 respectively, the FAOA still encounters cases where audit services have been provided without a licence or without the appropriate licence<sup>21</sup>. The licences required for audits subject to special law are shown in Appendix 4.

Providing audit services without a licence can have serious consequences for the audit firm, the lead auditor and the audited company under criminal, administrative and civil law<sup>22</sup>:

- The provision of audit services without a licence is a criminal offence (Art. 40 para. 1 indent a and para. 2 AOA). The penalties are imprisonment of up to 3 years or a fine of up to 1 million Swiss Francs for deliberate acts and a fine of up to 100,000 Swiss Francs for negligent acts. Where the FAOA learns of criminal actions it is legally obliged to inform the responsible cantonal criminal prosecution authorities (Art. 24 AOA).
- A breach of the criminal provisions of the AOA raises the question as to whether the lead auditor, as the individual responsible, remains of an impeccable character and accordingly assures the proper conduct of audit activities. The FAC decided that a licence applicant who had audited 17 limited companies without a licence was rightly not granted a licence<sup>23</sup>.
- Where a company body does not exist or is not correctly constituted a shareholder, creditor or the Company Registrar can ask the courts to take necessary measures (Art. 731b CO). Where the auditor does not meet the legal requirements regarding qualification and independence this would also be regarded as «incorrectly constituted». The qualification to act as auditor results from holding a licence from the FAOA. An auditor without a FAOA licence, or with the incorrect one, represents a deficient body under the meaning of Art. 731b CO. This applies also to an auditor who has the correct FAOA licence but does not, or no longer, meet the legal requirements to act as auditor. Thus there is a legal right to demand the correction of this situation.

– A valid shareholder resolution to approve the statutory and consolidated financial statements and the appropriation of profit requires the availability of the auditor's report. If the report is not available the resolution is null and void. It is generally agreed that an audit report issued by an unlicensed or inadequately licensed auditor is invalid and that resolutions based on this are null and void.

– Remediating the consequences of an invalid audit report or a general shareholders' meeting resolution which is null and void involves many legal problems. These problems and the effort and cost that result can lead to legal action against the auditor (Art. 755 CO).

### 1.7.2 Reconciliation of registers

In 2010 steps were taken to reconcile the FAOA Register of Auditors with the cantonal Commercial Registers. The aim is to filter out those audit firms that are registered in the Commercial Registers but do not hold a FAOA licence.

The reconciliation of registers is expected to be completed and evaluated early in 2011. Following this the FAOA will ask the respective firms to comment and clarify whether audit services have been provided without a licence.

<sup>21</sup> Cf. also Activity Report 2009 section 2.8.

<sup>22</sup> Cf. to the following: Reto Sanwald / Loris Pellegrini, Auditing without a licence, consequences under criminal, administrative and civil law: Schweizer Treuhänder 2010, 640 ff. (German version), 650 ff. (French version), respectively: TREX 5/2010, 294 ff. (German version), 301 ff. (French version).

<sup>23</sup> Cf. section 4.4.2.

### 1.8 Infringement of independence

The FAOA still encounters many infringements of independence (Art. 728 and Art. 729 CO) in practice.

The FAC has decided that disregard for independence requirements represents a severe violation of an auditor's duties. Such violations adversely affect professional character and good repute and cast significant doubt on credible conduct and compliance with responsibilities. They are therefore of relevance to professional character<sup>24</sup>. The FAC also gave its views on various specific scenarios in which auditor independence was infringed<sup>25</sup>.

### 1.9 Outlook in the licensing area

In contrast to individuals, audit firms are licensed for a period of only 5 years (Art. 3 AOA). The next large « wave » of licence applications is therefore to be expected in 2013. As from that year licence renewals will be pending for around 3,400 audit firms. The FAOA will inform the affected firms about the process at the appropriate time.

After its first few years of operation the FAOA has noted that the electronic data processing system currently used for processing and issuing licences requires further development. It will therefore be decided whether to enhance the current system with additional functions or to acquire a new system altogether. Functionality, alongside cost, is a prime consideration. The modernisation of the IT system is linked to the following developments:

- In order to minimise administrative effort the government administration is striving to create streamlined and economic processes for affected individuals and firms. The current FAOA system is already advanced in this respect. Even so, there is also potential for improvement here: For instance, in the future it should be possible to process all licence applications and correspondence with the FAOA electronically.
- Likewise, in connection with the reduction of the administrative burden on firms and the efficient use of data within the government administration, the National Assembly and Council of States decided in mid-2010 to introduce a uniform company identification number. As from the enactment of the relevant government law on 1 January 2011, each firm in Switzerland will receive a unique com-

pany identification number on a successive basis. Moreover, by the end of 2015 the numerous identification numbers used within the government administration (company register number, value added tax number etc.) will have been gradually replaced by the company identification number. The introduction of the company identification number will therefore also involve changes for the FAOA and the Register of Auditors. Particularly affected will be the current FAOA « 500'000 » numbers, as used for licensed audit firms. They will be replaced with company identification numbers by the end of 2015 at the latest.

<sup>24</sup> FAC Decision No. B-7348/2009 of 3 June 2010, E. 10, and No. B-4137/2010 of 17 September 2010, E. 4.

<sup>25</sup> Cf. Section 4.4.4.

## 2 Oversight

### 2.1 Introduction

In 2010 the oversight activities of the FAOA were influenced by the difficult global economic developments of the previous year. The economic and financial crisis left clear traces in the financial statements of many Swiss public companies<sup>26</sup>.

Many public companies were impacted by the economic situation in 2009, in terms of revenue and earnings growth on the one side and financing needs on the other. In a few cases events or conditions threw significant doubt on the ability of the company to continue as a going concern. Instances of material uncertainty as regards questions of financing and the material assumptions and estimates used in determining significant valuations were also observed. The higher levels of uncertainty affected the reports of state-regulated audit firms. In 2010 it was reflected particularly in an increased number of modifications to audit reports. The FAOA reacted to the above changes and focused on the appropriate high risk audit areas in the 2010 inspections<sup>27</sup>.

The completion of the 2010 inspections ended the first three year inspection cycle of the FAOA<sup>28</sup>. The most important findings from this were presented at the FAOA Seminar in Berne on 17 November 2010. A pertinent summary can be found in section 2.3.

The completion of the first cycle provides the FAOA with the opportunity to review its inspection procedures once more. In a quest to improve such procedures continually and to meet the needs of its various stakeholders as far as legally possible, the FAOA will optimise its inspection procedures further in 2011. Where allowed by the assessment of risk for the individual state-regulated audit firms, the quality assurance system inspection (firm review) will involve, to a greater extent, the rotation of key areas reviewed based on a multi-year plan. The inspection of the quality of audit services (file review) will continue to be focused clearly on areas of high audit risk. With a view to the duration of the inspection and in order to reduce this timeframe, the FAOA will endeavour to issue its draft inspection report within two months of completion in the case of routine inspections<sup>29</sup>.

It is a further aim of the FAOA that noted deficiencies are remedied or, as the case may be, addressed with effective remedial measures as soon as possible. With respect to the file review, more extensive measures will be demanded in the future. Henceforth, where file review findings potentially impact the audit opin-

ion on a set of financial statements, the FAOA will require the audit firm to confirm its continued belief that sufficient appropriate audit evidence exists to support the audit opinion and that the audited financial statements comply, in all material respects, with relevant accounting standards. Additionally, in line with international standards the audit firm will also be required to perform additional audit procedures and/or supplement the audit evidence within the working papers in order to provide proper evidence of the audit procedures performed.

In October 2010 the FAOA published its existing Oversight Concept<sup>30</sup>. The aim of the publication is to create transparency and to provide interested members of the public with a deeper insight into the oversight activities of the FAOA. It should also better illustrate the inspection process to audit firms interested in a licence as a state-regulated audit firm.

The FAOA supports state-regulated audit firms in moving towards greater transparency. The publication of a transparency report by one of the «Big 3» firms was particularly welcome<sup>31</sup>. Apparently for the first time, this transparency report provided information on the firm's management principles.

<sup>26</sup> The oversight activities of the FAOA in 2010 were based on the audit of 2009 entity and consolidated financial statements.

<sup>27</sup> See section 3.6 Activity Report 2009 for main areas to be covered by inspections.

<sup>28</sup> Art. 16 para. 1 AOA.

<sup>29</sup> The date of the last inspection activities is decisive in assessing compliance with this deadline.

<sup>30</sup> Vgl. [www.revisionsaufsichtsbehoerde.ch](http://www.revisionsaufsichtsbehoerde.ch). The Oversight Concept explains the procedures used by the FAOA in its oversight of state-regulated audit firms. The FAOA concept combines principles arising from regulatory requirements under the AOA with procedures used internationally.

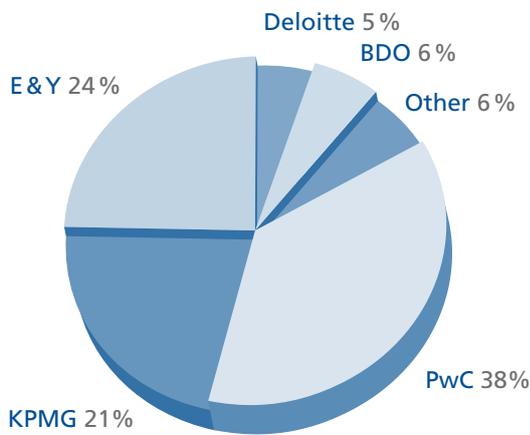
<sup>31</sup> The Big 3 firms, i.e. the 3 largest audit firms in Switzerland, are Ernst & Young AG, KPMG AG und PricewaterhouseCoopers AG. In 2010 KPMG AG published a transparency report.

## 2.2 Market share and structure of state-regulated audit firms

In terms of numbers of mandates there has been no material change in the share of public companies audited by the three largest audit firms. As can be seen from the following Figure 1, it amounted to around 83 per cent.

**Figure 1:**

Percentage share of public companies audited by state-regulated audit firm as per FAOA register entry (incl. significant subsidiaries and issuers of listed bonds); total numbers: 499, position as of 8 December 2010<sup>32</sup>



As of 31 December 2010, the three largest audit firms in Switzerland, Ernst & Young AG, KPMG AG and PricewaterhouseCoopers AG, still cover more than 90 percent of Swiss market capitalisation.

As of 31 December 2007, 48 firms had submitted an application to become a state-regulated audit firm<sup>33</sup>. Their numbers have continually decreased over the last 3 years. As at 31 December 2010, 21 firms hold a licence as a state-regulated audit firm. This significant reduction is due mainly to voluntary withdrawals.

It is unlikely that the number of state-regulated audit firms will reduce significantly following the completion of the first inspection cycle at the end of 2010.

The FAOA has no interest in there being too high a level of concentration on the Big 3 firms. The interest is far more in having a sufficient supply of licensed audit firms with the authority and ability to audit public companies.

<sup>32</sup> According to self-declarations by state-regulated audit firms.

<sup>33</sup> Cf. Activity Report 2006–2007, page 12.



**Figure 2:**

Quantitative development of state-regulated audit firms from 31 December 2008 to 31 December 2010 according to licensing status.

Reference date	Total state-regulated audit firms	Voluntarily under FAOA oversight <sup>34</sup>	Full licence	Provisional licence		
				Inspection complete <sup>35</sup>	Inspection process ongoing <sup>36</sup>	Inspection not yet begun
31 December 2008	37	13	2	–	8	27
31 December 2009	28	12	6	4	5	13
31 December 2010	21	4	15	6	0	0

## 2.3 Inspections

### 2.3.1 General

From 1 April 2008<sup>37</sup> to 31 December 2010 the FAOA performed a total of 31 inspections<sup>38</sup>. Of these, 10 inspections were performed at the «Big-3». The state-regulated firms were cooperative and supplied the FAOA with all the information and documentation requested.

To close the first three year inspection cycle (2008 to 2010) the inspection findings relating to firm-internal processes (firm review) and the quality of audit services (file review) are summarised below.

<sup>34</sup> This relates to audit firms that do not audit any public companies within the definition of Art. 727 para. 1 section 1 CO and are voluntarily under FAOA oversight (Art. 7 para. 2 AOA).

<sup>35</sup> Based on the deficiencies noted during the inspection no final decision is taken until agreed measures have been implemented.

<sup>36</sup> The FAOA is still in the inspection process at these state-regulated audit firms.

<sup>37</sup> The inspection activities of the FAOA began on 1 April 2008 with the enactment of the Ordinance of the Federal Audit Oversight Authority on the Oversight of Audit Firms (Oversight Ordinance FAOA, OOAF-FAOA; SR 221.302.33).

<sup>38</sup> Contains all inspections performed from 1 April 2008 to 31 December 2010, including inspections which are still to be completed as at 31 December 2010.



Silke Bradtke, member of the Oversight team.

**2.3.1.1 Overview of inspections and findings relating to firm-internal processes (2008 – 2010)**

From 1 April 2008 to 31 December 2010, 29 out of 31 inspections were completed<sup>39</sup>. An analysis of the findings relating to firm-internal processes results in the following view:

**Figure 3:**

Average number of firm review findings for 29 inspections performed between 1 April 2008 and 31 December 2010.

	Total	Thereof Big-3	Thereof remaining state-regulated audit firms
Number of firm reviews	29	9	20
Number of firm review findings	191	43	148
<b>Average number of findings per firm review</b>	<b>6.6</b>	<b>4.8</b>	<b>7.4</b>

The FAOA identified a larger average number of deficiencies per firm review at the small to medium-sized state-regulated audit firms than at the annually-inspected Big 3.

<sup>39</sup> A draft inspection report is available at 5 of the 29 completed inspections as per 31 December 2010. 9 of the 29 inspections were performed at the Big 3 firms.

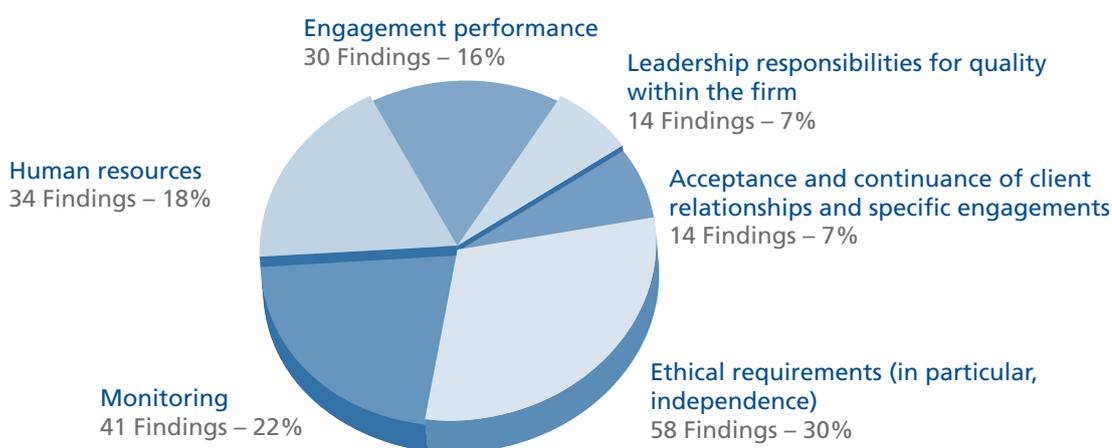
As only one inspection has been performed to date at the small to medium-sized state-regulated audit firms, improvements at these firms will first be measurable in the future.



A categorisation of the total 191 firm review findings for all state-regulated audit firms results in the following view:

**Figure 4:**

Categorisation of firm review findings from 1 April 2008 to 31 December 2010 based on the elements of a quality assurance system as per ISQC1 (a total of 191 findings from 29 inspections).



The greatest need for improvement was noted in the independence area. This is regrettable given that independence requirements have existed for a long time and form the essential basis of every audit. The FAOA will continue to enforce the independence requirements forcefully to further improve confidence in the audit industry and the services it provides.

The categorisation of findings showed that deficiencies relating to «ethical requirements» and «human resources» appear with similar frequency at all state-regulated audit firms.

On average, small to medium-sized state-regulated audit firms accumulated more findings with respect to the remaining four elements. This is most evident in the areas of «acceptance and continuance of client relationships and specific engagements», «monitoring» and «engagement performance». An explanation for this is that, in the past, small and medium-sized state-regulated audit firms often had only informal or insufficiently formalised client acceptance and engagement performance processes.

### 2.3.1.2 Overview of inspections and findings relating to the quality of audit services (2008–2010)

They had also developed their monitoring processes<sup>40</sup> later and these are now less comprehensive. Besides this, smaller scale makes it more difficult to ensure the independence and competence of reviewers. This in turn can have a negative impact on the results of monitoring activities. In such circumstances the FAOA has noted that the use of external experts can improve the quality of internal monitoring. The FAOA therefore welcomes it when smaller firms partially outsource their monitoring process to external qualified experts in order to achieve the necessary degree of objectivity.

From 1 April 2008 to 31 December 2010 the FAOA inspected the quality of audit services provided in a total of 63 cases (file review)<sup>41</sup>. Of these, 42 file reviews were performed at the «Big 3» firms.

Up to 31 December 2010, 58 file reviews had been completed and had been reported on in the 29 inspection reports prepared up to that date. An analysis of the findings from these 58 file reviews shows the following picture:

**Figure 5:**

Average number of file review findings for inspections performed between 1 April 2008 and 31 December 2010.

	Total	Thereof Big-3 <sup>42</sup>	Thereof remaining state-regulated audit firms
Number of file reviews	58	38	20
Number of file review findings	370	175	195
<b>Average number of findings per file review</b>	<b>6.4</b>	<b>4.6</b>	<b>9.8</b>

<sup>40</sup> Monitoring: Mandate-specific inspections and checks made on the effectiveness of the firm's system of quality control.

<sup>41</sup> This number includes all inspections performed by the FAOA from 1 April 2008 to 31 December 2010, including those which were yet to be completed as at 31 December 2010. As a rule, a file review comprises a review of the audit of the consolidated financial statements (incl. entity financial statements of the holding company) and a review of the audit of a material subsidiary company.

<sup>42</sup> Incl. KPMG Klynveld Peat Marwick Goerdeler SA.



### 2.3.2 Follow-up inspections at the «Big 3» audit firms

Comparing the number of findings per file review, it is evident that there were fewer findings at the Big 3 firms. However, as the quality of the files reviewed depends heavily on the people involved, the FAOA finds repeatedly that major differences exist in audit quality within the same audit firm.

The following categories are particularly well represented within the total 370 findings:

#### a. Audit documentation (ISA 230)

Deficiencies in audit documentation were found repeatedly during the inspections of the last three years. On subsequent inspections clear improvements had already been made.

#### b. Audit evidence (ISA 500)

In many cases insufficient appropriate audit evidence exists to support the auditor's conclusion on material individual financial statement balances. These findings often relate to the documentation deficiencies already mentioned.

#### c. Quality control measures (ISA 220)

Often, the involvement of the lead auditor and engagement quality reviewer was either not, or not sufficiently, documented.

#### d. Fraud and error (ISA 240)

Audits were repeatedly carried out without due professional scepticism and without incorporating a sufficient element of unpredictability. In many cases the fraud inquiries made of management, the Board of Directors and Internal Audit and the testing of unusual journal entries were also performed inadequately.

Except where the FAOA regards a perennial inspection cycle to be appropriate to a particular case, audit firms that audit more than 50 public companies are subject to annual inspection by the FAOA<sup>43</sup>. The three largest audit firms meet this target and were therefore inspected for the third time in 2010.

#### 2.3.2.1 Firm Review Findings

In terms of a multi-year planning process, the FAOA performed only minimal inspection procedures in the firm-internal processes area (firm review). The results of inspection procedures at the Big 3 firms are not comparable with those of the previous two years in that more comprehensive procedures were carried out in those years.

Generally, it can be said that the audit firms inspected have a process of continual improvement as regards their quality assurance systems and that these systems are of a high standard. The FAOA has nevertheless noted differences in the level of development and formalisation of the quality assurance systems at the Big 3 firms. One firm has comprehensive software-based documentation covering all processes and controls. This assists considerably in achieving firm-wide compliance with quality assurance guidelines and is regarded as exemplary by the FAOA.

The design of quality assurance processes can generally be described as good. Without neglecting the design and further development of these quality assurance processes, firms must ensure that existing processes, controls and measures are followed consistently.

Based on its findings, the FAOA regards the following points to be important in the future development of quality assurance systems at the Big 3 firms:

<sup>43</sup> Margin note 8 of FAOA Circular 1/2010.

#### a. Compensation and quality

To establish the proper tone when assessing and compensating partners and staff, quality-related factors should be considered still further. The factor «quality», as an important parameter in assessing performance and determining compensation, is to be taken account of adequately and presented transparently. This applies both to elements of compensation and to the consistent use of financial deductions in the event of negative quality-related findings from internal and external quality reviews.

#### b. Independence

The FAOA regards adherence to independence requirements as essential in assuring the quality of audit services and public confidence in those services. As a rule, firms have comprehensive quality assurance measures and systems in place to ensure compliance with these requirements. Changes to the provisions of the Code of Ethics, effective 1 January 2011<sup>44</sup>, and to the independence requirements of the Swiss Institute of Certified Accountants and Tax Consultants<sup>45</sup>, are expected to produce further improvements in this area. In accepting additional engagements from existing audit clients adherence to independence requirements must be assured. It should be highlighted in this regard that, as from 2011, audit firms are required to file an ad hoc report when the ratio of audit to non-audit fees for a public company client, as disclosed within the company's financial statements, exceeds 1 to 3 in two consecutive years<sup>46</sup>.

#### c. Monitoring

The effectiveness of monitoring is relevant to the FAOA in determining the scope of an inspection. The results of the monitoring process are also significant to the audit firm itself, however, since they flow into a large number of quality-related processes and thereby reduce firm-specific risks arising from deficiencies in the quality assurance system.

For the assurance of effective monitoring it is important that reviewers are objective. This can, for example, be achieved by assigning reviewers from other network firms (so-called «non-local reviewers»). Figure 2.4 illustrates that the participation of non-local

reviewers varies greatly between the Big 3 firms. The FAOA regards the findings produced by the internal monitoring process at the firm with 100% non-local reviewers, based on the testing performed, to be generally more informative than those at the other Big 3 firms.

#### d. Implementation of Clarified ISA

In March 2009 the IAASB announced the completion of the ISA revision process (known as the «Clarity Project»)<sup>47</sup>. Audit firms must ensure that the new requirements are implemented fully and on a timely basis. The FAOA has observed the implementation measures taken at the affected audit firms and will test certain key areas in 2011.

#### 2.3.2.2 File Review Findings

The FAOA reviewed 11 public company audits in the course of its 2010 inspections at the Big-3 firms.

During its inspections the FAOA does not perform an «audit of the audit» but rather focuses on certain individual risk areas.

Generally, the FAOA rates the quality of the work reviewed at the three largest audit firms as good. However, the following areas require action:

<sup>44</sup> As from 1 January 2011 the revised «Code of Ethics for Professional Accountants» of the International Ethics Standards Board for Accountants (IESBA) are to be applied.

<sup>45</sup> At their meeting of 6 December 2010 the Board of the Swiss Institute of Certified Accountants and Tax Consultants agreed to a selective revision of the Institute's independence guidelines (« Richtlinien zur Unabhängigkeit »). These amendments were necessary as a result of the amended requirements within the «Code of Ethics for Professional Accountants» of the IESBA. They are effective as from 1 January 2011.

<sup>46</sup> Cf. Margin note 22 indent b. of the FAOA Circular 1/2010. In this case the audit firm is required to report on the preventative measures taken to avoid a possible infringement of independence.

<sup>47</sup> The revised standards apply to the audit of entity and consolidated financial statements beginning on or after 15 December 2009.

#### a. Using the work of another auditor (ISA 600)

In the audit of consolidated financial statements the Group auditor (principal auditor) must work together with the local auditor (other auditor). In this regard, the part played by the principal auditor was judged to be insufficient in several cases. The FAOA found that the principal auditor obtained insufficient appropriate audit evidence that the work of the other auditor was sufficient to fulfil the requirements of the principal auditor. In particular, the audit instructions to the other auditors were insufficient or unclear. The principal auditor further failed to review the working papers of the other auditor in certain situations or did not review or consider their findings to a sufficient extent.

The FAOA expects that the quality of Group audits will be improved through the implementation of the revised ISA 600.

#### b. Audit of accounting estimates and fair value measurements and disclosures (ISA 540 and 545)

The audit of accounting estimates is of central importance to a significant number of financial statement positions. Given the uncertainties involved in the estimation processes of the audited companies, it is of no surprise that the FAOA had many findings in this area, as in the previous year. A significant number related to the audit of goodwill impairment tests (IAS 36).

In many cases the FAOA took the view that the auditor had obtained insufficient appropriate audit evidence as to the reasonableness of the financial statement estimate under the respective circumstances. In particular, the auditor had not obtained the necessary understanding of the estimation process used (e.g. the basic principles and information used in arriving at the estimate, including an assessment of their reasonableness and consistency) and had not performed any, or sufficient, audit procedures on the estimates themselves (e.g. use of independent estimates).

In conclusion, it should be pointed out that in several cases the required audit procedures in the area of accounting estimates and fair value measurements and disclosures were not performed with the necessary degree of professional scepticism.

#### c. Audit procedures with respect to IT (particularly ISA 315 and ISA 330)

In several cases the FAOA found deficiencies in the audit of application and IT general controls. In these instances the auditor relied upon what the FAOA regarded as insufficient IT-related audit procedures in determining the nature and scope of substantive testing.

Although improvements have been made compared to prior years, further efforts are needed to ensure that IT-related audit procedures meet internal<sup>48</sup> and external requirements on the one hand and produce the maximum benefits possible in terms of audit efficiency and effectiveness on the other.

#### d. Other findings

As in prior years there were several findings in the areas of fraud and error (ISA 240) and using the work of an expert (ISA 240)<sup>49</sup>.

<sup>48</sup> I.e. Audit methodology of the respective audit firm.

<sup>49</sup> See findings in Activity Report 2009, section 3.3.2.2.





From the left to the right: Frank-Oliver Schneider (Executive Director FAOA), Dr. Dominic Biedermann (CEO of the investment foundation Ethos), Thomas Rufer (Vice-Chairman of the Board of Directors of the FAOA), Dr. Hubert Achermann (CEO KPMG Switzerland), Prof. Dr. Peter Leibfried (University of St Gallen), Barbara Widmer (moderator of the FAOA Congress).

### 2.3.3 Inspection of small to medium-sized state-regulated audit firms

10 small and medium-sized state-regulated audit firms were subject to a firm review in 2010. At one firm this was the second inspection.

On average the FAOA identified more deficiencies per file review at the small and medium-sized state-regulated audit firms than at the Big 3. Only one inspection has been performed to date at most small and medium-sized state-regulated audit firms. Improvements at these firms will therefore first be measurable during future inspections.

All state-regulated audit firms have committed themselves to taking appropriate measures to rectify the deficiencies identified by the FAOA. The first inspection cycle has been completed and the necessary measures have been largely implemented. In principle, all state-regulated audit firms are therefore able to audit public companies.

#### 2.3.3.1 Firm Review Findings

The design of a quality assurance system depends on various factors, such as the size of the firm, the complexity of the firm's mandates, existing risks, the education and training of audit staff, and also past negative quality issues. It should also be noted that many smaller state-regulated audit firms have a quality assurance system which meets SAS 220 and not the more demanding ISQC1.

Although it is acceptable for the quality assurance systems of smaller state-regulated audit firms to be simpler, the need for further remedial action remains in certain cases.

#### 2.3.3.2 File Review Findings

Working paper reviews at the smaller state-regulated audit firms showed that audit documentation (SAS 230), in particular, requires improvement. For this reason it was not always possible for the FAOA to examine the work of the audit teams to the necessary depth. Due to the measures implemented since then, all of which have been reviewed in full by the FAOA, the situation has now improved.



## 2.4 Audit Quality Measures

This year the FAOA has once again collected various ISQC 1-related audit quality measures from the largest audit firms<sup>50</sup>. On the one hand, these audit quality measures allow for comparison between the audit firms. On the other, important trends can be detected early and factors influencing audit quality can be identified.

The measures collected show substantial differences in certain areas<sup>51</sup>:

### Figure 6:

Most important audit quality measures for the four largest state-regulated audit firms, with prior year comparatives

Audit quality measure	2009		2010	
	From	To	From	To
Average annual revenue per audit partner (CHF mio.)	2.4	4.2	2.6	4.0
Ratio of non-audit fees to audit fees	0.2	1.1	0.1	0.7
Number of staff per audit partner	7.5	11.5	8.4	11.4
Staff turnover (%)	15	22	17	27
«Non-local reviewer» participation within internal monitoring (%)	32	100	26	100

The following insights can be gained from this analysis:

- At one particular firm the **average annual revenue per audit partner** increased in 2010 due to a fall in the number of partners. At the other audit firms the average annual revenue per audit partner reduced slightly due to reduced audit fees and unchanged partner numbers. Reduced audit fees generally increase the risk that financial targets will take precedence over quality goals.
- The FAOA notes that the **ratio of non-audit fees to audit fees** fluctuates widely across companies. The FAOA will focus on examining adherence to independence requirements where audit firms and mandates show a high proportion of non-audit fees.
- The **number of staff per audit partner** increased, particularly at the lower end. This relates directly to those audit firms where partner numbers fell compared to 2009, which also led to increased revenue per partner. Where the number of staff per partner is high there is a risk that a partner will not be able

<sup>50</sup> The FAOA collected 12 audit quality measures relating to the individual elements of ISQC 1. They were collected from the four largest state-regulated audit firms in 2009 and from the five largest in 2010. The present analysis excludes the fifth largest firm to facilitate comparability with the prior year.

<sup>51</sup> In part, the calculation of the audit quality measures was made using unaudited data. Furthermore, in some cases simplifications and/or assumptions had to be made. The meaningfulness and comparability of these measures is therefore limited.

to fulfil his duties as lead auditor adequately. By international comparison the Swiss ratio still appears rather low however.

- Compared to the prior year, **staff turnover** has increased at both the upper and lower ends of the scale. The FAOA sees high staff turnover as potentially problematical due to the risk, for example, of loss of know-how and lack of team continuity on audit mandates. This may have a negative influence on audit quality.
- The **composition of monitoring review teams** for the purposes of ensuring objectivity differs considerably. On the one hand, the FAOA believes that the number and informative value of monitoring findings increases as the proportion of non-local reviewers increases. On the other, there must be assurance that Swiss-specific aspects are covered by reviewers with the necessary knowledge.

## 2.5 Proceedings and preliminary fact-finding

Since the FAOA commenced its inspection activities seven proceedings have been undertaken against state-regulated audit firms (completed and ongoing proceedings). In addition, many fact-finding investigations have been undertaken in response to internal and external leads.

Two proceedings were against audit firms. Both cases concerned the breach of independence requirements in performing public company audits. Five proceedings were against individuals, three of these concerned breaches of independence requirements, one professional negligence by an engagement partner, and one material non-compliance with Swiss GAAP ARR standards.

## 2.6 Cooperation with other Swiss regulatory authorities and stock exchanges

To avoid duplication the FAOA coordinates its oversight activities with the other authorities established under special law and with the stock exchanges<sup>52</sup>.

In the reporting year joint inspections were once again performed with FINMA.

The FAOA received three notifications from the SIX Exchange Regulation (SER) in connection with the latter's sanctions activities. Based on these notifications, the FAOA investigated the role of the auditor within the framework of preliminary fact-finding. In so doing, no additional consideration was given to compliance with accounting standards. In each case the FAOA investigated whether the auditor had complied with legal and professional requirements.

Three notifications were made by the FAOA to the SER during the reporting year. Two cases concerned possible non-compliance with accounting standards. In one case the SER was notified that proceedings had been opened.

## 2.7 Points of focus for 2011 inspections

The FAOA will focus on the following key areas during the 2011 inspections:

- Fraud and error (ISA 240)
- Audit of accounting estimates and fair values (ISA 540)
- Related parties (ISA 550)
- Audit of group financial statements (ISA 600)
- Audit of IT

For audits performed in accordance with ISA, the FAOA will direct attention to the implementation of the Clarified ISAs notwithstanding the above key areas.

In addition, the following key areas relating to accounting standards will be covered:

- IFRS 3R / IAS 27R (business combinations)
- IAS 18 (revenues, particularly revenue recognition)

<sup>52</sup> Cf. Art. 22 AOA and Art. 23 AOA.

## 2.8 Standard-setting

The Audit Oversight Ordinance stipulates that the FAOA determines the auditing standards which state-regulated audit firms must comply with when auditing public companies. In so doing, the FAOA refers to nationally and internationally accepted standards. If there are no such standards, or if those which do exist are inadequate, the FAOA can issue its own standards or add to or override existing standards (Art. 28, para. 2 AOO).

The principal body responsible for developing international auditing standards is the International Federation of Accountants (IFAC), which sets the internationally accepted International Standards on Auditing (ISA) through the International Auditing and Assurance Standards Board (IAASB). Through its Ordinance on the Oversight of Audit Firms of 17 March 2008 (OOAF-FAOA; SR 221.302.33), the FAOA declared the ISA to be binding for auditing statutory and consolidated financial statements prepared in accordance with foreign accounting standards<sup>53</sup>.

In Circular 1/2008, dated 17 March 2008, the FAOA declared that for the audit of statutory and consolidated financial statements prepared in accordance with US Generally Accepted Accounting Principles (US GAAP), US Generally Accepted Auditing Standards (US GAAS)<sup>54</sup> are recognised as being equivalent to the ISA standards. The FAOA generally adopts the ISA and American standards unchanged. Additions and overrides are made only where Swiss law requires this. In this context it should be noted that for companies registered in Switzerland the audit of the entity and consolidated financial statements must always comply with Swiss Audit Standards (SAS) as well<sup>55</sup>.

In its Oversight Ordinance, the FAOA stipulated that ordinary audits of statutory and consolidated financial statements prepared in accordance with the provisions of the Code of Obligations or Accounting and Reporting Recommendations (Swiss GAAP ARR) must be audited in accordance with the Swiss Audit Standards (SAS) recognised by the FAOA (Art. 2 OOAF-FAOA).

The SAS are issued by the Swiss Institute of Certified Accountants. As a member of the IFAC, the Institute has undertaken to implement the pronouncements of the IAASB in Switzerland, provided this is not incompatible with Swiss law. Where the ISA

are transposed in equivalent form into the Swiss Audit Standards, the FAOA sees no reason not to recognise them. The FAOA does, however, exercise a certain monitoring function with regard to the «as promptly as possible» aspect of the implementation of the ISA. Presently, a major challenge exists to transpose the Clarified ISAs, effective 15 December 2009, into the SAS as soon as possible (see below).

The FAOA is generally not required to develop auditing standards itself. According to Article 28 AOO it has a right to do so should such standards not exist or those that do are inadequate. The FAOA rarely exercises this right. The FAOA meets regularly with a delegation from the Auditing Commission of the Swiss Institute of Certified Accountants to keep itself abreast of developments in self-regulation and to make its own views known.

### 2.8.1 Standard-setting in 2010

The activities of the FAOA, in 2010 within the framework of standard-setting can be summarised as follows:

#### a. SAS 880 - Audit of public takeover offers

The auditor has important duties in connection with public takeover offers. Despite this, no auditing standard concerning the audit of public takeover offers existed before. At the suggestion of the Takeover Commission and the FAOA, the Swiss Institute of Certified Accountants launched a relevant project in 2009. Consultation on a draft standard completed at the end of 2009. The standard was approved finally by the Swiss Institute of Certified Accountants at the end of June 2010 and recognised by the Takeover Commission and the FAOA.

<sup>53</sup> Cf. Art. 3 para. 1 OOAF-FAOA. The individual ISA recognised by the FAOA are listed in the FAOA Circular 1/2008 of 17 March 2008.

<sup>54</sup> US Generally Accepted Auditing Standards (US-GAAS) of the American Institute of Certified Public Accountants (AICPA) plus, if applicable, the Auditing Standards of the Public Company Accounting Oversight Board (PCAOB).

<sup>55</sup> Cf. Art. 3 para. 3 OOAF-FAOA.

### b. Clarified ISA

In March 2009 the IAASB completed the so-called Clarity Project for the comprehensive revision of ISA. The resulting ISA, termed «Clarified ISA» clarified and supplemented the existing ISA significantly. The structure of the standards was also revised. With the amendment of Circular 1/2008 on 1 January 2011, the Clarified ISA apply to the audit of public company financial statements which are prepared under foreign accounting standards and relate to accounting periods beginning on or after 15 December 2009.

The revised SAS approved by the Board of the Swiss Institute of Certified Accountants in December 2009 (2010 edition) do not include the Clarity Project changes. The 2010 edition of the SAS still reflects ISA as at 30 June 2003. The FAOA considers the timely amendment of the SAS to be desirable and urgent. In 2010 the Swiss Institute of Certified Accountants presented the FAOA with a project plan and timetable for implementing the Clarified ISA within the SAS, which the FAOA accepted. Timely implementation also depends upon developments within the European Union and upon the preparation of comprehensive implementation guidance for small and medium-sized audit firms. The Clarified SAS should apply to audits in Switzerland as from 2013.

### c. Circular 1/2010

State-regulated audit firms are generally subject to reporting and ad-hoc notification requirements (Art. 14 para. 1 and 2 AOA; Art.30 para. 2 AOO), as specified in Circular 1/2010 dated 31 March 2010.

The information required by the FAOA depends heavily upon whether the audit firm concerned is subject to annual or perennial inspection. State-regulated audit firms with more than 50 public company audit clients are generally subject to annual inspection. During an inspection the FAOA receives all necessary information and documentation. In such cases an oversight report need not be submitted. State-regulated audit firms subject to perennial inspection are, in contrast, required to submit an annual oversight report<sup>56</sup>.

The subject of the relationship between audit and non-audit fees in relation to compliance with independence requirements, as discussed in the 2009 Activity Report<sup>57</sup>, has been reflected in Circular 1/2010 to the extent that ad-hoc notification is required when the relationship between audit and non-audit fees ex-

ceeds 1 to 3 in two consecutive business years; in this regard the preventative measures taken to avoid any infringement of independence must also be reported<sup>58</sup>. In addition, a summary of audit and non-audit fees per public company for the business years since the last FAOA inspection must be submitted as part of routine reporting requirements.

### d. Drafts of ISA 610 (revised) and ISA 315 (revised)

On 12 November 2010 the FAOA submitted a comment letter to the IAASB on the draft ISA 315 (revised), «Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment», and ISA 610 (revised), «Using the Work of Internal Auditors»<sup>59</sup>. With the revision of these two standards the IAASB aims to define the collaboration between external and internal audit more clearly.

The FAOA is also a member of the «Standards Coordination Working Group» IFIAR<sup>60</sup>. This working group is a discussion platform for regulators relating to the IAASB standards and, as such, allows the FAOA a certain degree of influence on international standard-setting.

## 2.8.2 Standard-setting in 2011

The FAOA will observe the transposition of Clarified ISA into SAS. It will also analyse the new draft standards (Exposure Drafts) of the IAASB and comment on these in collaboration with the IFIAR Standards Coordination Working Group.

<sup>56</sup> No oversight report needs to be submitted in calendar years during which an inspection takes place.

<sup>57</sup> Cf. Activity Report 2009, section 3.5.

<sup>58</sup> Cf. Circular 1/2010, margin note 22 indent b.

<sup>59</sup> The comment letter was published on the FAOA website ([www.revisionsaufsichtsbehoerde.ch](http://www.revisionsaufsichtsbehoerde.ch)).

<sup>60</sup> Cf. Section 3.5.

## 3 International

### 3.1 Introduction

The listing of a public company on a national stock exchange generally forms the tie between the respective audit oversight authority and the auditor under oversight<sup>61</sup>. This also applies to listed companies registered in a country outside the area of responsibility of the oversight authority. The duty of the oversight authority to protect investors on the national capital market is unchanged. For this reason most audit oversight laws also apply to auditors of foreign public companies.

The extra-territorial properties of audit oversight laws compel the audit oversight authorities to coordinate and harmonise their oversight activities at the international level. Only through increased cooperation and mutual recognition can an international oversight system develop that sets aside the disadvantages of a purely national focus, eliminates duplication for auditors under oversight and avoids excessive expense for national authorities.

As before, there are two opposing approaches as to how the problem of extra-territorial oversight is to be solved. On the one side, the EU and countries such as Japan and South Africa follow the principle of home country oversight. According to this, the oversight authority of the country of domicile is responsible for the licensing and oversight of the auditor, provided it is recognised as equivalent. On the other side, the US PCAOB is not, or to only a limited extent, prepared to recognise foreign oversight authorities and rely on their work. The PCAOB Policy Statement published at the end of 2007<sup>62</sup> has not been finalised by either the PCAOB or the SEC and remains in draft.

Switzerland recognised the necessity for mutual recognition and cooperation with foreign oversight authorities at an early stage and the course for efficient international audit oversight has been set at the legislator level. The Swiss system is generally based on that of the EU. Article 8 AOA allows the extra-territorial properties of Swiss law to be linked through a system of cooperation based on the principle of mutual recognition<sup>63</sup>.

### 3.2 Relations with the European Union

#### 3.2.1 Cooperation and equivalence

With a decision made on 5 February 2010 the EU Commission gave its member states the green light to negotiate cooperation agreements with their re-

spective partner authorities outside the EU. Alongside Switzerland, and accordingly the FAOA, the decision also covered the Japanese and Canadian oversight authorities.

With this the so-called adequacy process, on-going since 2008, came to an end for Switzerland. The aim of the process was to examine European regulations concerning data protection, official secrecy and international cooperation and ensure that the basic conditions for cooperation with the relevant third country authorities were met. With the above-mentioned decision the first important milestone for the cooperation of the FAOA with the audit oversight authorities of the 27 EU Member States has been set.

For economic and strategic reasons the FAOA first contacted the German Abschlussprüferaufsichtskommission (APAK) to examine the need for a cooperation agreement with Germany. The negotiations with APAK were postponed until the first half of 2011 because the oversight authorities of the EU Member States first wished to coordinate and produce a model Memorandum of Understanding (MoU) within the framework of the European Group of Auditors' Oversight Bodies (EGAOB).

A process to examine the equivalence of third country audit oversight systems ran parallel to the adequacy process at the EU level. As already mentioned<sup>64</sup>, the EU follows the principle of home country oversight. Provided it is recognised as equivalent, the oversight authority of the country of domicile is responsible for the licensing and oversight of the auditor. With a decision made on 19 January 2011 the EU Commission recognised the equivalence of the Swiss oversight system, and accordingly the FAOA. Alongside Switzerland, the decision also covered the oversight authorities of nine other countries including, amongst others, the USA and Japan.

<sup>61</sup> Cf. Art. 2 indent c AOA in conjunction with Art. 727 para. 1 sec. 1 CO, which envisages a somewhat greater area of responsibility for the FAOA.

<sup>62</sup> Cf. PCAOB Release No. 2007-011 of 5 December 2007, Request for Public Comment on Proposed Policy Statement: Guidance Regarding Implementation of PCAOB Rule 4012.

<sup>63</sup> Cf. Sec. 3.6.

<sup>64</sup> Sec. 3.1.

In connection with the equivalence process, on 29 July 2008 the EU Commission decided to grant auditors and audit firms from third countries a transitional period with respect to their EU licences. Accordingly, audit firms from a total of 33 third countries (including Switzerland) are permitted to continue providing audit services to companies from third countries that are listed on the EU markets. This is conditional upon the audit firm registering in the responsible EU country using a simplified process. The following Swiss audit firms have registered in EU or EEA Member States<sup>65</sup>:

Country	Registered Swiss audit firm
Germany (AbschlussPrüferAufsichtskommission)	Deloitte AG, Ernst & Young AG, Ferax AG, KPMG AG, PwC AG (5)
Great Britain (Professional Oversight Board, FRC)	Ernst & Young AG, KPMG AG, PwC AG (3)
Ireland (Irish Auditing & Accounting Supervisory Authority)	Ernst & Young AG, KPMG AG, PwC AG (3)
France (Haut Conseil du Commissariat aux Comptes)	Ernst & Young AG, KPMG AG, PwC AG (3)
Luxembourg (Commission de Surveillance du Secteur Financier)	Deloitte AG, Ernst & Young AG, KPMG AG, PwC AG (4)
Sweden (Swedish Supervisory Board of Public Accountants)	Ernst & Young AG, KPMG AG (2)
Finland (The Auditing Board of the Central Chamber of Commerce of Finland)	Ernst & Young AG (1)
Netherlands (Netherlands Authority for the Financial Markets)	Ernst & Young AG (1)
Liechtenstein Financial Market Authority FMA	Ernst & Young AG, KPMG AG (2)

<sup>65</sup> Source: Reports submitted to the FAOA by the relevant audit firms. It should be remembered that it is a requirement to report registrations with foreign oversight authorities to the FAOA (Margin note 22 letter c section 1 of Circular 1/2010 of 31 March 2010 on reporting by state-regulated audit firms to the FAOA).

Following the recognition of the equivalence of the Swiss oversight system the next step is for the interested oversight authorities in the EU Member States and the FAOA to negotiate cooperation agreements.

### 3.2.2 Green paper on lessons from the financial crisis

The EU Commission takes the view that the economic and financial crisis also brought some weaknesses in the auditing system to light. On 13 October 2010 the EU Commission therefore published the green paper «Audit policy: Lessons from the Crisis»<sup>66</sup> and invited interested parties to comment on the paper by 8 December 2010. Within the framework of this consultation the EU Commission wishes to investigate the question of how the European audit market can be improved and would like to open up a discussion on, amongst other things:

- Is the fact that the auditor is appointed and paid for by the audited company a problem? Would appointment by a third party (e.g. oversight authority) be justified in certain cases?
- Should the audit contract be subject to a time limit (mandatory change in auditor after a certain number of years)?
- Should the provision of non-audit services by the auditor be forbidden?
- Should mandatory joint audits, including at least one smaller, non-system-relevant, audit firm, be established?

The FAOA will analyse these questions and topics and follow international developments in this area attentively, but without taking premature regulatory action.

### 3.3 Relations with the USA

As already mentioned, the US audit oversight body (PCAOB)<sup>67</sup> is currently not prepared to rely on the oversight activities of foreign partner authorities, and therefore wishes to inspect audit firms based outside the US itself, at least for the time being. This applies particularly to the Swiss audit firms that have registered with the PCAOB in prior years. Since the end of 2008 the FAOA, in collaboration with FINMA, has been in negotiations with the

PCAOB over the need and legal framework for joint inspections in Switzerland.

At the negotiating delegate level it has been possible to reach general agreement on a so-called Statement of Protocol (SoP; a SoP is equivalent to a Memorandum of Understanding, MoU). Following postponement of the signature of the SoP at the request of the US, it is expected that the Board of the PCAOB will approve it in the first half of 2011.

Negotiations between Switzerland and the US were significantly alleviated by the Dodd–Frank Wall Street Reform and Consumer Protection Act of 21 July 2010<sup>68</sup>. Amongst other things, the draft envisages amendment of the Sarbanes–Oxley Act of 2002 (SOX) to include an international cooperation clause for the PCAOB<sup>69</sup>. For the first time the PCAOB would thus be able to pass on confidential documents to the FAOA and FINMA, previously one of the stumbling blocks to negotiations.

Amongst other things, the SoP foresees that over the next three years the PCAOB may perform one joint inspection at each of the affected Swiss audit firms. The SoP can, however, be terminated at any time, should legal or political problems arise. During the inspections the PCAOB will be accompanied by the FAOA and FINMA and will adhere to their inspection procedures and timetables. Prior to each inspection a work plan will be prepared detailing procedures for the forthcoming joint inspection. Contact between the PCAOB and the inspected Swiss audit firm will be made through the FAOA and FINMA. Should the SoP be signed, the first joint inspection is expected in the first half of 2011.

Although Swiss audit firms remain on the «grey list» of the PCAOB as at the end of 2010<sup>70</sup>, sanctions against Swiss audit firms appear unlikely at this time. The US cannot doubt the willingness of Switzerland to cooperate given that the rapid completion of negotiations and the execution of an initial joint inspection in 2010 were only prevented by delays on the US side.

<sup>66</sup> KOM(2010) 561 final.

<sup>67</sup> Cf. Sec.3.1.

<sup>68</sup> Public Law 111-203.

<sup>69</sup> Section 105(b) (5).

<sup>70</sup> On 31 July 2009 the PCAOB published a grey list containing the names of those audit firms that could not be inspected by the due date. Various Swiss audit firms are included on this list.

### 3.4 Relations with other countries

On 14 January 2010 Japan enacted specific statutory provisions for the oversight of foreign-registered audit firms. The question of the need for a cooperation agreement therefore also arises as regards the relationship between Japan and Switzerland. The discussions begun in 2009<sup>71</sup> continued during 2010 but are yet to produce specific results.

### 3.5 International Forum of Independent Audit Regulators

Founded in 2006, the International Forum of Independent Audit Regulators (IFIAR) now has 37 members. The President is Professor Steven Majoor of the Dutch Financial Markets Oversight Authority (AFM) and the Vice-President is Paul George of the British Financial Reporting Council (FRC). In 2010 IFIAR held plenary meetings in Abu Dhabi and Madrid, as well as an inspection workshop in Paris.

The foundation phase of IFIAR was completed at the plenary meeting in Abu Dhabi. IFIAR resolved to give itself a legal structure by forming an association which, first and foremost, is responsible for levying membership fees. The FAOA was able to contribute considerably to this important step for IFIAR: The IFIAR Verein is an association under Swiss law (Art. 60 and following CC) and has its registered offices in Bern (c/o FAOA). The Director of the FAOA was elected Treasurer. The auditor is the Swiss Federal Audit Office (SFAO).

In the second half of 2010 the IFIAR could look increasingly at oversight questions. The exchange of ideas with the «Big 6», respectively the Global Public Policy Committee (GPPC), could be continued. The four topics defined by IFIAR (group audits, role of auditor/scepticism, revenue recognition, the role of the engagement quality control reviewer), were discussed intensively with the global networks. Parallel to the exchange of ideas with the GPPC the IFIAR also sought an institutionalised dialogue with investors. The main topics here comprise the issue of the oligopoly of the largest audit networks (so-called «Big 4»), the form and content of the audit report, and the major goals of regulation in the field of audit oversight. Although this dialogue is considered to be of very high importance it remains a challenge to find the appropriate discussion partner.

Within the framework of its «International Cooperation Working Group» (the FAOA is a member of this working group) IFIAR was also very active in the area of international cooperation and discussed, amongst

other things, different models for international cooperation and questions around the exchange of inspection reports.

The inspection workshop held in Paris in February 2010 addressed the audit oversight topics that came up during and after the financial and economic crisis. Questions concerning going concern, the role of the lead auditor, the engagement quality review, and fair-value valuations were discussed particularly intensively. The FAOA moderated a workshop on the last of these topics.

The approval of the so-called IFIAR Core Principles is likely to be an important topic in 2011. This framework includes principles relating to the structure and duties of an audit oversight authority as well as the performance of an inspection. A decision of principle regarding this topic could already be reached in 2010. The details will be negotiated in 2011.

IFIAR remains an important platform for the FAOA, allowing contact with other oversight authorities and the opportunity to discuss the oversight strategy and its implementation within an international setting. The FAOA endeavoured to play an active part in the debates of IFIAR at various levels during 2010 and will do the same in 2011, as far as existing resources allow.

<sup>71</sup> Cf. Activity Report 2009, sec. 4.4.

### 3.6 Enactment of Article 8 of the Audit Oversight Act

#### 3.6.1 Scope

For the protection of investors in the Swiss capital markets the AOA also applies to audit firms that provide audit services to a foreign company. This applies only, however, where that company utilises the Swiss capital market.

Accordingly, audit firms that provide legally prescribed audit services (Art. 2 indent a AOA) or comparable services under foreign law to the following category of company require a licence as a state-regulated audit firm (Art. 8 para. 1 AOA):

- Companies incorporated under foreign law with shares listed on a Swiss stock exchange
- Companies incorporated under foreign law with outstanding bond issues in Switzerland
- Companies incorporated under Swiss or foreign law that contribute at least 20 percent of the consolidated assets or turnover of a company within either of the two categories above
- Companies incorporated under foreign law that contribute at least of 20 percent of the consolidated assets or turnover of a Swiss public company, as defined under Article 727 para. 1 number 1 letter a or b CO

#### 3.6.2 Future implementation

As it is a listing requirement under stock exchange law to have a licensed auditor, the enactment of Article 8 AOA would require the de-listing of a public company whose auditor was not licensed at that time (Art. 8 para. 3<sup>bis</sup> SEA in conjunction with Art. 13 of the listing regulations of the SIX Swiss Exchange). This would not be in the spirit of the Swiss capital markets. Various exceptions to the oversight of foreign audit firms are therefore envisaged:

- First, the obligation to oversight by the FAOA does not apply where the foreign audit firm is subject to oversight by a foreign oversight authority recognised by the Federal Council (Art. 8, para. 2 AOA).
- Secondly, no FAOA oversight is required if the outstanding bonds are guaranteed by a company whose auditor is subject to oversight by the FAOA or another oversight authority recognised as equivalent (Art. 8 para. 3 AOA). Bonds are often issued by issuers domiciled **off-shore** but guaran-

teed by a parent company domiciled **on-shore**. Article 8 paragraph 3 AOA is satisfied where the auditor of the parent company is subject to oversight by the FAOA or the oversight authority of the country in which the guarantor company is domiciled. Investors are not disadvantaged as the bonds are fully guaranteed by the parent company and there is assurance that the parent company's auditor is subject to oversight.

- Thirdly, there is no licensing requirement where the bond issues or comparable products are issued by a Special Purpose Vehicle (SPV) domiciled off-shore which has no duty to prepare accounts. Currently, this relates to the issuers of so-called Asset Backed Securities (ABS), Exchange Traded Commodities (ETC) and Credit Linked Notes (CLN).

In the sense of a counter-exception, foreign audit firms that provide audit services to Swiss public companies under Swiss law are in all cases subject to FAOA oversight (Art. 10 para. 2 AOO).

The recognition of foreign audit oversight authorities is effected through the Federal Council. Recognition requires the equivalence of the foreign oversight system. In considering this the Federal Council may take into account existing recognition by other states or international bodies and the granting of reciprocity (Art. 10 para. 1 AOO). The AOA and AOO do not define what is meant by equivalence. The Federal Council therefore has a corresponding amount of room for discretion. In view of the on-going equivalence processes in the EU<sup>72</sup> and the US<sup>73</sup>, as well as the expected IFIAR Core Principles<sup>74</sup>, the following criteria are likely to be of particular consideration, in the sense of international best practice, when assessing equivalence:

- Structure of oversight authority: Independence, official secrecy, funding and qualification of staff
- Responsibilities of oversight authority: Licensing and oversight of all audit firms providing audit services to public companies

<sup>72</sup> Sec 3.2.

<sup>73</sup> Sec 3.3.

<sup>74</sup> Sec 3.5.

- Oversight concept: The oversight authority performs inspections of supervised audit firms at the firms' premises. The inspection covers both firm-wide processes (so-called firm review) and specific audit mandates (so-called file reviews). Appropriate reporting takes place and noted deficiencies are remedied according to a process which allows for the remedial actions to be checked.
- Auditing standards: The audit of public companies is performed according to standards that are equivalent to those recognised by the FAOA (IAASB International Standards on Auditing, AICPA US Generally Accepted Auditing Standards and PCAOB Auditing Standards).
- Sanctions: Conduct of formal processes, administrative law sanctions, criminal law sanctions.

In order to give the affected audit firms sufficient time to register in Switzerland upon the enactment of Article 8 AOA, it is planned to combine the implementation with transitional provisions. The exact form of these transitional provisions is yet to be defined. Among the possible provisions that come into question are the provisional recognition of foreign oversight authorities and the provisional licensing of foreign audit firms in the first four months following the enactment of Article 8 AOA (Art. 43 para. 3 AOA).

Article 8 AOA has yet to be enacted. Thus the FAOA has the time necessary to find sustainable solutions for future cooperation with significant foreign partner authorities. The FAOA is of the view that the statutory provisions of Article 8 AOA should be implemented over the coming two years and plans to make appropriate proposals to the Federal Council.



## 4 Court rulings

### 4.1 Introduction

In 2010 the Federal Administrative Court (hereafter: FAC or the Court) had to rule on a number of appeals made against negative decisions of the FAOA. As in the prior year<sup>75</sup>, the Court examined whether the three licensing conditions (educational qualification, professional experience and good reputation) had been met. The FAC addressed the good reputation condition more frequently than in prior years. Although the Court has questioned the practices of the FAOA in some cases, to date they have upheld all decisions taken by the FAOA to reject an applicant's licence application or withdraw a licence-holder's licence where this has been based on the lack of good reputation on the part of the applicant or licence holder respectively. The following summarises the judgements or, as the case may be, the most important deliberations.

### 4.2 Educational qualifications

Article 4 paragraph 2 AOA contains an exclusive list of the educational qualifications that provide entitlement to a licence. Where former qualifications no longer exist or no longer have the same name it is necessary to decide whether they can be regarded as equivalent to those named in Article 4 paragraph 2 AOA. The FAC came to the conclusion that the title «mag.rer.pol», issued by the University of Berne, was equivalent to the Master of Science and therefore that the holder of such a title meets the educational licensing conditions of the AOA<sup>76</sup>. The FAC based this on a confirmation by the University of Berne as to the equivalence of the two qualifications referred to. The Court remarked that since the FAOA did not have discretionary power as to whether a Swiss educational qualification could be recognised as equivalent, it was also not responsible for questioning the substance of a decision to recognise a further education qualification taken by the responsible Swiss university.

In a further judgement the FAC took the view<sup>77</sup>, that the «Master of Advanced Studies HESSO en lutte contre la criminalité économique», issued by the University of Applied Sciences of Western Switzerland, did not constitute an AOA educational qualification. After comparing the Master/Bachelor and the Master of Advanced Studies it came to the conclusion that the Masters course, representing a second level of

education in terms of Article 4 FHSG, and the Master of Advanced Studies, representing a further education course, were two fundamentally different types of education. Since both Article 4 paragraph 2 AOA and Article 5 AOO are definitive regulations and the Master of Advanced Studies is not specifically mentioned within the latter, the Master of Advanced Studies does not meet the educational licensing conditions. Finally, the Court noted that the FAOA cannot decide whether Swiss educational qualifications other than those listed within the law would permit licensing.

The Court also had to judge whether a licence applicant, not contesting not having one of the educational qualifications required by law, could receive a provisional licence limited to four years on condition that he obtain the title of Treuhänder mit eidg. Fachausweis (which meets the educational conditions) within this period of time<sup>78</sup>. Here the view was taken that the legislator had consciously abstained from introducing a licensing system which permitted individuals to obtain a provisional licence when obviously holding none of the required educational qualifications recognised by law. It follows that such individuals cannot continue to act as auditors until they have completed a recognised course of education.

The FAC also had to judge the case of a licence applicant holding a «Diplomverwaltungswirt (FH)», as issued by the University of Applied Sciences of Kehl<sup>79</sup>. The FOPET had previously concluded that this educational qualification was not equivalent to any of the titles listed in the AOA. The Court declared that the decision of the FOPET was legally binding and that its rulings also bound the FAC. Even if the educational qualification of the appellant would otherwise be seen as equivalent, this could only lead to a licence under Article 4 paragraph 2 indent d AOA where this was so provided for in a state treaty with the country of origin or the country of origin grants reciprocity. In order to act as an auditor in Germany the relevant German state examinations must be taken. Only

<sup>75</sup> Cf. Activity Report 2009, sec. 5.

<sup>76</sup> FAC Decision No. B-5821/2009 of 4 March 2010.

<sup>77</sup> FAC Decision No. B-5636/2009 of 13 August 2010.

<sup>78</sup> FAC Decision No. B-7689/2009 of 21 July 2010.

<sup>79</sup> FAC Decision No. B-4875/2009 of 14 January 2010.

those who can evidence this can claim the right to have their diploma recognised as equivalent. As the licence applicant does not hold an educational qualification that would permit him to act as an auditor in Germany he cannot assert a claim for reciprocity.

Finally, it is to be noted that holders of foreign qualifications can be licensed only if they can evidence having sufficient knowledge of Swiss law. Up to 1 December 2010 the successful completion of a recognised course by the individual concerned was accepted as evidence. For cost reasons these courses could only be offered in English. A licence applicant who had wished to take the course in French challenged the rejection of his application at the FAC. Supported by the equal treatment of the various official languages in dealings between citizen and government, the Court took the view that the freedom of language<sup>80</sup> required the FAOA to recognise a course given in any of the official state languages, alongside one given in English. In view of the costs that would have been involved in offering courses in all the official languages of Switzerland, Article 6 and 34 AOO were amended in the sense that only the passing of the exam is decisive.

### 4.3 Professional experience

The licensing conditions relating to professional experience were the subject of four FAC judgements. On the one hand these concerned the term «supervision» of professional experience and on the other the application of the hardship clause in Article 43 paragraph 6 AOA<sup>81</sup>.

The AOA requires that part of the professional experience of a licence applicant is acquired under the oversight of a qualified person (Art. 4 para. 4 and Art. 5 para. 2 AOA). Article 7 AOO defines the term « under oversight » in more detail. According to this, professional experience is taken as having been acquired under oversight if the applicant was formally subordinated to a specialist who satisfied the legal requirements and was bound by instruction when she or he carried out the activity in question. The FAOA was of the view that a member of the Board of Directors of a limited company (AG) cannot claim to have been under the oversight of another member of the Board as both individuals assume the same hierarchical position and one member of the Board cannot issue binding instructions to another Board member.

However, the FAC took the view that, in principle, it is permissible to appoint employees to the Board of a limited company and that under case law of the Federal Supreme Court it is necessary to judge on an individual case basis whether a governing body of a limited company can, at the same time, be in an employment and company law relationship<sup>82</sup>. The Court takes the view that in making this assessment the decisive issue is whether the person concerned is actually in a subordinate relationship and receives instructions. If the answer is yes, an employment and company law double relationship exists. Hence two legal relationships can exist alongside one another. As the existence of an employment relationship was proved in the present case the Court assumed that a double relationship existed and accepted the professional experience as supervised based on the existing employment contract.

In another case the Court came to the conclusion that a person who is the only member of the Board of Directors cannot be subordinated formally to another person<sup>83</sup>. Furthermore, the auditor cannot be superior to the Board of Directors of the audited company and does not have the power to issue binding instructions. Finally, the FAC defined more precisely that teaching activity or, as the case may be, the management of a school does not generally constitute a comprehensive instruction-based activity within the meaning of Article 7 AOO.

In the same case the FAC emphasised, as regards the application of the hardship clause<sup>84</sup>, that Article 50 AOO was not conclusive and was first and foremost tailored to those applying for a licence as an audit expert. For those applying for a licence as an auditor the application of Article 50 AOO represented an excessive limitation on the hardship clause. In addition, the FAOA's requirement that evidence be provided of twelve years' professional experience in the accounting and auditing areas in order to obtain an auditor licence, was regarded by the FAC as excessive, being too undifferentiated and too long. How many years of unsupervised professional experience suffice to warrant an auditor licence, even without supervised professional experience, cannot be answered theo-

<sup>80</sup> FAC Decision No. B-4124/2009 of 5 February 2010.

<sup>81</sup> Under this clause, in hardship cases the FAOA may recognise professional experience which does not meet legal requirements if it can be evidenced that proper audit services are provided based upon many years of practical experience.

<sup>82</sup> FAC Decision No. B-3219/2009 of 22 March 2010.

<sup>83</sup> FAC Decision No. B-1379/2010 of 30 August 2010.

<sup>84</sup> Confirmed in FAC Decision No. B-3920/2010 of 9 December 2010.

#### 4.4 Good reputation

retically. Rather, the decision as to whether this professional experience suffices should be taken based on the nature and quality of the licence applicant's professional experience over an extended period of time.

In the same judgement the Court also came to the view that, contrary to the legal system classification, the hardship clause of Article 43 paragraph 6 AOA represented a general and indefinite exceptional rule and not a temporary and transitional one. Consequently, in assessing whether the hardship clause is applicable it is not only professional experience acquired up to 1 September 2007, i.e. until the enactment of the AOA, that applies. Professional experience acquired after this date and during the provisional licence period is also to be considered.

In a further case concerning the hardship clause<sup>85</sup> the FAC did not follow the position of the FAOA, which was to reject the application of the hardship clause for those applying for a licence after 1 September 2009, i.e. more than two years after the enactment of the AOA<sup>86</sup>. This situation could be judged to provide evidence against a hardship case but not in the sense of a rigid and unalterable presumption. To answer the question as to a hardship case more detailed explanations must be requested from the licence applicant.

A person who wishes to be licensed as an audit expert or auditor must be of good repute and accordingly assure the proper conduct of audit activities (Art. 4 para. 1, respectively Art. 5 para. 1 indent a AOA and Art. 4 AOO). In 2010 the FAC reached four judgements concerning the application of this licensing condition. As presented below, various situations can call into question whether this condition has been met.

<sup>85</sup> FAC Decision No. B-1181/2010 of 8 September 2010.

<sup>86</sup> The FAOA was of the opinion that Art. 43 para. 6 AOA, like Art. 43 para. 4 and 5 AOA, represented a two year transitional provision. The FAOA was further of the opinion that an individual who had not applied for a licence within this timeframe obviously had no interest in obtaining one. Additionally, the hardship clause had the purpose of smoothing the transition from the old to the new law according to the message of the Federal Council (BBl 2004 4093 f.).



#### 4.4.1 Financial instability

The FAC was asked to consider a case concerning a licence applicant who had been the subject of a private bankruptcy, as well as debt enforcements and certificates of unpaid debts amounting to around CHF 2.4 million<sup>87</sup>. In addition, the licence applicant had been the Executive Director of a limited liability company (GmbH) and member of the Board of Directors of a corporation (AG), both of which had gone bankrupt. The Court first pointed out that the refusal to grant a licence on the sole grounds that the applicant had certificates of unpaid debts against his name was neither justified nor proportionate. Rather, the exact circumstances must be investigated, such as the type, origin, size and number of certificates of unpaid debts. An auditor in financial difficulties is particularly dependent upon the companies whose financial statements he audits; the loss of an audit mandate would affect him more severely than it would an auditor without financial problems. Such a situation increases the risk that the audit will be carried out without due professional scepticism and in an accommodating way; in order to avoid losing the mandate the auditor is more likely to pass over findings which would disadvantage the audited company. The freedom of the auditor to give an opinion without regard to the possible consequences for the mandate and for his or her own interests is therefore limited, at least in appearance. Hence, there is a lack of independence from a third-party point of view. The FAC took the view that the size of the certificates of unpaid debts and the failure to pay the most recent debts showed that the licence applicant was in a difficult financial position, even though a large part of the debts originated from property speculation and was over 15 years old. Besides this, the bankruptcy of the two companies in which he had been a member of the highest executive body raised doubts about his ability to assess risks astutely. The Court came to the conclusion that the licence applicant could not assure the proper conduct of audit activities at the current time and that the refusal of a licence was not disproportionate bearing in mind that audit fees had represented 14.3% and 12.4% respectively of the licence applicant's 2007 and 2008 revenues.

#### 4.4.2 Audit without a licence

The FAC further confirmed the FAOA's decision not to grant a licence to an applicant who had audited the 2008 financial statements of 17 corporations (AG) without having a licence<sup>88</sup>. First, the Court determined that this constituted an offence under Article 40 paragraph 1 indent a AOA<sup>89</sup> Proper audit activity,

to the contrary, required proper conduct in business affairs, which is primarily understood to include compliance with the legal system, in particular audit law but also civil and criminal law, as well as regard for the basic principles of utmost good faith. Violation of the criminal law provisions of the AOA lead to a negative assessment of reputation, even in the absence of a judgement from the responsible criminal authorities. The appellant consequently failed to satisfy the requirements as to good reputation and was rightly neither licensed as an audit expert nor as an auditor.

#### 4.4.3 Civil and criminal law convictions and ongoing civil and criminal law proceedings

The FAC confirmed that civil and criminal judgements are to be taken account of in the assessment of good reputation. The FAOA has a right to use such legal judgements as support and, as a consequence, is generally not required to reassess the legitimacy of the judgement or the supporting arguments<sup>90</sup>. It added that in determining good reputation the date of judgement, not the date the misconduct took place, was decisive; this being said, misconduct committed recently is to be weighted differently to misconduct committed ten years ago where no relevant incidents have occurred since<sup>91</sup>.

Finally, the Court pointed out that ongoing or pending civil or criminal proceedings against the licence applicant, or those discontinued with a (court or out-of-court) settlement, can also be considered in determining whether the requirements as to good reputation have been met. An act of misconduct that casts doubt on audit activities being proper in every way cannot be precluded in this case, particularly if the licence applicant has committed himself to pay a sum of money to an opposing party as part of a court or out-of-court settlement<sup>92</sup>. The FAOA can also consider breaches which have been struck from the Criminal Register<sup>93</sup>.

<sup>87</sup> FAC Decision No. B-5115/2009 of 12 April 2010.

<sup>88</sup> FAC Decision No. B-7968/2009 of 6 May 2010.

<sup>89</sup> Under this clause, anyone providing audit services without the required licence or in spite of being prohibited from doing so is subject to imprisonment or a fine of up to 1,000,000 Swiss Francs.

<sup>90</sup> FAC Decision No. B-7348/2009 of 3 June 2010.

<sup>91</sup> FAC Decision No. B-4137/2010 of 17 September 2010.

<sup>92</sup> FAC Decision No. B-7348/2009 of 3 June 2010.

<sup>93</sup> FAC Decision No. B-7348/2009 of 3 June 2010.

#### 4.4.4 Infringement of independence

As explained above, proper conduct in business affairs, especially compliance with the legal system and with the audit law and principle of independence, is required to assure the proper conduct of audit activities<sup>94</sup>. At this point it should be remembered that the independence of the auditor, both in fact and appearance, must not be impaired and that the concept of the infringement of independence was already applied under the old law even if not explicitly prescribed, as it is under the new law<sup>95</sup>.

In two judgements the FAC considered an array of circumstances which were incompatible with independence requirements and which could impair assurance as to the conduct of proper audit activities.

This is the case if the audited company is controlled by a holding company belonging to the auditor (also if the auditor is not a member of that company's Board of Directors), if two audit firms audit each others' financial statements, or if there is a formal dependence relationship between the engagement partner of the audit firm and a member of the audited company's management<sup>96</sup>. If the auditor and the audited company share the same business address or internet site this is also incompatible with independence<sup>97</sup>.

The audit of the consolidated financial statements of a Group by an auditor who is a member of the Board of Directors or a shareholder of a Group company, or who takes part in the Board meetings of a bank which

has guaranteed credit to such a Group company, would likewise be incompatible with independence in appearance<sup>98</sup>.

Furthermore, the FAC found that the opting-out of a limited audit in no way alters the fact that independence requirements have been breached. Such breaches of duty remain relevant in determining whether good reputation is still given<sup>99</sup>.

<sup>94</sup> FAC Decision No. B-7348/2009 of 3 June 2010.

<sup>95</sup> FAC Decision No. B-4137/2010 of 17 September 2010.

<sup>96</sup> FAC Decision No. B-7348/2009 of 3 June 2010.

<sup>97</sup> FAC Decision No. B-7348/2009 of 3 June 2010.

<sup>98</sup> FAC Decision No. B-4137/2010 of 17 September 2010.

<sup>99</sup> FAC Decision No. B-7348/2009 of 3 June 2010.



#### 4.5 Procedural law issues

The FAC refused the request of a licence applicant for provisional measures, the applicant having wanted to obtain a provisional licence and an entry in the Register of Auditors pending a legal decision on the merits of the case. It noted that the licence applicant had not denied not having any of the required educational qualifications and came to the conclusion that making a provisional entry in the Register of Auditors within the framework of provisional measures would be too prejudicial to the outcome of the dispute<sup>100</sup>.

The Court did not consider one appeal on the grounds that the notice of appeal appeared to include neither a claim nor a reason for a claim<sup>101</sup>.

In considering an employer's confirmation of professional experience which had been signed by the licence applicant's father, the FAC decided that the family and business relationships, as well as the obvious associated conflicts of interest, limited the evidentiary value of the confirmation<sup>102</sup>.

Finally, the FAC confirmed the practice of the FAOA concerning a licence applicant's duty to cooperate<sup>103</sup>. The Court concluded that in failing to deliver documents requested by the FAOA, particularly as regards professional experience, the licence applicant had breached his duty to cooperate and was responsible for the consequences of lack of evidence.

<sup>100</sup> Interim FAC Decision No. B-7689/2009 of 4 January 2010.

<sup>101</sup> FAC Decision No. B-2384/2010 of 29 July 2010.

<sup>102</sup> FAC Decision No. B-3920/2010 of 9 December 2010.

<sup>103</sup> FAC Decision No. B-703/2010 of 23 November 2010.



## Appendices

### 1 Organisation of the Federal Audit Oversight Authority FAOA<sup>104</sup>

Legal form	Public-law institution and separate legal entity.	
Incorporation within government administration	Independent unit within the decentralised government administration, organisationally attached to the Federal Department of Justice and Police (FDJP).	
Registered office	Berne	
Representative bodies of the FAOA	Board of Directors	<b>Hans Peter Walter (Chairman)</b> , Dr. h.c., Professor of private and commercial law at the University of Berne
		<b>Thomas Rufer (Vice-Chairman)</b> , Graduate in Business Administration and Swiss Certified Accountant
		<b>Eugen Haltiner</b> , Dr. oec., Chairman of the Board of Directors of the Swiss Federal Financial Market Supervisory Authority (FINMA) (to 31.12.2010)
		<b>Alfred Stettler</b> , Prof. em., Dr rer. pol., University of Lausanne
		<b>Peter R. Voser</b> , Graduate in Business Administration and CEO of Royal Dutch Shell (to 31.12.2010)
	Executive Board	<b>Frank Schneider</b> , Chief Executive Director and Head of Oversight, Swiss Chartered Accountant
		<b>Reto Sanwald</b> , Head of Legal & International, Dr. iur., attorney
<b>Daniela Wieland</b> , Head of Licensing & Support		
Auditor	<b>Swiss Federal Audit Office (SFAO)</b>	
Number of staff	26 employees, representing 21 full-time equivalents (position 31.12.2010). As at the end of the prior year 29 employees, representing 23 full-time equivalents, were employed by the FAOA.	
Funding	The FAOA is financed entirely from the fees and oversight charges levied on licensed individuals and audit firms. No taxpayers' money is used. The FAOA maintains its own accounts outside the Federal budget.	
Legal function	To ensure the proper provision and quality of audit services (Art. 1, para. 2 AOA).	
Responsibilities	Appraisal of licence applications, oversight of the auditors of public companies, accomplishment of international administrative cooperation in the audit oversight area.	
Independence/Oversight	The FAOA performs its oversight activities independently but is subject to the oversight of the Federal Council, reporting annually to the Federal Council and the Federal Assembly on its activities.	

<sup>104</sup>Further information is included at the FAOA website ([www.revisionsaufsichtsbehoerde.ch](http://www.revisionsaufsichtsbehoerde.ch)) and in the Activity Report 2009, 6 f.

## 2 Financial data

### Income statement

(amounts in Swiss Francs thousands)

	2010	2009
Oversight charges	2'890	2'878
Inspection fees	1'216	1'238
Licensing fees net	659	872
Reimbursement of licensing fees	-148	-208
Accrual of licensing fees reporting year	-559	-738
Release of accrued licensing fees from prior years	1'692	1'508
Other income	92	27
<b>Net revenues</b>	<b>5'842</b>	<b>5'577</b>
Personnel expense	-4'083	-4'323
Operating expense	-742	-702
Depreciation	-133	-154
<b>Operating profit</b>	<b>884</b>	<b>398</b>
Financial income	71	96
Financial expense	-	-
<b>Net financial income</b>	<b>71</b>	<b>96</b>
Transfer to reserves under Art. 35 para. 3 AOA	-955	-494
<b>Profit/loss</b>	<b>0</b>	<b>0</b>

## Remuneration of Board of Directors and Management

(amounts in Swiss Francs thousands)

	2010	2009
<b>Board of Directors</b>		
Fee: Chairman of the Board of Directors	110	110
Fee: Vice-Chairman of the Board of Directors	75	75
Fees: Other members of the Board of Directors	90	90
Social security contributions <sup>105</sup>	0	0
<b>Total compensation paid to members of the Board of Directors</b>	<b>275</b>	<b>275</b>
<b>Director and Executive Board</b>		
Chief Executive Director's salary	247	247
Other benefits to Chief Executive Director	27	22
Other Executive Board members' salaries <sup>106</sup>	338	378
Other Executive Board members' benefits	36	35
Social security contributions <sup>107</sup>	112	113
<b>Total compensation paid to members of the Executive Board</b>	<b>760</b>	<b>795</b>

<sup>105</sup> All social security costs are paid by the members of the Board of Directors.

<sup>106</sup> Since 1<sup>st</sup> July 2010 Ms. Daniela Wieland has been member of the Executive Board.

<sup>107</sup> Comprises pension/invalidity/income compensation insurance contribution, unemployment insurance contribution, work-related/non-work-related accident insurance contribution, occupational pension savings contribution and risk premium.



### 3 Abbreviations (where used in English)

AICPA	American Institute of Certified Public Accountants
AOA	Audit Oversight Act of 16 December 2005 (SR 221.302)
AOO	Audit Oversight Ordinance of 22 August 2007 (SR 221.302.3)
BBI	Federal Law Gazette
BGE	Decision of the Federal Supreme Court
CC	Swiss Civil Code of 10 December 1907 (SR 210)
CO	Federal Act of 30 March 1911 on the Amendment of the Swiss Civil Code (Part Five: The Code of Obligations) (SR 220)
FAC	Federal Administrative Court
FSC	Federal Supreme Court
FSIO	Federal Social Insurance Office
EGAOB	European Group of Auditors' Oversight Bodies
EHRA	Federal Commercial Registry Office
EU	European Union
FDJP	Federal Department of Justice and Police
FHSG	Federal Act of 6 October 1995 on Universities of Applied Sciences (UAS Act) (SR 414.71)
FCC	Federal Casino Commission
FINMA	Federal Financial Market Supervisory Authority
FOPET	Federal Office for Professional Education and Technology
FOPH	Federal Office of Public Health
IAASB	International Auditing and Assurance Standards Board
IESBA	International Ethics Standards Board for Accountants
IASB	International Accounting Standards Board
IFAC	International Federation of Accountants
IFIAR	International Forum of Independent Audit Regulators
IFRS	International Financial Reporting Standards
ISA	International Standards on Auditing
ISQC	International Standard on Quality Control
PCAOB	Public Company Accounting Oversight Board
SAS	Swiss Audit Standards

SEA	Stock Exchange Act of 24 March 1995 (SR 954.1)
SEC	U.S. Securities and Exchange Commission
SER	SIX Exchange Regulation
SOX	Sarbanes-Oxley Act of 2002 (USA)
SR	Classified Compilation of Federal Legislation
US GAAP	U.S. Generally Accepted Accounting Principles
US GAAS	U.S. Generally Accepted Auditing Standards



## 4 Special-law licences

A special-law licence, deriving from a main licence granted under the Audit Oversight Act, must be obtained for activities in the following areas (position as of 31 December 2010):

Audits in the field of	Main licence under the Audit Oversight Act: Audit firms	Main licence under the Audit Oversight Act: Lead auditors	Special-law regulatory authority	Additional requirements
Banks <sup>108</sup>	State-regulated audit firm	Audit expert	FINMA	Art. 26 FMSA <sup>109</sup> Art. 3 FMAO <sup>110</sup>
Securities traders <sup>111</sup>	State-regulated audit firm	Audit expert	FINMA	Art. 26 FMSA, Art. 3 FMAO
Collective investments <sup>112</sup>	State-regulated audit firm <sup>113</sup>	Audit expert	FINMA	Art. 26 FMSA, Art. 3 FMAO
Insurers <sup>114</sup>	State-regulated audit firm	Audit expert	FINMA	Art. 26 FMSA, Art. 3 FMAO
Anti-money laundering <sup>115</sup>	Auditor	Auditor	FINMA	Art. 19b AMLA <sup>116</sup>
Central mortgage bond institutions <sup>117</sup>	State-regulated audit firm	Audit expert	FINMA	Art. 26 FMSA, Art. 3 FMAO
Pensions companies <sup>118</sup>	Audit expert <sup>119</sup>	Audit expert	(FSIO)	–
Health insurance companies <sup>120</sup>	Audit expert	Audit expert	(FOPH)	–
Casinos <sup>121</sup>	Audit expert	Audit expert	FCC	Art. 75 CO <sup>122</sup>

<sup>108</sup> Banking Act of 8 November 1934 (Bankengesetz; SR 952.0).

<sup>109</sup> Financial Market Supervision Act (FINMASA) of 22 June 2007 (Finanzmarktaufsichtsgesetz – FINMAG; SR 956.1).

<sup>110</sup> Financial Market Auditing Ordinance (FMAO) of 15 October 2008 (Finanzmarktprüfverordnung – FINMA-PV; SR 956.161).

<sup>111</sup> Stock Exchange Act (SEA) of 24 March 1995 (Börsen- und Effektenhandelsgesetz – BEHG; SR 954.1).

<sup>112</sup> Collective Investment Schemes Act (CISA) of 23 June 2006 (Kollektivanlagengesetz – KAG; SR 951.31).

<sup>113</sup> There are, however, two exceptions: First, audit firms that audit asset managers and representatives of foreign collective investment companies need to be licensed as audit experts. The lead auditor also requires a licence as an audit expert (cf. Art. 5 FMAO). Secondly, audit firms that have to prove that they meet the conditions of Art. 2, para. 3 of the CISA for investment companies need to be licensed as auditors (cf. Art. 6 FMAO).

<sup>114</sup> Insurance Supervision Act (ISA) of 17 December 2004 (Versicherungsaufsichtsgesetz – VAG; SR 961.01).

<sup>115</sup> Anti-Money Laundering Act (AMLA) of 10 October 1997 (Geldwäschereigesetz – GwG; SR 955.0).

<sup>116</sup> Applies only to the auditing of financial intermediaries that are

directly subject to supervision by FINMA. Selfregulatory organisations may define differing conditions for the admission of audit firms for their membership.

<sup>117</sup> Mortgage Bond Act (MBA) of 25 June 1930 (Pfandbriefgesetz – PfG; SR 211.423.4).

<sup>118</sup> Federal Act of 25 June 1982 relating to Occupational, Survivors' and Disability Pensions (Occupational Pensions Act – OPA) (Berufliche Vorsorgegesetz – BVG; SR 831.40).

<sup>119</sup> There is, however, one exception: Only audit firms that are licensed as state-regulated audit firms can act as auditors for investment foundations (Art. 33, para. 3 of the Ordinance of 18 April 1984 relating to Occupational, Survivors' and Disability Pensions (Occupational Pensions Ordinance – OPO) (Berufliche Vorsorgeverordnung – BVV2; SR 831.441.1).

<sup>120</sup> Federal Act of 18 March 1994 relating to Health Insurance (Health Insurance Act – HIA) (Bundesgesetz über die Krankenversicherung – KVG; SR 832.10).

<sup>121</sup> Casino Act of 18 December 1998 (Spielbankengesetz – SBG; SR 935.52).

<sup>122</sup> Casino Ordinance (CO) of 24 September 2004 (Spielbankenverordnung – SBV; SR 935.521).

## 5 List of state-regulated audit firms

Position as of 31 December 2010

### Fully licensed

500003	PricewaterhouseCoopers AG	Zürich
500038	Bankrevisions- und Treuhand AG	Zürich
500149	OBT AG	St. Gallen
500241	Mazars Coresa	Genève
500420	Deloitte AG	Zürich
500498	PKF Wirtschaftsprüfung AG	Zürich
500505	Treuhand- und Revisionsgesellschaft Mattig-Suter	Schwyz
500646	Ernst & Young AG	Basel
500705	BDO AG	Zürich
500770	Intercontrol AG	Zürich
501091	Provida Wirtschaftsprüfung AG	St. Gallen
501382	Berney & Associés SA	Genève
501403	KPMG AG	Zürich
501470	Ferax Treuhand AG	Zürich
501839	Grant Thornton AG	Zürich

### Provisionally licensed

500012	T&R AG	Gümligen
500168	Mäder + Baumgartner Treuhand AG	Neuhausen
500436	Refidar Moore Stephens	Glattbrugg
500762	Balmer-Etienne AG	Luzern
501570	Fiduciaire FIDAG SA	Martigny
502658	Treureva AG	Zürich



organisation



