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Federal Audit Oversight Authority FAOA

# Activity Report 2011



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## Foreword

2011 was a demanding year for the Federal Audit Oversight Authority FAOA. The great dynamism of the national and international environment in which it operates brought various challenges for the FAOA to overcome.

It is to be expected that the future will remain challenging. The latest financial scandals abroad require further action from oversight authorities to secure continued confidence in financial reporting. For Switzerland the following applies: Investors will invest in Switzerland only if it is internationally recognised that the auditing of financial reporting meets the highest standards of quality.

The FAOA will continue to follow ongoing regulatory activities in the European Union and the USA. The FAOA is open to changes that strengthen the audit system. In an audit environment moulded by international standards national unilateralism should, however, be avoided where possible. In addition, a comprehensive review should be made of corporate governance requirements, taking due account of the responsibility of those preparing the statutory and consolidated financial statements.

Berne, 23 January 2012

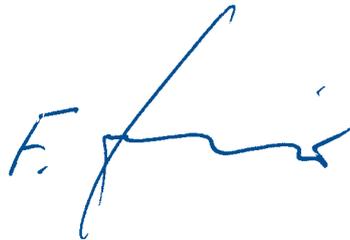


Prof. Hans Peter Walter  
Chairman of the Board of Directors  
(to 31 December 2011)

The Board of the FAOA will face these still upcoming topics with a new team. Chairman Hans-Peter Walter and member Alfred Stettler left the Board upon the completion of their respective terms of office at the end of 2011.

As from 1 January 2012, Chairman Thomas Rufer, Vice-Chairman Sabine Kilgus, together with Board members Renato Fassbind, Conrad Meyer and Daniel Oyon, will be responsible for the strategic leadership of the FAOA.

In a challenging environment much was achieved in 2011. At this point the dedication shown by the staff of the FAOA deserves our warmest thanks.



Frank-Oliver Schneider  
Chief Executive Officer



Thomas Rufer  
Chairman of the Board of Directors  
(from 1 January 2012)

## Key activities 2011

### Progress at the international level

An important strategic goal of the FAOA is the international recognition of its activities. Significant progress could be achieved on this point in 2011. European Union recognition of the equivalence of the Swiss audit oversight system and the completion of a Memorandum of Understanding with the German Auditor Oversight Commission AOC represent important steps towards the regulation of cooperation with EU member states.

Following the signature of a Statement of Protocol, joint inspections were carried out with the US audit oversight authority (PCAOB) at two state-regulated Swiss audit firms that are registered with the PCAOB. These inspections, time consuming for all concerned, are confidence-building measures that serve as a basis for future secure cooperation for both sides. The agreement with the PCAOB provides for reciprocity, i.e. the FAOA can also conduct inspections in the US.

In the coming years further progress must be made in the area of international mutual recognition. This calls for the FAOA to hold to international standards and practices and not succumb to the, at times, organised pressure not to conduct its oversight activities to the necessary depth. Only so can the sought-after relief for internationally active Swiss audit firms be achieved.

### Audits performed by Swiss public company auditors

For the first time, the majority of public company audits were performed according to the improved international auditing standards, the «Clarified ISAs». The adoption of these improved standards has already led to noticeable quality improvements. Taken overall, the industry can be issued a good report card here.

Further efforts are, however, necessary. Auditors must further optimise their professional scepticism. They should not forget that statutory audit services

are provided to benefit various stakeholders. The intended benefits of an audit can only manifest themselves if the auditor shows the necessary steadfastness vis-à-vis the management and Board of the audit client.

State-regulated audit firms have also achieved improvements in the area of independence. The forceful work of the FAOA has made an impact. All the same, breaches of independence requirements were again found in individual cases. As independence forms the essential basis for a credible and reliable audit the FAOA will continue with its efforts in this area.

With respect to audit procedures concerning possible fraud, further potential for improvement remains. Here the audit steps required by the standards are often carried out in too formalistic a way, incompletely, or without the necessary professional scepticism. More robust procedures are required in order that auditors can fulfil their role in detecting and combating fraud.

As mentioned, as far as possible the FAOA aims to carry out its inspections in line with international best practice. The membership of the FAOA in the International Forum of Independent Audit Regulators (IFIAR) and also, since 2011, its participation in the meetings of the European Audit Inspection Group (EAIG) ensure that Swiss oversight activities are consistent with international standards.

Due to the continual issuance of new accounting and auditing standards the public company audit has become increasingly complex. Accordingly, demands on auditors are great and varied. In this environment audit quality depends on audit firms being able to train the right people to become auditors and to keep them in the profession, respectively their firm. The benefits and development potential of the profession should be highlighted. Alongside audit firms, professional bodies should take appropriate measures here.

## Licensing

Unlike the licences of individuals, the licences of the approximately 2'700 audit firms are subject to a time limit. The FAOA is legally required to reassess the licences of audit firms every five years. The first licences expire at the beginning of 2013. To ensure an efficient and effective renewal process, the FAOA already began to plan the process during the reporting year. Also here, an eye will be kept on strict compliance with independence and quality assurance system requirements.

## Court rulings

The Federal Administrative Court and the Federal Supreme Court addressed FAOA practice in several decisions during 2011. Licensing requirements were defined more clearly in various areas and FAOA practice was thereby confirmed in most cases. Important decisions were reached, notably with respect to the licensing condition of good reputation, respectively the guarantee of proper audit practice, and hardship case requirements. Further, it was shown that the courts also attach great significance to auditor independence.



# 1 Oversight

## 1.1 Introduction

The second three year inspection cycle of the FAOA began in 2011. After concentrating in last year's Activity Report on a review of the first cycle<sup>1</sup>, the emphasis this year is on an analysis of the market structure and current risk factors in the audit area. In addition, initial cooperation with the PCAOB and the most important findings from the 2011 inspections are commented upon.

Changes in FAOA processes impacted the 2011 inspections<sup>2</sup>. The file review program was extensively revised because, with the Clarified ISAs, important changes to auditing standards became effective in 2011<sup>3</sup>.

The demands on the oversight function of the FAOA increase continually. The growing complexity of auditing and accounting standards adds to the inherent risk of material misstatement in entity and consolidated financial statements. A significant risk factor to highlight is the increasingly changed structure of public company balance sheets. The consistent increase in the contribution of goodwill with indefinite life to the balance sheet totals of Swiss companies<sup>4</sup> and the use of complex financial instruments harbour a greater risk of material misstatement in the financial statements. Professional scepticism and adequate knowledge of the auditing and valuation standards applying to these items are indispensable prerequisites to a good audit.

The network structure of audit firms and the international orientation of audited public companies make the use of a uniform approach by the various national audit oversight authorities of importance. Through its functions within IFIAR and the European Audit Inspection Group (EAIG) the FAOA can compare its activities and findings with foreign authorities, thereby ensuring as uniform an approach as possible.

The FAOA further strives to make various interest groups aware of the value of an audit and of effective and efficient audit oversight<sup>5</sup>. In addition, contacts with investors and other stakeholders are cultivated.

At the beginning of the reporting year the FAOA opened a new channel on its website for third party notifications<sup>6</sup>. The aim of this channel is to increase oversight effectiveness. On an anonymous basis, third parties can report possible irregularities at audit firms or gross deficiencies in the provision of legally-required audit services. Around ten notifications were received in 2011.

<sup>1</sup> C.f. FAOA Activity Report 2010, pages 17–32.

<sup>2</sup> C.f. FAOA Activity Report 2010, section 2.1.

<sup>3</sup> The standards, as revised by the IAASB of IFAC, apply to the audit of entity and consolidated financial statements which began on or after 15 December 2009.

<sup>4</sup> Leibfried, Peter/Marty, Lukas, «Viel Zukunft in den Bilanzen: Ein wachsender Anteil der Bilanzsumme von Schweizer Unternehmen besteht aus Goodwill», in: Finanz und Wirtschaft 84 (2011) No. 57, page 16.

<sup>5</sup> Section 1.9 below.

<sup>6</sup> [www.revisionsaufsichtsbehoerde.ch](http://www.revisionsaufsichtsbehoerde.ch) (Hinweise Dritter auf allfällige Missstände).

## 1.2 Market structure, audit risk factors

Since 31 December 2010 the number of state-regulated audit firms has, for the first time, not decreased (see Figure 1). An unchanged 21 firms held a licence as a state-regulated audit firm at the end of 2011<sup>7</sup>.

**Figure 1:**

Quantitative development of state-regulated audit firms from 31 December 2008 to 31 December 2011 according to licensing status.

Reference date	Total state-regulated audit firms	Voluntarily under FAOA oversight <sup>8</sup>	Full licence	Provisional licence		
				Inspection complete <sup>9</sup>	Inspection process ongoing <sup>10</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
31 December 2011	21	4	19	2	–	–

In terms of mandate numbers, the share of public companies audited by the three largest audit firms has increased slightly. This share now amounts to around 85 per cent (prior year 83 per cent; see Figure 2).

<sup>7</sup> C.f. Appendix 4 – List of state-regulated audit firms.

<sup>8</sup> This relates to audit firms that do not audit any public companies and are therefore voluntarily under FAOA oversight (Art. 7 para. 2 AOA).

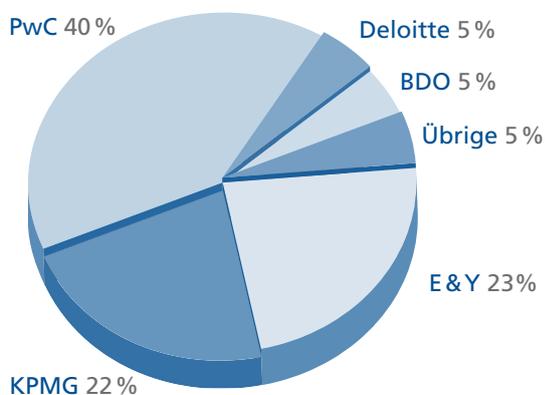
<sup>9</sup> A final licensing decision is pending the implementation of measures agreed to address identified deficiencies or new facts have come to light which prevent final licensing.

<sup>10</sup> These state-regulated audit firms are still in the inspection or reporting process.

<sup>11</sup> According to self-declarations by state-regulated audit firms.

**Figure 2:**

Number of public companies audited by state-regulated audit firms as per FAOA register entry (incl. significant subsidiaries and issuers of listed bonds); total: 493, position as of 20.12.2011<sup>11</sup>.



The three largest audit firms in Switzerland – Ernst & Young AG, KPMG AG and PricewaterhouseCoopers AG («Big 3») – still audit most large Swiss public companies. The «Big 3» also cover the majority of Swiss market capitalisation (around 95 percent). This picture is comparable with the majority of EU member states, where the «Big 4»<sup>12</sup> share more than 90 percent of the total public company market<sup>13</sup>.

The FAOA has no interest in there being too high a level of market concentration amongst audit firms. On the one hand, the choice public companies have is already very limited. On the other, the failure of one of the large audit firms could have systemic consequences. The public company audit market share of the fourth and fifth largest state-regulated audit firms<sup>14</sup> has remained largely unchanged over the last few years. Furthermore, the significance of the other twelve state-regulated audit firms to the audit of public companies remains minimal. Currently, they audit 5 percent of, or 24, public companies, six state-regulated audit firms auditing only one public company each<sup>15</sup>.

The reasons for the unchanged level of concentration within the public company audit market are complex. Generally, it appears difficult to gain entry to the mid- to top segment of public company audits. For example, public companies or their lenders may have guidelines under which only large audit firms come into question as auditors.

Small audit firms also often lack the critical size (e.g. number of staff with the required technical knowledge, access to an international network) necessary to be able to increase their share of public company audits substantially. This is also clear as regards their respective quality assurance systems. Only three of the twelve smaller audit firms referred to have a quality assurance system which accords with ISQC-1, and thereby have the basis necessary for auditing the IFRS financial statements of public companies. The question can also be asked whether, for strategic reasons, the small and medium-sized audit firms even want to increase their share of the heavily-regulated public company audit market.

### 1.3 Risk factors in the audit environment

Changes in the economic or regulatory environment of public companies and state-regulated audit firms

can have a direct or indirect affect on audit quality. The FAOA strives to identify such developments and risk factors in good time and to take adequate account of them in planning and performing inspections.

The FAOA believes the following risks can impact audit quality and are therefore to be taken account of within the framework of FAOA oversight.

#### 1.3.1 Fee pressure

Audit firms are basically free in determining audit fees. However, too low a fee and self-interest can impair the exercise of due care. This is so if the fee agreed with the audited entity is so low that it is difficult to perform the audit mandate to the required technical and professional standards for that fee<sup>16</sup>.

A significant reduction in audit fees is often seen where audits are put out to tender and auditors are changed. This is a worrying development given the increased complexity of the economic and regulatory environment. As far as it can, the FAOA seeks to influence competition amongst state-regulated audit firms, such that qualitative aspects are rated more highly than those of price. The FAOA cannot judge the extent to which audit firm cost structures and profitability goals justify the current fee reductions, but believes that too low a level of audit fee bears the risk of reduced audit quality and, as a result, less reliable public company reporting over the longer term.

To counter this risk the FAOA tracks the development of audit fees, amongst other things, and takes this into account when selecting engagements for review (file reviews). To date, however, no correlation between the development of audit fees and the quality of audit services could be identified.

<sup>12</sup> Deloitte & Touche, Ernst & Young, KPMG and PricewaterhouseCoopers.

<sup>13</sup> EU Commission Green Paper of 13 October 2010, «Audit policy: Lessons from the Crisis», KOM (2010) 561 final, page 18.

<sup>14</sup> BDO AG and Deloitte AG.

<sup>15</sup> Of the 21 state-regulated audit firms as at 31 December 2011 four are voluntarily under FAOA oversight. C.f. Figure 1.

<sup>16</sup> C.f. IESBA Code of Ethics for Professional Accountants, margin note 240.1

### 1.3.2 Pressure to improve efficiency

As a result of falling audit fees and generally increasing costs audit firms are seeking to adapt their processes to the changed conditions.

The FAOA has widely noted various actions on the part of audit firms to organise their internal processes more efficiently and economically. Examples of such actions and the response of the FAOA are presented below.

#### 1.3.2.1 Outsourcing of work

Some large audit firms have begun to combine similar processes and delegate them to a domestic or foreign shared service centre or to outsource certain work to third party companies. The delegation or outsourcing of simple audit work can be advantageous. However, the FAOA believes that this development bears the risk that a lack of customer contact and the use of insufficiently qualified personnel could reduce quality. The centralisation or outsourcing of certain functions abroad may also result in the contravention of statutory provisions. Data protection, independence and auditor confidentiality provisions particularly come to mind.

To counter this risk the FAOA assesses the nature and extent of shared service centre and outsourcing use. This assessment is made with respect to qual-

ity assurance system procedures (e.g. the external management of individual client data) as part of the firm review. As part of the file review specific audit procedures are assessed (e.g. centralised third party confirmation collection). The FAOA regards the existence of internal controls to be important. These must ensure that the centralised or outsourced services meet relevant quality standards.

#### 1.3.2.2 Reliance on the work of internal audit

Further efficiency gains are being made through the increased reliance of the external auditor on the work of internal audit, which can be appropriate under certain circumstances. Increasingly, internal auditors are also being integrated directly within the external audit team (so-called «direct assistance»)<sup>17</sup>. However, this trend holds risks. It should be borne in mind that internal auditors are not independent of their employers. Therefore, important audit work should only be performed by the independent external auditor. The audit work performed by internal audit must also be supervised and reviewed adequately.

<sup>17</sup> The concept of «direct assistance» is the subject of the current IAASB project to revise the existing standard ISA 610 «Using the work of internal auditors».

«As a result of falling audit fees and generally increasing costs audit firms are seeking to adapt their processes to the changed conditions.»

It should be noted that the current auditing standard concerning reliance on the work of internal audit<sup>18</sup> does not cover direct assistance. The standard is currently being revised and it is a matter of contention whether, and to what extent, direct assistance should be permitted<sup>19</sup>. Given the above-mentioned independence issues and the possible dilution of responsibilities, the FAOA would regard too strong an involvement as problematic.

### 1.3.2.3 Firm audit processes / software

Audit firms have revised their audit procedures and partly introduced new audit software in connection with the implementation of the Clarified ISAs. Alongside meeting regulatory requirements, audit firms are also aiming to reduce costs and improve efficiency with these measures. The appropriateness of such changes is assessed by the FAOA in its routine file reviews.

### 1.3.3 Provision of additional services

National and international independence guidelines permit the provision of certain additional services to an audit client. Depending on the nature of the services, however, necessary safeguards are to be taken.

The relative and absolute ratio of fees for other services to audit fees is in certain cases high. The ratio has, however, fallen slightly compared to prior years<sup>20</sup>. There are various reasons why auditors provide parallel services. The utilisation of potential synergies is often quoted as a reason, economic considerations certainly being of potential relevance.

The provision of additional services can impair auditor independence, at least in appearance. At the state-regulated audit firms the FAOA evaluates regularly whether this is the case. This evaluation is based particularly on an analysis of key ratios, of the fee information disclosed in public company corporate governance reports and on the type of the additional services provided. The FAOA plans its firm and file review inspection procedures such that it can identify possible infringements of independence requirements through the provision of additional services.

## 1.4 Inspections 2011

### 1.4.1 General

In 2011 the FAOA performed a total of seven inspections. The «Big 3» are subject to annual FAOA inspection since they audit more than 50 public companies each<sup>21</sup>.

The inspection of state-regulated audit firms includes aspects of both form and substance. The general approach taken by the FAOA is described in its Oversight Concept<sup>22</sup>.

The firm review encompasses checks as to whether licensing requirements have been met and whether there is a suitable and functioning internal quality assurance system. Subject to individual risk assessment, the elements of the quality assurance system selected for detailed inspection can be rotated based on a multi-year plan. However, certain areas are inspected annually by the FAOA due to their relevance and importance. These include, for example, independence and compliance with statutory licensing requirements. At the smaller state-regulated audit firms, which are inspected in-depth at least once every three years, the FAOA determines its inspection procedures according to the size and complexity of the audit firm.

The firm review is important with respect to compliance with quality assurance system requirements. This should not hide the fact, however, that a quality assurance system of the appropriate standard cannot guarantee the required quality of audit services. In its file reviews the FAOA finds repeatedly that, despite the existence of a uniform quality assurance system, the quality of audit services within an audit firm is heavily dependent on the composition of the audit engagement team. This demonstrates the inherent limitations of an expansive and fully standard-compliant quality assurance system in a people-oriented business. For this reason the focus of the FAOA is increasingly on file reviews.

<sup>18</sup> C.f. ISA 610, «Using the work of internal auditors».

<sup>19</sup> Section 1.6 below.

<sup>20</sup> Section 1.6 below.

<sup>21</sup> FAOA Circular 1/2010, margin note 8.

<sup>22</sup> See [www.revisionsaufsichtsbehoerde.ch](http://www.revisionsaufsichtsbehoerde.ch) (C.f. «Dienstleistungen/Informationen an staatlich beaufsichtigte Revisionsunternehmen»).

During the file reviews the quality of audit services is inspected on a sample basis. In so doing, the focus is placed in each case on high risk audit areas and the annual focus areas of the FAOA<sup>23</sup>. Alongside the ordinary audit, the FAOA's assessment of audit quality extends to numerous other legally-required audits and confirmations. These include, for example, the audit of formation reports, issue prospectuses, capital increases, capital reductions and audits in connection with mergers<sup>24</sup>.

File review engagement selection is based on a comprehensive analysis of the audit firm and its clients. Alongside risk-based considerations (high risk financial statement items, analysis of corporate governance structure, third party notifications etc.), other aspects are also taken into account. For instance, the FAOA aims to inspect all the public company auditors-in-charge over the medium term.

In 2011 the FAOA also reviewed the implementation of the measures agreed with audit firms as part of the 2010 inspections<sup>25</sup>. In some cases the granting of a final licence was dependent upon the successful implementation of the measures agreed during the first inspection. In 2011 four state-regulated audit firms were granted a final licence following the successful implementation of measures. However, two firms continue to be licensed on a provisional basis only, either because agreed measures have yet to be implemented satisfactorily or because new facts have emerged which prevent final licensing.

#### 1.4.2 First experiences from joint inspections<sup>26</sup>

Under US law, state-regulated audit firms registered with the US audit oversight authority PCAOB are subject to inspection by the PCAOB<sup>27</sup>. Following signature of a limited-term Statement of Protocol, the first two joint inspections in Switzerland took place in 2011. To ensure compliance with Swiss law, the FAOA took responsibility for the administrative organisation of the inspections and accompanied the PCAOB as they performed their inspection procedures.

The firm review inspection procedures concentrated on compliance with US quality assurance system and independence requirements. In its file reviews the PCAOB focused on individual risk-specific focus ar-

reas. The selection of working papers for review was based on a document prepared by the audit firm under inspection which, alongside US issuers, included US-relevant substantial role and referred work engagements<sup>28</sup>.

During the firm review meetings with audit firm management were run jointly by the FAOA and the PCAOB. In other respects, however, inspection procedures were carried out largely independently. For the file reviews the PCAOB selected different engagements to those chosen by the FAOA. This resulted in considerable additional work for the inspected audit firms. In addition, PCAOB and FAOA reporting is not coordinated. Separate reporting is made, part of the PCAOB reporting being public as required by US regulations.

Overall, cooperation with the PCAOB went well and the main goal of the FAOA, namely the legal protection of all concerned, was achieved. Furthermore, trust could be established between the two oversight authorities. This represents an important pre-condition to increased reliance in the future.

<sup>23</sup> Section 1.11 below.

<sup>24</sup> C.f. Listing contained in the Message of the Federal Council of 23 June 2004 relating to the amendment of the Swiss Civil Code (audit requirement under corporate law), as well as Federal Law on the licensing and oversight of auditors, BBl 2004 4059 f.

<sup>25</sup> Art. 16 para. 2 OoAF-FAOA.

<sup>26</sup> Section 2.3 below.

<sup>27</sup> PCAOB Rule 4000 f.

<sup>28</sup> PCAOB Rule 1001 (i) (iii) and (p) (ii).

### 1.4.3 Firm Review findings

The number of firm review findings has tended to reduce at all state-regulated audit firms. On the one hand, this is due to the implementation of remedial measures from prior inspections. On the other, audit firms have further developed their quality assurance systems out of self-interest. Notwithstanding this, it should be noted that the FAOA continues to identify deficiencies.

The FAOA has the following comments on the individual elements of a quality assurance system<sup>29</sup>:

#### 1.4.3.1 Ethical principles and independence

Compliance with independence requirements is essential to the credibility of an audit. Therefore, it is particularly important that audit firms have adequate processes and controls to ensure compliance with relevant statutory and professional requirements. The FAOA had the following findings in this regard:

##### a. Prohibition of self-auditing

As part of a file review relating to the audit of a smaller public company, the FAOA noted, through a review of the Board meeting minutes, that the auditor-in-charge was married to a manager in the finance department of the audited company. The auditor's spouse was responsible for significant financial reporting processes. This personal relationship was not disclosed in either the audit report to the General Meeting or in the comprehensive report to the Board and it was not clear from the working papers whether the relationship had been assessed in terms of a potential independence breach. The spouse also held shares in her employer. In this case contravention of the self-auditing prohibition<sup>30</sup> and the holding of a prohibited temporary direct participation<sup>31</sup> in the audited entity were criticised. The breach of independence requirements led to a limited-term licence withdrawal for the auditor-in-charge. The state-regulated audit firm was given a written reprimand.

In response to a notification from the Federal Financial Market Supervisory Authority (FINMA) the FAOA carried out a preliminary investigation at another state-regulated audit firm. The audit firm concerned had performed payroll accounting and payroll administration work at a client subject to ordinary au-

dit. This potential threat to independence had been recognised by the audit firm but not rectified immediately. In this case, the FAOA came to the conclusion that there had been a breach of independence, at least in appearance. Since the audit firm had managed part of the audited entity's accounting records there had been a breach of the self-auditing prohibition<sup>32</sup>. The auditor-in-charge and the audit firm were given written reprimands.

##### b. Provision of additional services

The FAOA often has unsatisfactory findings concerning the client and engagement-related procedures used when accepting additional engagements at audit clients. This applies particularly to the inadequate or untimely assessment of the proposed additional services with respect to independence requirements.

In one case there were indications that additional services with respect to acquisition-related valuations could breach independence requirements. Despite these indications the auditor-in-charge failed to make an adequate or verifiable assessment of the relevant independence implications and of the protective measures to be taken.

##### c. Disciplinary measures

The majority of audit firms react to internally-discovered independence breaches by taking strong measures against the culpable individuals. In minor cases it is usually a written warning. Financial and other disciplinary measures, extending to dismissal, are taken in serious cases or in the cases involving repeated breaches.

However, the FAOA has found that some audit firms do not punish breaches, or do so insufficiently. Also, in some cases processes do not exist which explain the relevant discretionary decisions reached.

The FAOA believes adequate internal disciplinary mechanisms to be necessary to ensure compliance with independence requirements and thus also to ensure the effectiveness of the quality assurance system.

<sup>29</sup> The findings and comments relate to all state-regulated audit firms, irrespective of their size or complexity.

<sup>30</sup> Art. 728 para. 2 section 4 in conjunction with paras. 3 and 5 CO.

<sup>31</sup> Art. 728 para. 2 section 2 in conjunction with paras. 3 and 5 CO.

<sup>32</sup> Art. 728 para. 2 section 4 CO.

### 1.4.3.2 Engagement acceptance and continuance

State-regulated audit firms are required to establish policies and procedures which ensure that business relationships and audit engagements can only be accepted if the firm has the relevant required knowledge and resources. In addition, engagements may only be accepted if relevant professional conduct requirements are met. The consideration and assessment of the integrity of the audited entity plays an important role here<sup>33</sup>.

The FAOA has found repeatedly that the integrity of the audited entity is not assessed, or not sufficiently so. In one case the auditor failed, as part of the acceptance process, to understand the reasons for the change in auditors, although indications existed of occurrences relevant to integrity at the management and Board level of the audited entity. With respect to audit engagement continuance, the FAOA has noted that, in some cases, contradictory statements made by management and the Board, which might call their credibility into question, have not been assessed adequately. In one case a Board member had made accusations concerning possible management fraud. These accusations were not assessed on a timely basis by the auditor as regards engagement continuance. In addition, the conclusions drawn and considerations supporting them were not documented in a comprehensible way.

<sup>33</sup> C.f. ISQC 1, para. 26 f.

«The FAOA has found repeatedly that the integrity of the audited entity is not assessed, or not sufficiently so.»

### 1.4.3.3 Compensation and quality

In assessing performance and setting partner and employee compensation the «quality factor» must be given due attention. In so doing, a sensible balance between the various performance goals must be achieved. It is important that quality failures can be traced to the compensation-setting process or to a financial disciplinary measure and that equal treatment within the firm is guaranteed<sup>34</sup>.

In some cases the FAOA finds that the «quality factor» is still not considered adequately when setting compensation. For example, in some cases negative results from internal quality reviews or FAOA inspections have not, not adequately, or not clearly been reflected in the performance evaluation of, and compensation-setting for, the responsible auditor-in-charge. In a further case the FAOA also found that equality of treatment with respect to quality-related findings from the internal quality reviews was not guaranteed. In this case, two auditors-in-charge received the worst possible ratings in a quality review. This resulted in financial consequences for partner A and no disciplinary measures for partner B.

The FAOA finds repeatedly that performance evaluation and objective-setting take too little account of quality goals. Chargeable hours and fee income goals are defined and assessed comprehensively and specifically for partners and staff. By contrast, quality goals are often not taken into account to any great extent and then only in general terms. In such cases it is not clear to the FAOA how performance evaluations and resulting compensation and promotion decisions can recognise and reward the development of individual employees adequately and, at the same time, ensure continued technical competence and compliance with ethical principles.

### 1.4.3.4 Audit reporting

State-regulated audit firms are required to establish policies and procedures which ensure that audit reports adequately reflect the given circumstances<sup>35</sup>.

If, in performing an ordinary audit of a public company, the auditor concludes from the evidence obtained that the use of the going concern assumption is justifiable despite the existence of material uncertainties this must be referred to in the auditor's report. Depending on the circumstances, this is made by way of an additional paragraph or directly in the audit opinion paragraph. In some cases the FAOA has seen this additional paragraph has not, or not adequately, reflected the material uncertainties that existed regarding going concern. In certain cases the additional paragraph also did not state explicitly that the uncertainty was material («material uncertainty») and that the level of doubt was significant («significant doubt»). In one case, the FAOA also found that the events and conditions leading to the uncertainty were not disclosed adequately in the notes to the consolidated financial statements. As such, there was no assurance that the users of the entity and consolidated financial statements had been informed adequately about the going concern uncertainty and it follows that, in this case, the auditor should have issued a qualified rather than modified report. Firmwide consultation and reporting processes were inadequate and inconsistent in the above cases.

As a result of the deficiencies found in the application of the relevant requirements (PS 570), the FAOA issued so-called Frequently Asked Questions (FAQ) showing the impact of a material uncertainty relating to going concern on state-regulated audit firm reporting<sup>36</sup>.

<sup>34</sup> C.f. ISQC 1, para. 18 A4 and, in particular, A5.

<sup>35</sup> C.f. ISQC 1, para. 32.

<sup>36</sup> C.f. FAQ dated 26 September 2011, «Wesentliche Unsicherheit bezüglich der Unternehmensfortführung – Auswirkung auf die Berichterstattung von staatlich beaufsichtigten Revisionsunternehmen» included on the FAOA website ([www.revisionsaufsichtsbehoerde.ch](http://www.revisionsaufsichtsbehoerde.ch)).

### 1.4.4 File Review findings

Audits of the consolidated financial statements of public companies were performed in 2011 in accordance with the Clarified ISAs. In its file reviews the FAOA therefore had to assess the first application of the revised standards. On the whole, the implementation of the new standards was assessed positively by the FAOA. This being said, the FAOA did find there to be potential for improvement in relation to those specific standards which had been subject to significant revision. This applies particularly to the audit of estimates (ISA 540), related parties (ISA 550) and consolidations (ISA 600).

Summarised below are the most significant findings of the FAOA arising from the 2011 file reviews at state-regulated audit firms<sup>37</sup>:

#### 1.4.4.1 Professional scepticism

The auditor is required to plan and perform every audit with professional scepticism. Both must be carried out knowing that the financial statements may contain certain material misstatements<sup>38</sup>. Using professional scepticism in all aspects of planning and performing an audit improves the effectiveness of audit procedures considerably.

The FAOA often finds that the auditor shows too little professional scepticism in carrying out audit procedures. This relates particularly to the following important areas:

##### a. Estimates

Particular awareness and professional scepticism is required where a piece of audit evidence contradicts other audit evidence or information received calls into doubt the reliability of documents or of answers given to questions.

Since beginning its inspection activities in 2008 the FAOA has noted that the auditor often shows too little professional scepticism in auditing estimates<sup>39</sup>. This is particularly problematical given that the complexity of estimates is high and that they have generally become more significant. Contradictory informa-

tion, which calls the reliability of an estimate, or the audit evidence supporting it, into question, is often not recognised or adequately addressed by the auditor. As such information relates to financial statement items which are subject to high estimation uncertainty (e.g. annual impairment tests), the risk of material misstatement within the entity and consolidated financial statements is increased in such situations. The FAOA also finds that, overall, the critical assumptions used in goodwill impairment tests (e.g. revenue growth, discount rate) are not questioned sufficiently. Furthermore, in many firms the use of experts is too restricted.

##### b. Fraud

Circumstances suggesting possible fraud must be assessed particularly carefully by the auditor. Throughout the audit the auditor should be aware of the risk of material misstatement due to fraud, irrespective of the auditor's previous experiences of the honesty and integrity of management and the Board. The professional scepticism of the auditor is therefore particularly important with respect to the audit procedures relating to fraud.

The FAOA often finds that although the audit procedures required with respect to fraud<sup>40</sup> are formally signed-off in given checklists they are insubstantial. For example, in some cases general, unclear or contradictory statements are given in the fraud working papers. In other cases there is no evidence from the meetings held with management and the Board that the auditor has asked the correct and critical questions; this hinders an assessment of the risk that the financial statements may be materially misstated due to fraud. In these cases the auditor shows inadequate professional scepticism.

<sup>37</sup> No differentiation has been made between large and small audit firms. In addition, the findings relate to engagements audited under ISA.

<sup>38</sup> C.f. ISA 200, «Overall objectives of the independent auditor and the conduct of an audit in accordance with International Standards on Auditing», para. 15.

<sup>39</sup> ISA 540, «Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures».

<sup>40</sup> ISA 240, «The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements».

#### 1.4.4.2 Group audits

The FAOA has had further findings with respect to the audit of general ledger journal entries («journal entry testing»). Journal entry testing is regarded as an appropriate response to the risk that management may circumvent controls («management override of controls»). However, in some cases the FAOA finds that the sampling period or the journal characteristics used to identify potentially manipulated journal entries are inadequate. In addition, given the sometimes large number of journal entries to be tested, the question arises as to how far the widespread use of manual audit procedures is conducive to meeting the relevant audit objectives. A focused IT-based analysis of journal entries would be more effective in such situations, even if not explicitly required by the standard.

##### c. Related parties

Transactions with related parties carry a high risk of misstatement in the audited financial statements. Related parties are also able to carry out fraud more easily<sup>41</sup>. Given this, particular professional scepticism is required of the auditor in planning and performing audit procedures concerning relationships and transactions with related parties.

The FAOA often has findings concerning the identification and understanding of related party transactions. This is particularly critical where transactions fall outside the ordinary course of business. Additionally, the FAOA often finds that disclosures made in the notes to the consolidated financial statements to the effect that related party transactions are at «arm's length» have not been audited, or not sufficiently so. In one FAOA file review, for example, this disclosure concerned the purchase of a participation from the main shareholder and Chairman. As the transaction was with a related party with dominant influence it was of particular risk. The arm's length nature of the transaction was disclosed in the notes to the financial statements of the public company but not audited adequately by the auditor.

In Switzerland there are many listed companies with major operating activities abroad. For such cases the work of the Group auditor is particularly important in exposing the risk of a material misstatement in the consolidated financial statements<sup>42</sup>.

The FAOA finds, in particular, that analytical procedures with respect to components classified as non-significant are not performed and that components are not rotated. In addition, the audit instructions issued to component auditors are, to some extent, not tailored to the specific circumstances of the client or Group. This relates, for example, to the identification of significant risks, the listing of related parties and the determination of component materiality. Finally, in certain cases the Group auditor fails to take sufficient account of component auditor reporting. This carries the risk that the Group auditor will not obtain sufficient audit evidence.

<sup>41</sup> C.f. ISA 550, «Related Parties» paras. 2 and 5.

<sup>42</sup> C.f. ISA 600, «Special Considerations – Audits of Group Financial Statements», para. 8.

#### 1.4.4.3 Engagement quality control review

The engagement quality control review ensures that the audit engagement team performs an objective evaluation of the relevant facts and that the conclusions drawn are reasonable<sup>43</sup>.

In certain cases the FAOA finds that the individual responsible for the engagement quality control review (Engagement Quality Control Reviewer or «EQCR») does not meet his or her responsibilities adequately. This is found when inspecting files that relate to both small and large public companies. In the case of file reviews in which the FAOA notes deficiencies in the audit procedures applied to high risk areas the question arises as to why the EQCR had not identified and addressed such deficiencies.

The FAOA believes the nature, timing and extent of EQCR participation is therefore to be improved. In addition, state-regulated audit firms should use selective measures to make the EQCR more accountable. This should particularly be the case where unsatisfactory results are noted as part of either internal monitoring or FAOA file reviews.

#### 1.4.4.4 Using the work of internal audit

Where the external auditor judges the work of internal audit to be relevant to the audit an assessment has to be made of the extent to which this work can be used. Further, an assessment has to be made as to whether the work is appropriate for external audit purposes<sup>44</sup>.

In certain cases the FAOA has found that the auditor relied on the work of internal audit without performing an adequate assessment of the objectivity, competence and quality of the work relied upon. The FAOA has found additional deficiencies in cases where the auditor has used members of internal audit directly as part of the external audit team. Examples of this are:

- Involvement of internal audit in complex rather than routine audit procedures;
- Insufficient involvement of internal auditors in engagement team discussions;
- Insufficient guidance regarding sample selection, materiality etc.;

- Insufficient assessment of the quality of work performed (e.g. through reperformance);
- Failure to file working papers prepared by internal audit in the audit working papers;
- Use of internal audit for procedures required by auditing standard «Special Considerations – Audits of Group Financial Statements» (ISA 600).

<sup>43</sup> C.f. ISQC 1, para. 35 f.

<sup>44</sup> C.f. ISA 610, «Using the Work of Internal Auditors», para. 6.

### 1.5 FAOA proceedings and preliminary fact-finding

In addition to routine inspections, the FAOA carries out ad hoc event-driven preliminary fact-finding and proceedings. In so doing it considers, in particular, plausible information from third parties (e.g. media) and possible findings and insights from routine inspections.

Since the FAOA inspections began in 2008 eleven proceedings<sup>45</sup> have been taken against state-regulated audit firms.

- Five proceedings concerned audit firms. In three cases the FAOA found breaches of independence requirements<sup>46</sup>. In two cases measurements agreed as part of the first inspections were not implemented or not implemented within the given deadlines. By 31 December 2011 four out of these five proceedings had been settled with a reprimand.

- Six proceedings concerned individuals with FAOA licenses. Three cases concerned the same breaches of independence requirements as those at the respective audit firm. In one case it was found that the auditor-in-charge had been negligent and that there had been a significant breach of auditing standards with respect to a set of Swiss GAAP FER financial statements. In a further case, agreed measures had not been implemented. Of these six proceedings five are complete as at 31 December 2011. Four proceedings resulted in reprimands and one in a limited-term licence withdrawal.

In addition, numerous preliminary fact-finding exercises were performed in 2011 based on information from internal and external sources, the number showing an increase over prior years.

<sup>45</sup> Both ongoing and completed proceedings.

<sup>46</sup> Section 1.4.3.1 above.

«The auditor must plan and perform every audit with professional scepticism. The audit must be carried out knowing that the financial statements may contain material misstatements.»

## 1.6 Audit Quality Measures

In the reporting year the FAOA once again collected various audit quality measures relating to ISQC 1 from the largest audit firms<sup>47</sup>. These allow for trend analysis and comparisons between the individual audit firms. In addition, they allow for the timely identification of possible negative influences on audit quality.

### Figure 3:

Most important audit quality measures for the five largest state-regulated audit firms, with prior year comparison<sup>48</sup>.

Audit quality measure	2010		2011	
	From	To	From	To
Average annual revenue per audit partner (CHF mio.)	1.5	4.0	1.4	4.0
Average number of chargeable hours per partner	699	1'060	761	1'203
Ratio of additional fees to audit fees	0.1	0.7	0.1	0.5
Number of staff per audit partner	7.5	11.4	8	11.5
Staff turnover (%)	15	27	16	23
«Non-local reviewer» participation within internal monitoring, in percent	11	100	0	100
Average number of EQCR hours per public company audit	4	16	9	30

The most important observations from the analysis of this key data are as follows (see Figure 3):

- In 2011 the **average annual revenue per audit partner** changed very little compared to the prior year. However, the differences between the individual firms are of note. One firm reached the maximum amount and three firms reached amounts CHF 0.5 to CHF 1.2 million below this. Since reduced audit fees increase the risk that financial goals will be placed above those relating to quality<sup>49</sup> the FAOA pays particular attention to this average. It can be further noted that there is no positive correlation between the **average chargeable hours per partner** and the revenue per partner. For example, the firm with the lowest annual revenue per partner shows the largest number of chargeable hours per partner in 2011. Average revenue therefore depends particularly on the number of staff per partner and the client structure of the firm.

<sup>47</sup> In part, the calculation of the audit quality measures was made using unaudited data. In certain cases simplifications and/or assumptions had to be made. The informative value and comparability of these measures is therefore limited and no responsibility is taken for their accuracy.

<sup>48</sup> The FAOA collected 12 audit quality measures relating to the individual elements of ISQC 1. They were collected from the five largest state-regulated audit firms. It should be noted that some firms also amended their prior year calculation bases to account for known errors.

<sup>49</sup> Section 1.3.1 above.

- The ratio of **additional fees to audit fees** at public companies did not change in comparison with last year at the lower level and fell slightly at the higher level. The ratio of additional fees to audit fees represents an important risk factor for the FAOA in terms of compliance with independence requirements<sup>50</sup>.
- The **staff to partner ratio** increased slightly at the lower level. With a high staff to partner ratio the risk exists that a partner cannot adequately fulfil his or her responsibilities as auditor-in-charge. However, the ratio in Switzerland is still relatively low by international standards.
- **Staff turnover** increased at four firms compared to the prior year. The firm with the highest staff turnover last year could reduce this from 27 % to 23 %. The FAOA sees high staff turnover as problematical since it can endanger staff continuity on engagements and this in turn can have a negative impact on audit quality.
- The **composition of quality control review teams** varies considerably in terms of ensuring objectivity. At two firms the participation of «non-local reviewers»<sup>51</sup> was 100 percent. The FAOA has noted that there is a tendency for there to be more, and more substantial, quality control review findings where non-local reviewer participation is greater. However, it must also be ensured that reviewers with the necessary knowledge cover Swiss-specific areas.
- The **average number of EQCR hours** increased at three firms and was unchanged at one. At two firms the number of hours doubled, which explains the large increase in the maximum amount. In its inspections the FAOA has consistently had findings concerning the engagement quality review conducted by the EQCR<sup>52</sup>. The reason for this need not necessarily be the low number of hours since, against internal rules, hours are not always charged in full. However, given the duties of the EQCR and the complexity of specific mandates the low number of charged hours is surprising and could indicate that EQCR participation needs to be improved.

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

To avoid duplication the FAOA coordinates its oversight activities with the other oversight authorities established under special law and with the stock exchanges<sup>53</sup>.

In the reporting year one joint inspection was performed with FINMA.

In addition, a regular exchange of information and findings took place between the FAOA and FINMA.

The FAOA received five notifications from the SIX Exchange Regulation (SER) in connection with their sanctions activities. Based on these, the FAOA performed preliminary fact-finding to assess the role of the auditor. In performing such fact-finding the FAOA focuses on whether legal and professional audit requirements have been met and does not reassess compliance with accounting standards.

If the FAOA identifies possible material breaches of accounting standards during the course of an inspection it notifies the SER. One such notification was made to the SER this year. In a further case, the FAOA issued a notification to both a cantonal oversight authority (BVG) and a pension trustee.

<sup>50</sup> Section 1.3.3 above.

<sup>51</sup> Non-local reviewers are partners or staff from foreign network member firms.

<sup>52</sup> Section 1.4.4.3 above.

<sup>53</sup> C.f. Art. 22 and 23 AOA.

## 1.8 International working groups and workshops

The authority of each national audit oversight authority ends at its national borders. However, the oversight activity of the FAOA is aligned to international standards. With numerous initiatives the FAOA is striving to coordinate and, as far as possible, harmonise its oversight activities at the international level. Amongst others, the aim is to achieve maximum possible uniformity of treatment for international audit firm networks across national boundaries.

The Oversight department of the FAOA takes part in the annual IFIAR Inspection Workshops. Together with around 30 other audit oversight authorities, representatives from the FAOA took part in a Workshop that took place in Washington in February 2011 and led a session on the subject of partner compensation.

In 2011 the FAOA also took part, for the first time, in the meetings of the European Audit Inspection Group (EAIG). In principle, this Group is restricted to EU members but the FAOA has been invited to take part since June 2011. The main activity of the EAIG in 2011 was to survey EAIG members on findings in certain audit areas and analyse the results<sup>54</sup>.

In the autumn of 2011 the FAOA took part in the International Regulatory Institute of the PCAOB in Washington. On this occasion, together with representatives from other oversight authorities, the FAOA took part in a panel and made a presentation on developments in the Swiss audit oversight market.

The FAOA noted that its own inspection findings appear repeatedly in other countries. In particular, insufficient professional scepticism is a far-reaching problem with significant impact<sup>55</sup>. The exchange of views within IFIAR<sup>56</sup> highlighted other areas or findings that apply internationally. This relates particularly to audit deficiencies in the areas of the Group audit, revenue recognition, and EQCR involvement. Regular meetings with the six largest networks («Big 6») take place within IFIAR to coordinate and respond to recurring topics at a global level<sup>57</sup>. Reasons for the noted deficiencies are discussed and possible remedial measures agreed with the networks<sup>58</sup>. These measures are then implemented by the global networks in the individual member countries. This process has the advantage of reducing duplication of effort by the oversight authorities.

## 1.9 Investors and Audit Committees

### 1.9.1 Contact with investors

The public relations work of the FAOA includes contact with professional investors. On the one hand, this contact widens awareness in the work of the FAOA and encourages investor trust in the financial reporting of Swiss public companies. On the other, investor community expectations of the audit industry and of audit oversight can be better understood.

Investors in the Swiss capital markets are increasingly global. There has, for example, been an increase in the number of Asian and Arab investors in recent years. Given this, the FAOA has decided to cultivate contact with international investors primarily within the framework of the IFIAR Investor Working Group. The FAOA had various contacts with the representatives of Swiss investors in the reporting year.

### 1.9.2 Contact with Audit Committees

Alongside investors, the members of public company Audit Committees are further important stakeholders. Like the FAOA, this group has a great interest in high audit quality. The cultivation of contact with Audit Committees is, however, at an early stage. In the reporting year a FAOA seminar for Audit Committees was cancelled due to lack of interest. However, the FAOA can revert to the Audit Committee experience of its own Board members. This allows the FAOA to take the views and needs of this stakeholder group directly into account in its work.

On various occasions the FAOA has been asked whether it could provide the results of its file reviews to the Audit Committees of the respective public companies. The FAOA is bound by official secrecy and, as such, cannot do this. By contrast, audit firms can supply their clients' Audit Committees with FAOA findings. The FAOA would welcome this as it would assist Audit Committees in their duty to evaluate the work of the auditor and reassess it on a continual basis.

<sup>54</sup> The EAIG survey covered the following areas: EQCR, ISA 240, ISA 315, ISA 600 and ISA 620.

<sup>55</sup> Section 1.4.4.1 above.

<sup>56</sup> Section 2.5 below.

<sup>57</sup> BDO, Deloitte Touche Tohmatsu, Ernst & Young, Grant Thornton, KPMG und PricewaterhouseCoopers.

<sup>58</sup> C.f. IFIAR Annual Report 2010, «Dialogue with the International Networks» ([www.ifiar.org](http://www.ifiar.org)).

### 1.9.3 Audit Committee regulatory requirements

Financial scandals and other fraud cases have drawn attention not only to audit firms. The call for improved management control mechanisms has also been strengthened. Audit Committees represent an important instrument in safeguarding the adequate control and supervision of financial reporting. In order to strengthen the financial reporting system as a whole it is necessary not only to strengthen audit firms but also other elements of corporate governance and, in particular, the Audit Committee.

Neither the Code of Obligations (CO) nor the Stock Exchange Act (SEA) require a public company to have an Audit Committee. Consequently, they make no requirements with respect to such a possible Audit Committee. In Switzerland these have been set rather within the framework of self-regulation. The Swiss Code of Best Practice (Swiss Code) of the Swiss Business Federation *economiesuisse*, as originally issued in 2002, contains recommendations for Audit Committees, amongst other things. Parallel to the Swiss Code, the Corporate Governance Directive of the SIX Exchange Regulation (SER) has also been in existence since 2002<sup>59</sup>. The SER Directive requires issuers to disclose certain key corporate governance information to investors in a suitable form. Amongst other things, the Directive requires details to be disclosed as to how the Audit Committee conducts its work.

The Swiss Code and SER Directive have been updated at various times since their issuance. International developments since 2002 are largely yet to be taken account of. Many public companies have aligned themselves to the international standards of their own free will. Financial services companies are also required to adhere to the additional special requirements of FINMA. The FAOA nonetheless believes that international developments should be analysed as to their suitability for public companies and adopted if applicable. Switzerland should not be allowed to become a «regulation island» in this area, thereby discouraging international investors. With respect to audit, the following are particularly worthy of investigation<sup>60</sup>:

- Obligation for public companies to appoint an Audit Committee;
- Preparation of an Audit Committee Charter with clear role definitions;

- Requirements regarding the minimum number of experienced financial experts;
- Procedures for audit tendering;
- Nature and extent of monitoring with respect to auditor independence;
- Approval of auditor fees (including additional fees);
- Revision of transparency requirements (including improved information regarding audit, audit-related and other fees).

The nature of standard-setting is also significant as only credible regulation can be effective. The question is whether the existing system of self-regulation remains sufficient to satisfy the needs of the capital markets.

<sup>59</sup> Directive on Information Relating to Corporate Governance (DCG) and Commentary on Corporate Governance Directive.

<sup>60</sup> See in addition, «Global Disclosure Guidelines/Audit Committee Reports» issued by «The Enhanced Disclosure Working Group», October 2011.

## 1.10 Standard-setting

The FAOA determines the auditing standards to which state-regulated audit firms must comply. 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, add to, or override existing standards<sup>61</sup>.

The FAOA rarely exercises this right and generally does not aim to develop auditing standards itself. Regular meetings are held with a delegation from the Auditing Commission of the Swiss Institute of Certified Accountants to allow the FAOA to make its views known and to keep itself abreast of, and influence, developments in self-regulation.

Entity and consolidated financial statements prepared in accordance with foreign accounting standards must be audited in accordance with IFAC IAASB auditing standards<sup>62</sup>. With respect to the audit of entity and consolidated financial statements prepared in accordance with US GAAP, the FAOA has recognised US Generally Accepted Auditing Standards as being equivalent<sup>63</sup>. Companies registered in Switzerland must also be audited in accordance with Swiss auditing standards<sup>64</sup>. Entity 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 Auditing Standards (SAS) recognized by the 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, as far as the particular circumstances in Switzerland permit<sup>65</sup>.

Where the ISAs are taken up in equivalent form within the Swiss Auditing Standards the FAOA sees no reason not to recognise them. The FAOA does, however, exercise a monitoring function with respect to the «as promptly as possible» implementation of the ISA within the SAS.

### 1.10.1 Standard-setting in 2011

#### a. Implementation of the Clarified ISAs

After completing the «Clarity Project» in March 2009, the IAASB published the revised «Clarified ISA» in April 2010. The first-time use of Clarified ISA with respect to the audit of public company financial statements prepared under foreign accounting standards was the subject of the FAOA inspections in 2011.

The SAS currently applicable (SAS, 2010 edition) do not include the Clarity Project changes. The current SAS relate mainly to ISA as at 30 June 2003 and the reformed Audit Law of 2008. The FAOA considers it a matter of urgency to align SAS to the current ISAs as contemporaneously as possible. In 2010 the Swiss Institute of Certified Accountants presented the FAOA with a project plan and timetable for implementing the Clarified ISAs within the SAS, which the FAOA accepted. During 2011 the FAOA has kept itself informed as regards the progress of the project. The «Clarified SAS» should apply to ordinary audits in Switzerland as from 2013.

#### b) Material uncertainty relating to going concern

As a result of the deficiencies found in the application of PS 570 «Going Concern», the FAOA issued so-called Frequently Asked Questions (FAQ) on its website<sup>66</sup>. The FAQ show the impact of a material going concern uncertainty on the reporting of state-regulated audit firms<sup>67</sup>.

#### c) Internal audit

The FAOA submitted a comment letter to the IAASB on their Exposure Drafts regarding risk assessment and using the work of internal audit<sup>68</sup>. In revising the standards the IAASB is looking particularly to define the cooperation between external and internal audit more comprehensively. At the September 2011

<sup>61</sup> Art. 28 para. 2 AOO

<sup>62</sup> Art. 3 para. 1 OAAF-FAOA

<sup>63</sup> FAOA Circular 1/2008, margin note 5.

<sup>64</sup> Art. 3 para. 3 OAAF-FAOA

<sup>65</sup> Introduction to the Swiss Auditing Standards (SAS), section D.

<sup>66</sup> C.f. FAQ dated 26 September 2011, «Wesentliche Unsicherheit bezüglich der Unternehmensfortführung – Auswirkung auf die Berichterstattung von staatlich beaufsichtigten Revisionsunternehmen», included on the FAOA website ([www.revisionsaufsichtsbehoerde.ch](http://www.revisionsaufsichtsbehoerde.ch)).

<sup>67</sup> Section 1.4.3.4 above.

<sup>68</sup> See in addition FAOA Comment Letter of November 2010 on the IAASB Exposure Drafts of ISA 610 and ISA 315 [www.revisionsaufsichtsbehoerde.ch](http://www.revisionsaufsichtsbehoerde.ch)

EAIG meeting in Oslo there was a direct exchange of views on this topic with representatives of the IAASB. This exchange of views and the IAASB consultation have shown that the direct involvement of internal audit staff in the audit engagement team («direct assistance») has created widely differing views amongst interest groups. Together with other audit oversight authorities, the FAOA raised objections to such involvement, particularly having regard to independence considerations. Since the previous drafts are likely to be revised extensively, the IAASB is currently discussing a possible new consultation process with respect to the revised drafts.

#### d) Further comments

In addition to commenting on internal audit, together with the IFIAR Standards Coordination Working Group the FAOA also commented on the following Consultation Papers: «Proposed IAASB Strategy and Work Program», «The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications» and «Enhancing the Value of Auditor Reporting: Exploring Options for Change»<sup>69</sup>.

### 1.10.2 Standard-setting in 2012

The progress made in taking up Clarified ISA within Swiss Auditing Standards will continue to be monitored closely. In addition, the new Exposure Drafts of the IAASB will be analysed and commented upon in cooperation with the IFIAR Standards Coordination Working Group<sup>70</sup>. The following projects are of particular interest to the FAOA in 2012:

- Audit Quality
- Auditor's Report
- ISA Implementation Monitoring
- The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements
- Using the Work of Internal Auditors (see above)

Further, the recommendations of the EU Commission with respect to the improvement of the European audit market and other regulatory initiatives will be watched and analysed closely<sup>71</sup>.

### 1.11 Points of focus for 2012 inspections

The following focus areas continue to remain valid in 2012:

- Compliance with independence requirements in relation to non-audit services
- Auditor responsibility with respect to fraud (ISA 240)
- Audit of accounting estimates, including estimated fair values and related disclosures (ISA 540)
- Related parties (ISA 550)
- Particular considerations with respect to the audit of consolidated financial statements, including the work performed by component auditors (ISA 600)
- Audit of IT
- Assessment of EQCR work

Further points of focus (e.g. PS 570 «Going Concern») arise from the analysis of specific circumstances.

<sup>69</sup> Section 2.5 below.

<sup>70</sup> Section 2.5 below.

<sup>71</sup> Section 2.6 below.

## 2 International

### 2.1 Introduction

For the business location Switzerland, access of Swiss audit firms to international (audit) markets continues to be highly significant. Formal recognition of Swiss audit law and the oversight activities of the FAOA represent central pre-conditions for this. Only if the equivalence of the Swiss oversight system is recognised internationally can local public companies raise capital on foreign stock exchanges without disadvantage. For this reason, since its formation the FAOA has worked consistently to be involved and recognised at the international level. In 2011 it achieved a number of important steps towards this goal.

### 2.2 Relations with the European Union

#### 2.2.1 Equivalence of Swiss oversight system

On 19 January 2011 the EU commission resolved to recognise the Swiss audit oversight system, and accordingly the FAOA, as equivalent<sup>72</sup>. A recognition process lasting around three years was thereby successfully completed. This equivalence decision is the second important step to be taken towards the regulation of cooperation with the EU, following the so-called «adequacy decision» of 5 February 2010, which concerned the adequacy of the Swiss administrative assistance apparatus<sup>73</sup>.

Based on this recognition decision the audit oversight authorities of the EU member states can rely on the oversight activities of the FAOA with immediate effect. However, the scope and conditions of such cooperation must be determined through cooperation agreements with the individual EU member states.

#### 2.2.2 Memorandum of Understanding with Germany

As mentioned, the EU Commission has delegated negotiation of specific actions in connection with the equivalence of third country state oversight systems to the oversight authorities of the EU member states. Having anticipated this, the FAOA and the German Auditor Oversight Commission (AOC) had already begun negotiating the terms of audit oversight cooperation in 2010. These negotiations were completed with the signature of a Memorandum of Understanding (MoU) on 24 October 2011.

Cooperation between national audit oversight authorities becomes of particular importance with respect to the oversight of global and regional audit networks. At the same time, this avoids unnecessary duplication of effort on the part of the audit firms. Thus the FAOA and the AOC respect the oversight of an audit firm in its home country and waive the right to exercise oversight of that firm themselves. This principle of home country oversight creates considerable relief for Swiss audit firms:

- Cross-border inspections, such as those also required of Switzerland by the US PCAOB<sup>74</sup>, are waived by both parties.
- Swiss audit firms wishing to audit a Swiss company with a German listing are no longer required to register with the AOC.

The MoU represents the first concrete agreement between the FAOA and an oversight authority from the EU area. Since the MoU with the AOC was partly based on the example MoU prepared by the European Group of Auditors' Oversight Bodies (EGAOB), it could be used as the basis for similar discussions with oversight authorities from other EU member states. Initial exploratory talks have taken place with further oversight authorities from the EU area. The FAOA aims to complete a MoU with the most important EU oversight authorities in a timely manner.

<sup>72</sup> See also page 33 of the FAOA Activity Report 2010, and the EU Commission Decision 2011/30/EU of 19 January 2011 on the equivalence of certain third country public oversight, quality assurance, investigation and penalty systems for auditors and audit entities and a transitional period for audit activities of certain third country auditors and audit entities in the European Union, page 12 f. of the Official Journal of the European Union L12, dated 20 January 2011.

<sup>73</sup> See also page 33 of the FAOA Activity Report 2010 and the EU Commission Decision 2010/64/EU of 5 February 2010 on the adequacy of the competent authorities of certain third countries pursuant to Directive 2006/43/EC of the European Parliament and of the Council, page 15 f. of the Official Journal of the European Union L35, dated 6 February 2010.

<sup>74</sup> Section 2.3 below.

### 2.2.3 Registration within the EU

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 EU licensing. This transitional period ended at the end of July 2010. After this, the registration process was handled differently by the EU member states. Some member states continue to waive the requirement for full registration. However, other countries, such as Spain, the Netherlands and Sweden, now require full registration. The FAOA is currently considering whether it would be possible to obtain, at a minimum, simplified registration for Swiss audit firms within the framework of a MoU, as is the case with Germany<sup>75</sup>. The aim is to avoid duplication of effort within the context of registration.

See Appendix 5 for an overview of Swiss audit firm registrations in the EU.

### 2.3 Statement of Protocol with the USA

Gaining access to the US audit market is more time-consuming for Swiss audit firms than it is with respect to the European Union<sup>76</sup>. Currently, the US audit oversight body (PCAOB) is not prepared to rely on the work of foreign oversight authorities without gaining experience of them through joint inspections.

As anticipated in the 2010 Activity Report,<sup>77</sup> on 4 April 2011, following negotiations lasting around two years, the FAOA and the Federal Financial Market Authority (FINMA) agreed a Statement of Protocol (SoP) with the PCAOB regarding cooperation. A Statement of Protocol is equivalent to a Memorandum of Understanding (MoU), such as that completed with the German oversight authority<sup>78</sup>. This agreement establishes the conditions for greater cooperation between Switzerland and the USA in the oversight of audit firms. Public company investor protection is thereby strengthened. At the same time, the SoP provides legal security to those audit firms that have registered themselves with the PCAOB for the purposes of auditing Swiss entities with US listings.

The SoP provides the basis for carrying out PCAOB joint inspections in Switzerland. As a direct result of

this agreement Swiss firms were removed from the «grey list» of the PCAOB<sup>79</sup> and, as such, no longer risk PCAOB sanctions.

Swiss law specifically foresees that foreign audit oversight authorities may operate in Switzerland under certain conditions (Art. 27 para. 3 and 4 AOA). From a legal perspective there are therefore no objections to joint inspections, provided Swiss law is upheld. However, should joint inspections take place without perspective and a concrete goal the danger arises that a transitional solution will become a permanent state and new reasons for joint inspections will be sought time and again. For this reason the SoP was limited to a term of three years. During this time the PCAOB can perform one joint inspection at each of the audit firms concerned.

During 2011 the PCAOB already inspected two Swiss audit firms, accompanied by the FAOA and FINMA<sup>80</sup>. With respect to both of these inspections the main aim of the FAOA was to test the functioning of the agreement with the PCAOB in practice and to create legal security for the audit firms and issuers concerned. This aim could be achieved. The inspections ran without major problem. The distinction drawn between a simplified review of documents on site and the formal process for transferring documents to the USA proved particularly valuable<sup>81</sup>. A joint inspection is, however, associated with much effort on the part of the Swiss oversight authority and the inspected audit firm.

The SoP expires on 4 April 2014. The question of PCAOB reliance on the work of the Swiss oversight authority will be central to renewal negotiations. The PCAOB has already published a list of criteria that will be used in reaching a decision (adequacy and integrity, independence, financing, transparency and work performed)<sup>82</sup>. For all foreign oversight

<sup>75</sup> Section 2.2.2 above.

<sup>76</sup> Section 2.2. above.

<sup>77</sup> C.f. in addition FAOA Activity Report 2010, page 35.

<sup>78</sup> Section 2.2.2 above.

<sup>79</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. Since then the list has been updated every six months.

<sup>80</sup> Section 1.4.2 above.

<sup>81</sup> Documents are only transferred to the PCAOB where these serve to support findings at the inspected audit firm.

<sup>82</sup> C.f. PCAOB Rule 4012, Inspections for Foreign Registered Public Accounting Firms.

bodies the extent of reliance will be defined according to a sliding scale. With respect to the firm review, partial reliance is imaginable only after the first experiences of joint inspections. In the file review area, by contrast, the PCAOB has never previously relied on a foreign oversight authority. The FAOA is striving for the widest PCAOB reliance on the Swiss oversight authorities. To this end the FAOA will increase the level of cooperation with the PCAOB continually during the next joint inspections and coordinate its firm review work more closely with the PCAOB.

## 2.4 Extra-territorial impact of the AOA

### 2.4.1 Basis

In line with comparable regulations in the USA, the member states of the EU and other countries, the Audit Oversight Act (AOA) has a certain extra-territorial impact. Accordingly, the auditors of foreign companies who draw directly or indirectly on the Swiss capital market also require a licence as a state-regulated audit firm.

Thus the scope of audit oversight at home (Art. 727 para. 1 section 1 CO) is reproduced internationally. Article 8 AOA forms the basis of this extra-territorial scope and is yet to be enacted. The Federal Council will enact this provision as soon cooperation and mutual recognition agreements can be made with the most significant foreign partner authorities.

The extra-territorial scope of the AOA results in the auditor of an international group being covered by the audit oversight of several countries. To avoid duplication of effort the legislator has decided to waive FAOA licensing and oversight requirements with respect to foreign audit firms in two cases:

- First, where a foreign audit firm is subject to oversight by a foreign audit oversight authority recognised by the Federal Council (Art. 8, para. 2 AOA).
- Secondly, where outstanding bonds are guaranteed by a company whose auditor is subject to Swiss audit oversight or that of a foreign oversight authority recognised by Switzerland (Art. 8 para. 3 AOA)<sup>83</sup>.

If the auditor of an international group does not fall under the above exceptions that auditor must be licensed and subject to oversight in Switzerland. If not, the SIX Exchange Regulation (SER) de-lists the relevant securities or sanctions the issuer (Art. 8 para. 3bis SEA in conjunction with Art.13 of the listing regulations of the SIX Swiss Exchange).

An initial analysis suggests that it will not be possible to recognise the oversight authorities of a number of countries. This is either because the country concerned has no audit oversight authority or because doubts already exist as to the equivalence of the oversight system. Contrary to the original assumptions of the legislator, these countries do not fall under the two above-mentioned exceptions. As such, the audit firms from these countries must be licensed and subject to oversight by the FAOA. For foreign audit firms, and thereby indirectly also for listings of shares and bonds in Switzerland, completing the licensing process applicable for state-regulated audit firms and being inspected by the FAOA would cause a certain amount of work. From a competitiveness perspective this would lead to some market entry restriction. At the same time, the Federal Council has decided that investors in the Swiss capital market should receive the same level of protection, irrespective of whether they invest in domestic or foreign securities issues. Investor protection and Swiss capital market competitiveness are therefore in conflict with one another to some extent. The relationship between the two can be looked at more closely with respect to three categories of audit firm that would be subject to FAOA oversight upon the enactment of Article 8 AOA.

<sup>83</sup> Bonds are often issued by issuers domiciled off-shore but guaranteed by a parent company domiciled on-shore. Investors are not disadvantaged as the bonds are fully guaranteed by the parent company and thereby subject to audit oversight (Federal Council Message of 23 June 2004 on the amendment of the Swiss Civil Code (audit requirement under corporate law), as well as the Federal Law on the licensing and oversight of auditors, BBl 2004 4068.

### 2.4.2 Equities

The first to fall within the scope of the AOA are audit firms who audit, under foreign law, issuers with equities listed on a Swiss stock exchange (Art. 8 para. 1 indent a AOA). The decision to list equities in a particular country depends on numerous regulatory and economic considerations and is generally made with a longer-term horizon. In addition, the foreign issuers of equities on the Swiss stock exchanges tend not to be from «exotic» countries and it is therefore most likely that the oversight authorities of their home countries can be recognised. The exemption of Art. 8 para. 2 AOA would therefore be applicable as a rule<sup>84</sup>. The EU also foresees a similar rule, so that Switzerland would not be at a disadvantage to the EU in relation to foreign equity issues. In summary, the enactment of Art. 8 para. 1 indent a AOA would make it more difficult to access the Swiss equity market. However, looked at overall this may turn out to be of secondary importance and appropriate with a view to investor protection.

### 2.4.3 Bonds

Secondly, the AOA covers audit firms who audit, under foreign law, entities with outstanding bond issues in Switzerland (Art. 8 para. 1 indent b AOA). According to significant market participants,<sup>85</sup> the impact of adopting this provision would be greater than that for equities. The bond market is volatile and the decision of an entity to issue bonds in a particular country is often made at short notice. In such an environment there is often insufficient time to wait for the completion of a long audit firm licensing process. In addition, the Swiss bond market has developed as a result of the financial crisis, with bonds from «exotic», and accordingly «higher risk», countries increasingly being listed in Switzerland. These countries do not generally have an audit oversight authority and therefore FAOA recognition is not possible.

Furthermore, all outstanding bond issues in Switzerland are within scope, whether listed or not<sup>86</sup>. By contrast, EU law limits audit firm oversight to issuers with quoted bonds which exceed certain thresholds<sup>87</sup>. Without accompanying measures the enactment of Art. 8 para. 1 indent b AOA would likely lead to a competitive disadvantage vis à vis the EU.

### 2.4.4 Material subsidiaries

Finally, the AOA would also cover the auditors of so-called «material subsidiaries». Such companies are those subject to Swiss or foreign law that account for 20 percent or more of the consolidated assets or revenue of a foreign public company (Art. 8 para. 1 indent c AOA) and those subject to foreign law that account for at least 20 percent of the consolidated assets or revenue of a Swiss public company (Art. 8 para. 1 indent d AOA).

Material subsidiaries can normally be identified only with considerable effort. The Swiss stock exchanges could introduce a corresponding notification requirement but the above-mentioned market participants doubt whether such a notification requirement would be appropriate or enforceable. In addition, no such requirement exists in the EU and thus a competitive disadvantage would result in this area for the Swiss capital market. Furthermore, the question arises as to how the failure to appoint an auditor under adequate oversight or the failure to report material subsidiaries would be sanctioned. Generally, it would only be possible to sanction the (Swiss or foreign) holding company listed in Switzerland but not the material subsidiary abroad that is actually responsible.

<sup>84</sup> Section 2.4.1 above.

<sup>85</sup> The FAOA is in regular dialogue with the issuer banks (UBS, CS, Zürcher Kantonalbank) on this subject. In addition, a half day workshop took place on 18 April 2011 with participants from FINMA, the Federal Department of Justice and Police, the SIX Exchange Regulation, the Swiss Institute of Certified Accountants and the above issuer banks.

<sup>86</sup> For the term «outstanding bonds» (Art. 727 para. 1 section 1 indent b CO and Art. 8 para. 1 indent b AOA) the FAOA generally follows the CO. According to this, an invitation to subscribe is taken as public when it is not addressed to a limited audience. 20 is becoming more and more accepted as a guideline number of addressees (C.f. also Art. 3a para. 2 BankV SR 952.02).

<sup>87</sup> C.f. Art. 27 Audit Directive 2006/43/ED and Art. 3 para. 2 Prospectus Directive 2010/73/EG.

### 2.4.5 Solutions and next steps

For the above reasons the modalities of enacting Article 8 AOA will be challenging. The FAOA is reviewing various possible solutions in order to satisfy the need for both investor protection and Swiss capital market competitiveness. Amongst others, the phased enactment of Article 8 AOA, clarification of the term «bonds», the elimination of an oversight requirement for the auditors of material subsidiaries or the creation of an appropriate transitional law all come into question. In any event, it would be helpful to recognise as many oversight authorities as possible. The FAOA is currently devising a recognition process and plans to implement this in 2013.

### 2.5 International Forum of Independent Audit Regulators

Founded in 2006, the International Forum of Independent Audit Regulators (IFIAR) had 41 members at the end of 2011. The current President and Vice President are from the British Financial Reporting Council (FRC) and the American PCAOB respectively. The Chief Executive Officer of the FAOA acts as Treasurer. In 2010 IFIAR held plenary meetings in Berlin and Bangkok, as well as an inspection workshop in Washington.

IFIAR approved the IFIAR Core Principles at the plenary meeting in Berlin. This framework contains the most important principles relating to the structure and duties of an audit oversight authority, as well as the performance of audit firm inspections. The Core Principles should encourage the establishment of more efficient and independent audit oversight structures and thereby serve to improve audit quality and investor protection.

Furthermore, the regular exchange of ideas with representatives of the «Big 6», respectively the Global Public Policy Committee (GPPC), continued. The most important topics of discussion were the role of the auditor, auditor communication with investors, the Audit Committee and measures and audit procedures in the loans crisis economic environment.

IFIAR delegates an increasing part of its duties to so-called Working Groups. These include the Standard Coordination Working Group (SCWG), whose goal is to allow affected oversight authorities to exchange ideas on current international standard-setting and

to communicate to the IAASB and IESBA the experiences oversight authorities have had concerning the implementation of, and compliance with, current standards. The FAOA is an active member of this Working Group. In 2011 the SCWG had twelve telephone conferences, the subjects being:

- Planned revision of ISA 610 (Using the Work of Internal Auditors)
- IAASB project regarding the Practice Statement on Complex Financial Instruments
- ISA Implementation & Monitoring Project
- IAASB Strategy and Work Program for 2012–2014
- Preparation for meetings between IFIAR and the chairmen of the IAASB and IESBA
- Audit Quality Framework
- IAASB Consultation Paper – Audit of Disclosures
- IESBA Exposure Draft – Inadvertent Violations

The FAOA submitted Comment Letters on the consultation papers, «Proposed IAASB Strategy and Work Program», «The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications» and «Enhancing the Value of Auditor Reporting: Exploring Options for Change».

The FAOA is also a member of the «International Cooperation Working Group», which deals with questions concerning international cooperation. Amongst others, the topics dealt with were the exchange of inspection reports and the registration of foreign audit firms. The aim of these discussions is to understand the differing systems used in member states and to identify possible best practices.

The above-mentioned progress in the area of international recognition,<sup>88</sup> is not least due to the networking and positioning of the FAOA on the international stage. IFIAR remains an important platform for the FAOA, allowing contact with other oversight authorities and the opportunity to define and implement an oversight strategy which is in line with

<sup>88</sup> Section 2.2 and 2.3 above.

international developments. As far as current resources allow, the FAOA again aims to be involved at various levels in the debates at IFIAR during 2012.

## 2.6 Lessons from the financial crisis

Owing to the manifold effects of the financial crisis a growing international discussion has emerged on the question of the contribution audit can make to avoiding such crises in the future. The aim of the various initiatives and regulatory proposals is mostly to improve audit quality and to lessen the effects of the oligopoly of the four largest audit networks.

Particularly wide debate was caused by the publication of the EU Commission's Green Paper of 13 October 2010 and its, in part very progressive, proposed solutions<sup>89</sup>. In this regard, the high level of concentration within the public company audit market, as referred to above, was seen as a significant risk. In spring 2011 a comprehensive report on the risks of market concentration was also published in Britain<sup>90</sup>. In the USA the PCAOB is concentrating on the question of independence<sup>91</sup> and the creation of greater transparency in the audit market<sup>92</sup>.

On 30 November 2011 the EU Commission presented a package of measures that will now be discussed by member states and the European Parliament<sup>93</sup>. The draft includes several far-reaching changes as before, in particular in the independence area, but these have been toned-down compared to the Green Paper of October 2010. For example, the draft envisages that public interest entities (which includes, in particular, listed companies, banks and insurance companies) should, in principle, appoint a new auditor every six years (so-called «external rotation»). At the same time, the auditor may no longer provide non-audit services to an audit client. A further important measure is the strengthening of audit firm oversight by the European authorities. The Commission proposes the coordination of audit oversight within the framework of the European Securities and Markets Authority (ESMA). Finally, the Commission plans to create a single audit market by introducing a European passport for audit firms.

The FAOA follows international developments with interest. Due to the international and regional integration of audit firms and the registration of Swiss

audit firms in EU member states<sup>94</sup>, developments in EU law are particularly likely to have an impact on Swiss audit firms.

<sup>89</sup> EU Commission Green Paper of 13 October 2010, «Audit policy: Lessons from the Crisis», KOM (2010) 561 final.

<sup>90</sup> Auditors: Market concentration and their role, House of Lords, Select Committee on economic affairs, second report of session 2010–2011, Published by the Authority of the House of Lords, March 2011.

<sup>91</sup> Concept Release on Auditor Independence and Audit Firm Rotation, PCAOB Release No. 2011-006, August 16, 2011.

<sup>92</sup> Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards and Form 2, PCAOB Release No. 2011-007 October 11, 2011.

<sup>93</sup> Proposal of 30 November 2011 for a Directive of the European Parliament and of the Council amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts, KOM (2011) 778 final and Proposal for a Regulation of the Parliament and of the Council on specific requirements regarding statutory audit of public-interest entities, KOM (2011) 779 final.

<sup>94</sup> Section 2.2.3 above.

## 3 Licensing

### 3.1 Introduction

An FAOA licence is required by both individuals and audit firms who provide audit services within the meaning of the AOA. After the flood of licensing applications received in the first years following the enactment of the AOA, the FAOA now receives significantly fewer licence applications. The average per month is now around 50 (2011 total: 605). As in prior years, only in the month following the audit expert examinations was a significantly higher number of applications noted.

New incoming applications are processed promptly provided all necessary information and documentation is submitted. The function of the FAOA in this area has partly moved towards the provision of support to individuals and firms who are already licensed. For example, upon request the FAOA often provides support with respect to the management of entries within the Register of Auditors, in order

to keep this up to date, or answers various technical and legal licensing questions.

Preparatory work has already begun with a view to the upcoming renewal of audit firm licences, starting in 2013 (see 3.3 below). The FAOA will endeavour to organise the licence renewal process as efficiently as possible. The necessary legal duties will be performed and compliance with licensing conditions will again be assessed. This applies particularly to the internal quality assurance system<sup>95</sup>.

### 3.2 Statistics

#### Figure 4:

Statistics with respect to licensed individuals and audit firms as at 31 December 2011<sup>96</sup>:

Type of licence	Auditor	Audit expert	Total at 31.12.2011	Total at 31.12.2010
Individuals	2'177	5'519	7'696	7'253
Sole proprietorships	386	468	854	826
Audit firms	866	1'841	2'707	2'648
State-regulated audit firms <sup>97</sup>	–	21	21	21
<b>Total licences</b>	<b>3'429</b>	<b>7'849</b>	<b>11'278</b>	<b>10'748</b>

<sup>95</sup> Section 3.3.2 below.

<sup>96</sup> All numbers refer to legally binding completed proceedings. Pending appeals are not included. The determining factor is therefore the status of the licensing process as per the end of 2011.

<sup>97</sup> C.f. Appendix 4.

At the end of the year under review 28 individuals, 27 audit firms and two state-regulated audit firms still held provisional licences. On the one hand, this is due to appeals proceedings which have a direct or indirect impact on the application in question. On the other, an extraordinary amount of time is required to assess and process applications from individuals with foreign qualifications, some of whom additionally live abroad<sup>98</sup>.

In the reporting year 43 applications were rejected, though in nine cases an auditor license could be issued instead of the requested audit expert licence. In 74 cases the applicant withdrew his or her application. Two applications were not proceeded with on the grounds of incomplete documentation. Additionally, 12 licence withdrawals were imposed and 32 reprimands issued.

### 3.3 Renewal of audit firm licences

#### 3.3.1 General

In contrast to individuals, whose licenses are unlimited, audit firms are licensed for a period of 5 years (Art. 3 para. 2 AOA). The licence has no effectiveness after this period elapses and is also not automatically extended. Steps should be taken early to renew the licence and avoid (temporary) removal from the Register of Auditors. The FAOA issued the first definitive licences to audit firms in 2008. These therefore lose their validity in 2013. The audit firms concerned will be contacted by the FAOA around six months before licence expiry and asked to submit the required information and documentation if the licence is to be renewed. On the other hand, no action is required from firms not wishing to renew and not wishing to offer audit services henceforth. To avoid unnecessary work, the FAOA would nonetheless appreciate a brief notification if the licence is not to be renewed.

Licensing requirements are set out by law and those for renewals are the same as those for initial licensing. Licensing conditions are divided between individual-related (Art. 6 para. 1 indent a–c AOA) and organisational (Art. 6 para. 1 indent d AOA) requirements. A risk-based approach is used in determining the extent to which the FAOA checks the information and documentation submitted. Audit firms

performing ordinary audits are therefore subject to more extensive checks than those performing only limited audits, particularly as regards internal quality assurance.

Individual-related licensing conditions are generally tested using a systems-based approach and manual checks are made only in exceptional cases. This could be the case, for example, if contradictory information is supplied or if it is obvious that the links between individuals and the firm are out of date. Another matter that could be checked more extensively is adherence to the minimum ratio of licensed to unlicensed staff. The law states in this regard that at least a fifth of staff involved in providing audit services must hold the relevant licence (Art. 6 para. 1 indent b AOA). At least 20% of the annual audit hours charged by the audit firm must therefore have been worked by staff with the appropriate individual licence.

<sup>98</sup> Section 3.4. below.

### 3.3.2 Quality assurance system requirements

Checking compliance with quality assurance system requirements is central to licence renewal. These requirements differ according to the type of licence: At a minimum, audit firms performing ordinary audits must generally<sup>99</sup> apply Swiss Auditing Standards (SAS 220 – «Qualitätssicherung in der Wirtschaftsprüfung»). Audit firms performing only limited audits have to adhere, at a minimum, to the guidance of professional bodies with respect to quality assurance at small to medium-sized audit firms.

As part of the licence renewal application the audit firm must describe the quality assurance system it uses. At the time of initial licensing a questionnaire was sent to the firm for completion. As part of licence renewal a refined version of this questionnaire is to be completed. The FAOA will review and verify in detail the information supplied in this questionnaire. Additional information and documentation will be requested should ambiguities or contradictions be noted. The FAOA will pay particular attention to the areas of independence, training and internal monitoring<sup>100</sup>. The general appropriateness of the policies and procedures stipulated by the respective audit firm will be checked. In individual cases adherence to legal and professional requirements will be checked by requesting additional documentation. The subject of such a check could, for instance, be adherence to independence requirements at the engagement level<sup>101</sup>, guidelines and controls covering the training of staff in accounting and auditing, and the documentation of internal monitoring.

### 3.3.3 Peer review system

Audit firms with only one licensed individual must join a scheme under which their audit services will be checked regularly by professionals of equal rank (Art. 9 para. 2 in conjunction with Art. 49 AOO). This so-called peer review system allows a firm to outsource quality assurance activities to a competent external body when it is not able to perform such activities itself. The design of this system is being reviewed again. In particular, it is being considered whether the duty to join a peer review system ought to be restricted to those audit firms that perform ordinary audits. The current applicable deadline of 31 August 2013 will therefore most likely be extended

again. Audit firms licensed subject to this provision therefore need take no action at the moment. The FAOA will inform those concerned as regards the next steps as soon as possible.

### 3.4 Licence applicants with a foreign education

The assessment of licence applications from individuals with foreign qualifications is, and will remain, highly time consuming<sup>102</sup>. The toughest nuts to crack are the assessment of the equivalence of a foreign qualification to a relevant Swiss qualification and the investigation as to whether the country from which the qualification originates offers (substantial) reciprocity. Checks as to the equivalence of a foreign qualification and as to other licensing conditions are therefore now undertaken only after the submission of a concrete application. Equivalence and reciprocity checks will no longer be made in response to preliminary questions, as they were in the past. This will also ensure that all necessary information and documentation is available. To save applicants unnecessary time and expense in such cases it will initially not be necessary to evidence sufficient knowledge of Swiss law. The relevant Educaris AG examinations must first be taken when it is clear that the other licensing conditions are met. However, in every case a licence is only granted once all licensing conditions have been satisfied.

<sup>99</sup> Audit firms that perform ordinary audits of entity and consolidated financial statements prepared according to IFRS must, in all cases, comply with IAASB standards (ISQC 1 and ISA 220). Audit firms that perform ordinary audits of entity and consolidated financial statements prepared according to US GAAP must, in addition and where applicable, comply with PCAOB and AICPA standards.

<sup>100</sup> C.f. for further information FRANK SCHNEIDER/SÉBASTIEN DERADA, Erneuerung der Zulassung von Revisionsunternehmen - Erfüllung der gesetzlichen Anforderungen als oberstes Ziel, in: Der Schweizer Treuhänder 2011, 790 f. (German version), 794 f. (French version), and TREX, Der Treuhänder, 5/11, 284 f. (German version), 288 f. (French version).

<sup>101</sup> If, for example, in the context of a limited audit accounting assistance is provided simultaneously.

<sup>102</sup> Foreign licence applicants who hold a foreign educational qualification equivalent to a recognised Swiss qualification (Cf. in addition 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).

Licence applicants can influence the work required of the FAOA considerably and thereby also the time required to assess applicants with foreign qualifications. In this respect it is important that the equivalence questionnaire on the FAOA website is completed fully and in detail and that this is submitted together with all required attachments. The translation of important documents and regulations can also be helpful, if not in one of the Swiss national languages or English. The FAOA reserves the right to request such translations should they not be supplied to begin with.

In the reporting year the FAOA was able to license individuals with qualifications from additional countries (particularly Ireland and the Philippines).

#### Figure 5:

List of equivalent foreign educational qualifications as at 31 December 2011

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

### 3.5 Reconciliation of registers

In 2011 a reconciliation was performed of the FAOA Register of Auditors to the cantonal Commercial Registers. The aim of this reconciliation was to identify individuals and firms registered as auditors in the Commercial Registers but not holding a FAOA licence.

In a first step, around 400 entries from auditors without a FAOA licence were filtered out. This large number can be explained by the fact that many Commercial Register entries are out of date and not updated. As a second step, the registrars of the cantonal Commercial Registers are now investigating how many of the above entries reflect current circumstances.

The Commercial Register is not always amended appropriately following the resignation or, as the case may be, dismissal of the auditor, or following an audit waiver (so-called opting-out Art. 727c CO). This leads to differences between the Register of Auditors and the Commercial Register. It should be noted in this regard that although it is not primarily the duty of the auditor to ensure that the Commercial Register entry is deleted, he or she also has a great interest in this being done as contemporaneously as possible. Where a fact is not entered into the Commercial Register despite being required (see also Art. 45 para.1 indent. p in conjunction with Art. 62 HRegV), such a fact can only be used in defence of a third party claim where it can be proved that the third party was aware of it. Depending on the circumstances, if the auditor remains in the Commercial Register it may appear to third parties that this registered auditor is still responsible for auditing the entity and, where applicable, consolidated financial statements of the company and bears the responsibility of being auditor (Art. 755 CO). Incidentally, authority to update the Commercial Register does not lie solely with the Board of the audited entity, but rather can be initiated by the auditors themselves (see Art. 938b para. 2 CO).

Where a company body does not exist or is not correctly constituted (thereunder an unlicensed auditor, for example) this represents an organisational deficiency (see Art. 731b para. 1 CO). In such a case, a shareholder, creditor or the Company Registrar can ask the courts to take necessary measures.





The judge can, in particular:

- Under threat of dissolution, set a time limit within which a lawful state is to be restored;
- Appoint the missing body or a trustee;
- Dissolve the company and order its liquidation according to insolvency provisions.

The provision of audit services without a licence is a criminal offence (Art. 40 para. 1 indent a AOA). Should there be indications that audit services have been provided without the appropriate licence the FAOA is obliged to clarify the facts more precisely and to inform the responsible criminal prosecution authorities of possible criminal conduct (Art. 24 para. 3 AOA). Should an individual involved in such a case subsequently submit a licence application, it would have to be assessed whether the offence represents such a serious breach of audit law that there is any assurance at all of a proper audit (Art. 4 AOA).

After this data clean-up and evaluation process the FAOA or the responsible cantonal Commercial Register offices will contact those unlicensed individuals and firms who are entered as registered auditors in the Commercial Register.

This will in no way mean that those contacted are suspected of having acted illegally. In this first phase the aim is far more to clarify the facts, although the individuals and firms contacted have a duty to assist (Art. 14 AOA).

### 3.6 Reporting and disclosure requirements

All licensed individuals and firms are subject to various reporting and notification requirements from the time of submitting their licence application<sup>103</sup>. The experience of the FAOA shows that adherence to this obligation and the maintenance of the Register of Auditors could often be improved. For example, details as regards leavers and joiners are often either not recorded in the Register of Auditors or are recorded late. This means, on the one hand, that the personal links of the individuals concerned are no longer up to date and, on the other, that compli-

ance with audit firm licensing requirements cannot be checked, or at least not without additional inquiry. From time to time contact details are also not updated to reflect changed circumstances, such as changes to a personal or office address, telephone number or e-mail address. In such a case the FAOA cannot contact the affected individual or firm, or only with considerable research. The danger therefore exists that important information cannot be communicated to the licence holder which, in the case of licence renewal for example,<sup>104</sup> could be disadvantageous. It is therefore important that details within the Register of Auditors are kept up to date.

It should be remembered that contravention of reporting and disclosure requirements is punishable by law (Art. 39 AOA, Art. 45 AOO)<sup>105</sup>.

## 3.7 Auditor independence

### 3.7.1 General

Independence is fundamental to the auditing profession. The FAOA has therefore once again defined compliance with independence requirements to be a focus area in its 2012 oversight activities<sup>106</sup>. Compliance with independence requirements is an indispensable pre-requisite for the professional practice of all other licensed individuals too. It is indeed so that the FAOA does not perform oversight activities outside the state-regulated audit firms. However, it is nevertheless bound to follow up on evidence of independence breaches. In the reporting period the FAOA investigated around 30 scenarios in more detail. Such investigations can be prompted by a (coincidental) FAOA finding or a third party notification.

<sup>103</sup> Detailed information can be found on the FAOA website under the heading «Häufige Fragen».

<sup>104</sup> Section 3.3 above.

<sup>105</sup> Contraventions of reporting and notification duties can be subject to a fine of up to CHF 100'000 and also 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 services. Should an audit firm contravene its reporting and notification duties this would call into question whether the firm's quality assurance system meets legal requirements and operates effectively.

<sup>106</sup> Section 1.11 above.

Given that independence requirements represent a licensing condition to be adhered to at all times, breaches of those requirements<sup>107</sup>, are relevant in assessing whether there is assurance that proper audit services will be provided<sup>108</sup>. Depending on the circumstances, breaches of independence requirements can raise significant doubts as to the credibility and proper performance of work and compliance with the duties of the auditor. Serious breaches of independence can result in licence withdrawal. Given the central importance of independence for the audit profession, the FAOA pays particular attention to compliance with independence requirements.

With respect to compliance with independence requirements, various aspects are to be considered: First of all, it should be noted that independence is to be assured in fact and appearance. All situations should therefore be avoided which would cause the average observer, based on general life experiences, to conclude that independence is no longer given<sup>109</sup>. The audit of a clean set of accounts by a subjectively (i.e. effectively) unbiased or, as the case may be, independent auditor has no value to third parties if independence is seen as compromised when viewed from the outside. Of relevance is not what the aver-

age observer actually knows but how the average observer would judge the situation with respect to independence, based on general life experiences, if he or she were aware of the relevant facts.

The law contains a list of matters of fact that are incompatible with independence, or at least breach independence in appearance (Art. 728 para. 2. Section 1–7 CO). Professional standards<sup>110</sup> must also be adhered to, where applicable. The auditor performing limited audits is basically subject to the same independence requirements as the auditor performing ordinary audits. According to doctrine and case law the above matters of fact also apply to limited audits. The only exception is the provision of book-keeping and other services to the audited entity, where certain general conditions are met (Art. 729 para. 2 CO).

<sup>107</sup> C.f. in addition and in particular Art. 728 and Art. 729 CO.

<sup>108</sup> Section 4.4 below.

<sup>109</sup> C.f. in addition the Message of the Federal Council of 23 June 2004 relating to the amendment of the Swiss Civil Code (audit requirement under corporate law) as well as Federal Law on the licensing and oversight of auditors, BBI 2004 4018.

<sup>110</sup> In particular, the independence guidelines («Richtlinien zur Unabhängigkeit (RzU)») of the Swiss Institute of Certified Accountants, 2007 edition.

«Independence is fundamental to the profession!»

### 3.7.2 Accounting assistance in the context of a limited audit

The FAOA has published information on its website regarding the principles to be followed when providing accounting assistance or other services to an audit client<sup>111</sup>. Rather than being a set of mandatory instructions, it presents the professional view of the FAOA on a topic which is often the subject of queries. The most important principles are presented briefly below:

According to the law (Art. 729 para. 2 CO), it is permissible to provide accounting assistance. This infers that it is not permissible for the auditor to maintain the accounts completely and independently (in the sense of complete outsourcing). It is necessary to ensure that the Board of the audited entity remains responsible for all critical matters of approach (for example, depreciation, write-downs, provisions, capitalisation of specific costs, write-backs, and changes in accounting policies). The Board may not transfer this decision-making authority to the auditor. The audited entity must remain the creator and author of the financial statements. The auditor may only assist in the preparation of the financial statements, not prepare them or significant parts of them completely.

In terms of organisational measures, it must be ensured that the audit department and the department responsible for providing accounting assistance or other services are not managed operationally by the same person or group of people. Those who provide the accounting or other services may also not have the power to instruct those involved in the audit.

Finally, to safeguard division of duties it must be ensured that those providing accounting or other relevant services to the audited entity are not allowed to be involved in the audit of that entity.

On 26 October 2011 the Swiss Institute of Certified Accountants also published a position paper on accounting assistance<sup>112</sup>. Most notably, this contains conceptual departures from the position of the FAOA, particularly as regards the permissibility of outsourcing the bookkeeping function to the statutory auditor completely.

### 3.7.3 Other incompatible matters of fact

It would go too far to present all matters of fact that are problematical in terms of independence. However, the FAOA often encounters similar independence breaches. The following represent a few typical scenarios that are to be avoided:

Close relationships between the auditor-in-charge and a member of the Board, another decision-maker or a significant shareholder (C.f. Art. 728 para. 2 section 3 CO) are often the subject of an objection. In this regard, it is to be remembered that independence provisions apply to all individuals involved in the audit, not just the auditor-in-charge. If the auditor is a partnership or a corporate body independence provisions also apply to the members of the highest management or administrative body and for others in a decision-making function (Art. 728 para. 3 CO). Under the above provisions, if two partners run a trust company together and one has their own audit firm, the latter could not audit companies in which the other is active (e.g. as Board member) at the same time.

It should be noted that independence is also not given if the auditor, individuals involved in the audit, members of the highest management or administrative body and others in a decision-making function are related parties (Art. 728 para. 5 CO). It would be incompatible with independence for an immediate family member or a close relative to have a position at an audited entity which allows them influence over financial accounting. For example, if the spouse of an auditor has a managerial role in the accounting function of the respective audited entity independence is no longer given. Independence in appearance is also significant thereby.

<sup>111</sup> C.f. FAQ of 18 July 2010 relating to the independence of the auditor during a limited audit; ([www.revisionsaufsichtsbehörde.ch](http://www.revisionsaufsichtsbehörde.ch); home page, under «AKTUELL», 18.07.2011).

<sup>112</sup> Swiss Institute of Certified Accountants, «Eingeschränkte Revision und Mitwirkung bei der Buchführung», in: *Der Schweizer Treuhänder 2011*, 1000 f. (German version), 1004 f. (French version).

Mutual auditing, i.e. where audit firm A audits audit firm B and vice versa, is also not permitted. This applies also to scenarios which lead to indirect mutual auditing. Happily, the number of objections in this area has fallen greatly. This is no doubt related to the fact that the subject was explicitly taken up in the independence guidelines of the Swiss Institute of Certified Accountants upon their revision as at 1 January 2011<sup>113</sup>.

### 3.8 New thresholds for the ordinary audit

On 17 June 2011 the Federal Council approved a change in audit requirements. The thresholds separating the limited and ordinary audit were increased from a balance sheet total of CHF 10 million, turnover of CHF 20 million and annual average full-time equivalent employees of 50 to a total balance sheet total of CHF 20 million, turnover of CHF 40 million and 250 full-time equivalent employees (Art. 727 para. 1 section 2 CO). The new thresholds come into force on 1 January 2012 and apply to the audit of entity and consolidated financial statements for financial years beginning on or after 1 January 2012.

The calculation method is unchanged: An ordinary audit is required where two of the three thresholds are exceeded in two consecutive years. According to the legislative authorities and the Federal Council, it is the amounts in the reporting year and the year prior to that which are decisive in assessing whether two of the three thresholds have been exceeded in two consecutive years. With respect to the financial year 2012 these are therefore 2012 (reporting year) and 2011 (prior year). Retrospective application to financial year 2011, or earlier financial years, is not permitted<sup>114</sup>.

The new thresholds have no direct impact on the licensing of auditors or audit experts. What has changed, however, is the scope of the two types of licence: As from the financial year 2012, individuals and firms with auditor licences can now also audit the financial statements of entities falling above the old thresholds of 10-20-50 and below the new ones of 20-40-250.

### 3.9 New accounting law

On 23 December 2011 the Federal Council approved the total amendment of the bookkeeping and accounting law. As early as the end of 2007, the Federal Council had issued a Message concerning the amendment of the corporate and accounting law<sup>115</sup>, primarily to achieve four objectives: Improving corporate governance, making capital structures more flexible, updating general meeting provisions and modernising bookkeeping and accounting. This submission was suspended due to the referendum «gegen die Abzockerei». At the same time, however, the accounting law was separated and deliberated on to completion by the Federal Assembly.

Even though the Federal Council draft was toned down considerably by the Federal Assembly, the new law will modernise the outdated bookkeeping and accounting provisions comprehensively. It will create a uniform system for all organisational forms under private law, although the requirements on entities will differ according to their economic significance. Provisions applicable only to certain organisational forms will be removed (e.g. Art. 662 ff. CO for incorporated companies). The submission contains general provisions that apply to all legal entities with bookkeeping and accounting obligations (Art. 957 ff. OR). According to the Federal Council and the Federal Assembly, these reflect the current bookkeeping and accounting practices of a well-run small to medium-sized entity. Further-reaching provisions apply to large entities (Art. 961 ff. CO) and groups (Art. 963 ff. CO). Under certain conditions, financial statements must be prepared according to a recognised financial accounting standard (Art. 962 ff. CO; e.g. according to Swiss GAAP FER or IFRS), alongside those prepared under the CO. These provide a fair presentation of the economic situation of the entity.

<sup>113</sup> C.f. section IV indent C para. 3 of the independence guidelines («Richtlinien zur Unabhängigkeit (RzU)») of the Swiss Institute of Certified Accountants, 2007.

<sup>114</sup> C.f. in addition also the FAQ «Eingeschränkte oder ordentliche Revision (Grössenkriterien)», amended 27 October 2011, on the home page of the FAOA website.

<sup>115</sup> Message of the Federal Council of 21 December 2007 on the revision of the Swiss Civil Code (corporate and accounting law, as well as the amendment of the laws concerning partnerships and limited partnerships, limited companies, associations, the commercial register and firms) BBI 2008 1589 f.

In the appendix to the new accounting law the Federal Assembly has also made a provision relating to the responsibility of the FAOA. Previously this had been addressed by the Responsibility Law of 14 March 1958 (SR 170.32): Should a representative body or employee of the FAOA cause a third party unlawful losses in carrying out their duties, the FAOA is liable according to the Responsibility Law (C.f. Art. 19 Responsibility Law).

From a regulatory and professional point of view, this absolute liability appears objectionable in a case where a state-regulated firm has been grossly negligent and the oversight authority has committed only a minor breach of official duties. Based on similar considerations, the Federal Council already implemented a special liability provision for FINMA in 2009. The Federal Council and Federal Assembly have decided that FINMA and the FAOA should be subject to the same liability provisions given their

comparable activities and their collaboration with respect to the oversight of audit firms. In principle, the responsibility of the FAOA, its responsible bodies, personnel and the third parties it employs continues to be in accordance with the Responsibility Law. However, the FAOA will only be liable in the future if it has contravened its oversight duties significantly and the loss concerned is not attributable to the negligence of an auditor, audit expert or audit firm. This provision also applies to state-regulated audit firms and individuals and firms that require a licence from the FAOA but have not obtained one<sup>116</sup>.

The Federal Council has yet to decide when the new law is to be enacted.

<sup>116</sup>Message of the Federal Council of 21 December 2007 on the revision of the Swiss Civil Code (corporate and accounting law, as well as the amendment of the laws concerning partnerships and limited partnerships, limited companies, associations, the commercial register and firms) **BBI 2008 1739 f.**

«The FAOA will only be liable in the future if it has contravened its oversight duties significantly and the loss concerned is not attributable to the negligence of an auditor, audit expert or audit firm.»

## 4 Court rulings

### 4.1 Introduction

As in 2010, the Federal Administrative Court (FAC) issued a range of pertinent rulings last year. The court expressed itself in one decision on the licensing condition relating to education, in eight decisions on professional experience and in seven decisions on good reputation. In addition, the court decided on the legality of reprimands issued by the FAOA and on various procedural questions. The Federal Supreme Court also adjudicated on one case connected with professional education and three cases around the topic of reputation. The following summarises the most important deliberations behind these decisions (referenced in the footnotes using the pre-fix «E») and the licensing condition definitions contained therein.

### 4.2 Education

According to Art. 4 and 5 AOA, every person applying for a licence as audit expert or auditor must, amongst other things, evidence having met legal educational requirements. Foreign qualifications are handled in Art. 4 para. 2 letter d AOA. According to this provision, a licence applicant holding a foreign educational qualification satisfies the conditions for licensing if he or she can demonstrate that this qualification is equivalent to a Swiss qualification mentioned under letters a to c of Art. 4 para. 2 AOA, he or she has appropriate professional experience, he or she can demonstrate the necessary knowledge of Swiss law, and a state treaty exists with the country of origin or the country of origin grants reciprocity.

In its one decision on the licensing condition relating to education<sup>117</sup> the FAC reviewed the question of reciprocity and whether reciprocity could be reconciled with the basic right of economic freedom. The appellant was the holder of a «Bachelor of Science in Business Administration» from the University of California. He was also permitted to work as a «Certified Public Accountant» (CPA) in this US state. Furthermore, he held a provisional licence from the FAOA. The court first remarked, which incidentally was not a point of contention, that no state treaty exists with the USA and that the USA does not grant

reciprocity to those holding a Swiss educational qualification under AOA. The refusal to license the appellant due to the absence of reciprocity was not a violation of economic freedom in the view of the court. The court agreed with the FAOA that reciprocity enables the holder of a Swiss qualification to gain entry to foreign audit markets and was therefore in the public interest. Under such circumstances, the refusal to license was also not an unreasonable impairment of economic freedom. Furthermore, in this particular case the refusal to license did not contravene the basic right to economic freedom.

In the same ruling the FAC remarked that it would be unjustifiable to suspend proceedings, such that the provisionally-licensed appellant could take the appropriate examinations and obtain a licence from the «Association of Chartered Certified Accountants» (ACCA) to work as an auditor in England (which grants reciprocity).

The FSC also commented on the licensing condition relating to education and, in particular, as to whether the «Master of advanced Studies HES-SO en lutte contre la criminalité économique» represented a qualification under Art. 4 para. 2 letter c AOA<sup>118</sup>. The court remarked that the question in the present case was not whether the relevant course of education was equivalent to one mentioned in the AOA<sup>119</sup>, but rather whether the course of education represented a Master under the law. The court came to the view that the methods by which AOA provisions could be interpreted in a literal, historical or systematic way were of limited value, and it was therefore essentially necessary to rely on a teleological interpretation of Art. 4 para. 2 letter c AOA. This method of interpretation led the court to the conclusion that the «Master of advanced Studies HES-SO en lutte contre la criminalité économique» was a qualification under the above provision.

<sup>117</sup> FAC Decision No. B-8732/2010 of 22 September 2011 (not yet effective).

<sup>118</sup> Decision No. 2C\_731/2010 of 16 November 2011.

<sup>119</sup> If this had been the case, under Article 83 letter t of the Law of 17 June 2005 over the Federal Supreme Court (BGG, SR 173.110), the FSC would have had to refuse to adjudicate on a professional qualification assessment due to lack of authority.

### 4.3 Professional experience

In various decisions the FAC defined the terms internal audit, controlling, management accounting and «layman audit», and the extent to which these should be accounted for in the context of professional experience. It also defined the scope of supervised professional experience. Finally, the court broadened its adjudications concerning the hardship clause of Art. 43 para. 6 AOA.

#### 4.3.1 Internal audit, controlling, management accounting and «layman audit»

In two cases the FAC addressed the recognition of internal audit work within the meaning of professional experience under AOA<sup>120,121</sup>. The court remarked that in order for the internal audit work performed and evidenced by a licence applicant to be recognised as financial statement audit work it must, to a large extent, be equivalent to external audit work. The court accepted equivalence in the concrete case of a person who worked as a «Financial Controller» but carried out internal audit work comparable to that of external audit in the context of Group mergers and acquisitions. According to the court, current concepts cannot be used in making an assessment of work performed between 1987 and 1993<sup>122</sup>. By contrast, in a case where the applicant was an accountant and provided evidence only that he had helped to prepare the financial statements and had cooperated with the external auditors as part of the financial statement audit, the FAC did not accept equivalence<sup>123</sup>.

With regards to the controlling function, the court noted that the aim of this function was not, in contrast to the financial statement audit, to perform an independent check as to whether the financial statements meet legal and professional requirements. The role of controlling is far more to ensure in a general way that the business is on course, through identifying variances from business targets, budget overruns or business inefficiencies. Such work is generally not comparable with the financial statement audit. In the concrete case concerned the licence applicant could not provide sufficient evidence that his work had great similarities to the financial statement audit and this work was therefore not recognised<sup>124</sup>.

In a further case the FAC addressed management accounting. The court took the view that the AOA draws no distinction between management and financial accounting and that it contains no definition of accounting. After detailed analysis the court came to the conclusion that the legislator had deliberately avoided limiting the term accounting as far as it relates to the recognition of professional experience. Professional experience in the management accounting area is accordingly taken into account even if it is not obtained in the financial accounting area simultaneously<sup>125</sup>.

With regard to the so-called «layman audit», the fact that such audits are not specifically envisaged in the law (in concrete terms these relate to the audit of associations with no statutory audit requirement) does not per se make them incomparable to a financial statement audit. The applicant must, however, provide evidence that the work performed is comparable to that of a statutory financial statement audit. In the case concerned, the work submitted could at most be taken account of in conjunction with other financial audit engagements<sup>126</sup>.

<sup>120</sup> Decisions No. B-5668/2010 of 7 April 2011 and No. B-7516/2009 of 6 July 2011.

<sup>121</sup> In the following Decisions the FAC defined the terms accounting, external audit and controlling: No. B-639/2010 of 7 July 2011, E. 7.2.2; No. B-5668/2010 of 7 April 2011, E. 4.1; No. B-7516/2009 of 6 July 2011, E. 5.1.4; No. B-3737/2010 of 12 October 2011, E. 5.4.1.

<sup>122</sup> Decision No. B-5668/2010 of 7 April 2011, E. 4.3.4.

<sup>123</sup> Decision No. B-7516/2009 of 6 July 2011, E. 5.1.4.

<sup>124</sup> Decision No. B-3737/2010 of 12 October 2011, E. 5.4.1.

<sup>125</sup> Decision No. B-639/2010 of 7 July 2011, E. 7.2.

<sup>126</sup> Decision No. B-7516/2009 of 6 July 2011, E. 5.1.5.

### 4.3.2 Definition of supervision

The AOA requires that part of the professional experience of a licence applicant in the areas of accounting and audit is acquired under the supervision of a qualified person (C.f. Art. 4 para. 4 and Art. 5 para. 2 AOA). Art. 7 AOO defines the term «under supervision» in more detail. This is taken as given if the applicant was formally subordinated to a professional satisfying the legal requirements and carried out his or her work under instruction.

It can first be noted that the court confirmed the practice of the FAOA on two points. On the one hand, the supervision criterion relates to the accounting as well as audit area<sup>127</sup>. On the other, the FAOA had not exceeded its authority in requiring that at least 10% of a full-time equivalent position must be spent in audit. In fact, the court left the question open as to whether the goal of the FAOA (namely assuring the regular exercise and quality of audit services) would be met, given this low percentage<sup>128</sup>.

In 2010 the Court had ruled that a subordinate relationship within the meaning of the AOA can exist when both the licence applicant and his or her supervisor belong to a Board of Directors. In so doing, the court referred to the theory of the so-called employment and company law double relationship<sup>129</sup>. A licence applicant claimed professional experience supervised by the Chairman of a company of which he was Executive Director and in which he had a shareholding of between 70 and 80 percent. The court was of the opinion that a subordinate relationship was not ruled out under this scenario as there was an employment contract (in this case an oral employment contract) and the supervised person was neither the sole shareholder nor the sole Board member. The fact that the licence applicant controlled the company via the General Meeting did not change the fact that he was bound by the instructions of the Board. The court therefore found that a subordinate relationship existed<sup>130</sup>.

By contrast, the FAC did not find that a formal subordinate relationship existed in a case in which the licence applicant acted as the Finance and Administration Director of a subsidiary company in Switzerland and claimed supervision by a person working

at the parent company. Such a position implies a certain autonomy and can possibly lead to a virtual subordinate relationship in specific areas, but not to a formal subordinate relationship under AOA and AOO. Given the physical distance between the relevant individuals the court additionally found it difficult to imagine that actual supervision had taken place<sup>131</sup>.

Finally, in a scenario in which the licence applicant and the supervisor are in a contractual relationship with one another, supervision can only exist if the licence applicant is the contracted party and follows the instructions of the contractor. In an inverse relationship no subordinate relationship exists<sup>132</sup>.

### 4.3.3 Hardship clause

In hardship cases Art. 43 para. 6 AOA allows the FAOA to recognise professional experience which does not meet the statutory provisions, provided that the proper conduct of audit services is evidenced through many years of practical experience. Art. 50 AOO lists the preconditions that individuals must meet in order to be licensed as an audit expert or auditor under Article 43 para. 6 AOA.

The FAC addressed these provisions in a number of cases. In 2010 it had noted already that Art. 50 AOO was not to be regarded as the only application of Art. 43 para. 6 AOA<sup>133</sup>. In its most recent adjudication it added that practical experience requirements for an audit expert licence must be greater than those for a licence as auditor<sup>134</sup>.

<sup>127</sup> Decisions No. B-5668/2010 of 7 April 2011, E. 4.2, and No. B-3648/2010 of 5 May 2011, E. 2.1.

<sup>128</sup> Decisions No. B-5668/2010 of 7 April 2011, E. 4.2, and No. B-3648/2010 of 5 May 2011, E. 2.2.1.

<sup>129</sup> Decision No. B-3219/2009 of 22 March 2010, C.f. also FAOA Activity Report 2010, page 40.

<sup>130</sup> Decision No. B-187/2010 of 12 January 2011, E. 4.4.3 to 4.4.6.

<sup>131</sup> Decision No. B-1350/2010 of 29 April 2011, E. 4.2.4.

<sup>132</sup> Decision No. B-7516/2009 of 6 July 2011, E. 4.2.

<sup>133</sup> Decision No. B-3920/2010 of 9 December 2010, E. 6.2. C.f. also FAOA Activity Report 2010, page 40.

<sup>134</sup> Decision No. B-5668/2010 of 7 April 2011, E. 5.

With regard to the application of the hardship clause to individuals applying for an audit expert licence, the court argued in its 2011 decisions that a licence is to be granted if an individual cannot be licensed under regular conditions and the result of this is objectively unacceptable. The rejection of a licence application from an applicant falling far short of meeting the licensing conditions would not constitute an objectively unacceptable result. In the specific case the individual concerned could evidence only 43 months of professional experience under supervision, whereas 72 months would have been necessary. Beyond that, he was only working in the audit area part-time and the majority of his engagements did not require a licensed audit expert<sup>135</sup>. There was therefore no hardship case<sup>136</sup>. In a later decision<sup>137</sup> the court found that the assessment of a hardship case includes a comprehensive analysis of the professional experience of the licence applicant. In this analysis the ordinary audits of companies meeting the conditions of Art. 727 para. 1 indent 2 CO<sup>138</sup>, which can only be performed by an audit expert under the new law, are critical. In the case concerned the licence applicant could not evidence that he met the regular licensing conditions. He could provide just as little documentation showing that he had performed ordinary audits.

With regard to the application of the hardship clause for auditors, the FAC emphasised that it was not possible to define the duration and substance of «many years of professional experience» in general terms. Overall professional experience and the quality of the services provided is far more to be judged in each individual case, though such an analysis is superfluous if it is obvious that there is no lengthy professional experience<sup>139</sup>. In addition, the court supported the practice of the FAOA under which at least 10 percent of a full-time equivalent post must have been devoted to financial statement audits over many years. The court denied a hardship case in one specific instance, where a total of 36 audit engagements had been performed since 2009, in so doing meeting the 10 percent criterion, but only one per year had been performed between 2002 and 2008<sup>140</sup>. The court came to the same conclusion in the case of a licence applicant who could provide evidence of one audit report per year for the peri-

od from 1989 to 1995, two per year for the period 1995 to 1999 and three in 2000 and who had performed no audit work since 2001<sup>141</sup>.

#### 4.4 Good reputation

Generally, the adjudications of the FAC and FSC support the legality of FAOA practices with respect to good reputation and the assurance of proper conduct of audit services. To that effect, the court confirmed that oversight practices from the financial markets area (Banking Act [BA, SR 952.0], Stock Exchange Act [SEA SR 954.1] and Anti-Money Laundering Act [AMLA, SR 955.0]) could be drawn upon in interpreting this general legal term. In checking reputation, respectively assurance, particular consideration must thus be given to reputational characteristics of a professional nature, such as integrity, conscientiousness and proper care, as well as general qualities such as esteem, regard and trustworthiness. The assessment as to the propriety of audit services can, under certain circumstances, be influenced by actions taken outside the role of auditor or audit expert. These require professional expertise and proper conduct in business matters. The latter term is first and foremost understood to mean compliance with the law, including not only audit law but also civil and criminal law, and regard for the principle of good faith<sup>142</sup>.

<sup>135</sup> In addition, the licence applicant worked part-time for another company and on the strength of his 5 engagements, which constituted 50 percent of revenue, he would generally have required a licence as audit expert. The opinion was that the refusal to grant a licence was not disproportionate if reasonable measures could be taken within the firm to reorganise (Decision No. B-1350/2010 of 29 April 2011, E. 6).

<sup>136</sup> Decision No. B-1350/2010 of 29 April 2011, E. 5.2 and E. 5.3.

<sup>137</sup> Decision No. B-3737/2010 of 12 October 2011, E. 5.4.

<sup>138</sup> Pursuant to this provision companies that exceed two of the following measurements in two consecutive years are subject to ordinary audit: Balance sheet total CHF 10 million, revenue CHF 20 million annual average full-time equivalent employees of 50.

<sup>139</sup> Decision No. B-3648/2010 of 5 May 2011, E. 3.1.

<sup>140</sup> Decision No. B-3648/2010 of 5 May 2011, E. 3.4.

<sup>141</sup> Decision No. B-6595/2010 of 26 May 2011, E. 3.3.6.

<sup>142</sup> FSC Decision No. 2C\_505/2010 of 7 April 2011, E. 4.2. and No. 2C\_834/2010 of 11 March 2011, E. 3.2.

The FSC confirmed the practices of the FAC and the FAOA, whereby breaches of independence requirements are taken account of negatively when assessing good reputation and the ability to assure the proper conduct of audit services<sup>143</sup>. According to the FSC, contraventions of the criminal law provisions of the AOA also lead to a negative assessment of reputation, in particular where individuals have performed audits under the law without holding the appropriate licence<sup>144</sup>. In contrast, contraventions of audit law that did not lead to a criminal conviction and are over 10 years old no longer call the good reputation of the individual concerned into question<sup>145</sup>. The FAOA can, however, take into account pending criminal proceedings and audit law contraventions that took place between 1995 and 1999, if contraventions have also taken place recently<sup>146</sup>.

The FAC again found that in assessing good reputation the severity, number and timing of the committed contraventions were to be taken into account. The court remarked further that all facts that have a positive effect on the good reputation of the licence applicant, or that put negative acts into a better light, are also to be taken account of (for example, the reimbursement of losses caused, the restoration of a lawful situation or the one-off nature of the committed contravention)<sup>147</sup>. Mitigating or positive considerations do not, however, automatically have a positive effect on the assessment of good reputation. In principle, they are to be valued neutrally<sup>148</sup>. Having regard to possible future licensing, the FAOA must, in addition, make a prediction and comment both on the future and current effects that the noted contravention will have on the work of the appellant<sup>149</sup>. In light of these deliberations the FAC sent three decisions back to the FAOA, in order that the latter make a statement as to when good reputation is restored.

The court also expressed itself on a number of occasions with regard to independence. It noted, in particular, that independence requirements applied not only to the auditor-in-charge and the audit team members but also to all individuals who take part, or could take part, in the audit. Thus, for example, Executive Board members of the audit firm and auditors who monitor the work of their colleagues

would be affected. In this connection it is beside the point whether the individual is involved in the work within the framework of an employment or an engagement contract. In addition, the independence requirements for the ordinary audit also apply to the limited audit, though this is subject to the exception stated in Art. 729 para. 2 CO<sup>150</sup>. The court specifically found a breach of independence in the following case. The appellant was the sole shareholder of his company. This company acted as auditor for a number of other companies, each of whose sole Board member or executive worked for the auditor and thus for the appellant. Even though, in this specific case, it could not be proved that the sole Board member or executive of the audited entity had worked on the audits of the said companies, a corresponding breach of independence in appearance existed. In addition, the engagement between the two individuals had created a relationship which was also incompatible with independence since it gave the appearance that the audited company would be subject to a less rigorous audit<sup>151</sup>. In another case the court also confirmed a breach of independence and with this the lack of assurance of proper audit services. This concerned an appellant who had held a direct shareholding (up to 10 percent) in the company he had audited. This company had also been registered at the same address as its auditor. In addition, a close relationship had existed to a Board member of the said company. The appellant ultimately confirmed having supervised the work of this Board member, with whom he had also held a joint

<sup>143</sup> FSC Decisions No. 2C\_834/2010 of 11 March 2011, E. 5 and Nr. 2C\_591/2010 of 15 March 2011, E. 4., and FAC Decisions No. B-4137/2010 of 17 September 2010, E.4/5; B-7348/2009 of 3 June 2010, E.9 and 10.

<sup>144</sup> Decision No. 2C\_505/2010 of 7 April 2011, E. 4.4.

<sup>145</sup> Decision No. 2C\_834/2010 of 11 March 2011, E. 6.

<sup>146</sup> Decision No. 2C\_591/2010 of 15 March 2011, E. 4.

<sup>147</sup> Decisions No. B-7967/2009 of 18 April 2011, E. 5.2.1 and E. 5.2.2, and No. B-4420/2010 of 24 May 2011, E.4.

<sup>148</sup> Decisions No. B-1355/2011 of 5 October 2011, E. 4.1.4 and No. B-4465/2010 of 3 November 2011, E. 4.2.4.

<sup>149</sup> Decision No. B-4420/2010 of 24 May 2011, E. 4.2.

<sup>150</sup> Pursuant to this provision accounting assistance and other services may be provided to the audited company. If there is a risk of self-auditing suitable organisational and personnel-related measures must be taken to ensure a reliable audit (on this see section 3.7.2 above).

<sup>151</sup> Decision No. B-6373/2010 of 20 April 2011.

86% shareholding in another company. The appellant had furthermore held a significant position in several subsidiaries of the company, which he and the other person owned, and these companies had been audited by a company in which the appellant was the sole Board member and employee. In view of these breaches, the court confirmed the licence withdrawal, adding that in the event that the appellant wished to apply for a new licence he must prove that he had restored proper order and understood the independence requirements<sup>152</sup>.

Regarding the provision of audit services without a licence the FAC appears to have made its adjudications somewhat more precise. At first the court held that the reasons for a contravention of applicable law and its specific consequences were of no relevance in assessing good character<sup>153</sup>. In a recent ruling, however, the court remarked that not only had Art. 40 been contravened but a pension fund audited by an unlicensed auditor had also suffered loss in as much as its audit report was of doubtful legal validity and a further report may, under certain circumstances, be required<sup>154</sup>. In this second decision the consequences of the contravention therefore appear to have been taken into account.

Finally, the FAC had to adjudicate on a case involving an appellant who had been convicted of misappropriation, as well as being subject to debt enforcements of over CHF 100'000 and certificates of unpaid debts amounting to more than CHF 6 million. With reference to a decision of the FSC, it was noted that criminal convictions could only be taken account of in assessing good reputation if still entered in the criminal register. On this point the court specified that criminal law distinguished between entries in the electronic criminal register (VOSTRA) and entries in the extract for private individuals; as a rule, entries in the extract are deleted sooner than those in the electronic criminal register. Since the FAOA has no access to the VOSTRA register, it must abide by the criminal register extract<sup>155</sup>. With respect to the existence of certificates of unpaid debts, the court further noted that the rejection, as

<sup>152</sup> Decision No. B-1355/2011 of 5 October 2011, E.4.4 and 7.2 (not yet effective).

<sup>153</sup> Decision No. B-4420/2010 of 24 May 2011, E. 3.1.

<sup>154</sup> Decision No. B-786/2011 of 28 June 2011, E. 4.7.

<sup>155</sup> Decision No. B-4465/2010 of 3 November 2011, E. 4.3.2 and E. 4.3.3; see also Decision No. B-3837/2010 of 14 December 2011, E. 6.

«In the year under review the Federal Administrative Court and the Federal Supreme Court issued 21 rulings on licensing practice. »

a matter of general principle, of licence applicants against whom such certificates have been issued appeared neither reasonable nor compatible with the principle of proportionality. In a specific case, the origin, value and number of unpaid debt certificates should therefore be examined. In the case adjudicated upon the court found, however, that unpaid loss certificates of more than CHF 6 million and current certificates of unpaid debts of CHF 100'000 were not compatible with good reputation, and accordingly the assurance of proper audit services<sup>156</sup>.

#### 4.5 Reprimand

The court has, in the meantime, decided on the question as to whether the FAOA may issue a reprimand against an individual outside the scope of Art. 18 sentence 1 AOA<sup>157, 158</sup>. The court argued that the AOA provided no legal basis for a reprimand beyond Art. 18. If necessary, a reprimand could be issued using Art. 17 para. 1 sentence 2 AOA if the individual concerned has yet to restore proper order<sup>159</sup>.

<sup>156</sup> Decision No. B-4456/2010 of 3 November 2011, E. 4.4.1 to 4.4.3.

<sup>157</sup> Where an individual working for a state-regulated audit firm contravenes legal requirements the oversight authority issues that individual with a written reprimand.

<sup>158</sup> In two earlier Decisions the FAC had left the question open (Decision No. B-6373/2010 of 20 April 2011, E.4) or did not address the question (Decision No. B-786/2011 of 28 June 2011, E. 2).

<sup>159</sup> Decision No. B-3988/2010 of 31 May 2011.



## Appendices

### 1 Organisation of the Federal Audit

#### Oversight Authority FAOA<sup>160</sup>

Legal form	Public-law institution with separate legal identity	
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 (to 31.12.2011)
		<b>Thomas Rufer (Vice-Chairman, from 1.1.2012: Chairman)</b> , Graduate in Business Administration and Swiss Certified Accountant
		<b>Alfred Stettler</b> , Prof. em., Dr rer. pol., University of Lausanne (to 31.12.2011)
		<b>Sabine Kilgus (Vice-Chairman, from 1.1.2012)</b> , PD Dr., Member of the Board of the Federal Financial Market Supervisory Authority FINMA (until 31.12.2011)
		<b>Renato Fassbind</b> , Dr., US CPA, Senior Advisor to the CEO of Credit Suisse
		<b>Conrad Meyer</b> , Prof., Dr., Professor of Accounting, University of Zurich, President of the Commission Swiss GAAP FER (from 1.1.2012)
		<b>Daniel Oyon</b> , Prof., Dr., Dean of the Faculty of Economics, University of Lausanne (from 1.1.2012)
	Executive Board	<b>Frank Schneider</b> , Chief Executive Officer and Head of Oversight, Swiss Chartered Accountant
		<b>Reto Sanwald</b> , Head of Legal & International, Dr. iur., attorney
		<b>Sébastien Derada</b> , Head of Licensing & Support
Auditor	<b>Swiss Federal Audit Office (SFAO)</b>	

<sup>160</sup>Further information is included on the FAOA website ([www.revisionsaufsichtsbehoerde.ch](http://www.revisionsaufsichtsbehoerde.ch)) and in the FAOA Activity Report 2009, 6 f.

<b>Number of staff</b>	23 employees, representing 17 full-time equivalents (position 31.12.2011). As at the end of the prior year 26 employees, representing 21 full-time equivalents, were employed by the FAOA. The reduction in full-time equivalent positions is due primarily to the departure of trainees and a reduction in workloads.
<b>Funding</b>	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.
<b>Legal function</b>	To ensure the proper provision and quality of audit services.
<b>Responsibilities</b>	Appraisal of licence applications, oversight of the auditors of public companies, accomplishment of international administrative cooperation in the audit oversight area.
<b>Independence/Oversight</b>	The FAOA performs its oversight activities independently but is subject to the oversight of the Federal Council. It reports annually to the Federal Council and the Federal Assembly on its activities.

## 2 Abbreviations

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
CC	Swiss Civil Code of 10 December 1907 (SR 210)
CO	Swiss Civil Code of 30 March 1911 (SR 220)
EAIG	European Audit Inspection Group
EGAOB	European Group of Auditors' Oversight Bodies
EHRA	Federal Commercial Registry Office
EQCR	Engagement Quality Control Reviewer
EU	European Union
FAC	Federal Administrative Court
FAQ	Frequently Asked Questions
FCC	Federal Casino Commission
FDJP	Federal Department of Justice and Police
FHSG	Federal Act of 6 October 1995 on Universities of Applied Sciences
FINMA	Federal Financial Market Supervisory Authority
FOPET	Federal Office for Professional Education and Technology
FOPH	Federal Office of Public Health
FSC	Federal Supreme Court
FSIO	Federal Social Insurance Office
IAASB	International Auditing and Assurance Standards Board
IASB	International Accounting Standards Board
IESBA	International Ethics Standards Board for Accountants
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 Auditing Standards of the Swiss Institute of Cert. Accountants
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

### 3 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: 31.12.2011):

Audits in the field of	Main licence under the AOA: Audit firm	Main licence under the AOA: Lead auditor	Special-law regulatory authority	Additional requirements
Banks <sup>161</sup>	State-regulated audit firm	Audit expert	FINMA	Art. 26 FMSA <sup>162</sup> Art. 3 FMAO <sup>163</sup>
Securities traders <sup>164</sup>	State-regulated audit firm	Audit expert	FINMA	Art. 26 FMSA, Art. 3 FMAO
Collective investments <sup>165</sup>	State-regulated audit firm <sup>166</sup>	Audit expert	FINMA	Art. 26 FMSA, Art. 3 FMAO
Insurers <sup>167</sup>	State-regulated audit firm	Audit expert	FINMA	Art. 26 FMSA, Art. 3 FMAO
Anti-money laundering <sup>168</sup>	Auditor	Auditor	FINMA	Art. 19b AMLA <sup>169</sup>
Central mortgage bond institutions <sup>170</sup>	State-regulated audit firm	Audit expert	FINMA	Art. 26 FMSA, Art. 3 FMAO
Pensions companies <sup>171</sup>	Audit expert <sup>172</sup>	Audit expert	(FSIO)	–
Health insurance companies <sup>173</sup>	Audit expert	Audit expert	(FOPH)	–
Casinos <sup>174</sup>	Audit expert	Audit expert	FCC	Art. 75 CO <sup>175</sup>

<sup>161</sup> Banking Act of 8 November 1934 (BA; SR 952.0).

<sup>162</sup> Financial Market Supervision Act of 22 June 2007 (FMSA; SR 956.1).

<sup>163</sup> Financial Market Auditing Ordinance of 15 October 2008 (FMAO; SR 956.161).

<sup>164</sup> Stock Exchange Act of 24 March 1995 (SEA; SR 954.1).

<sup>165</sup> Collective Investment Schemes Act of 23 June 2006 (CISA; SR 951.31).

<sup>166</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 (C.f. 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 (C.f. Art. 6 FMAO).

<sup>167</sup> Insurance Supervision Act of 17 December 2004 (ISA; SR 961.01).

<sup>168</sup> Anti-Money Laundering Act of 10 October 1997 (AMLA; SR 955.0).

<sup>169</sup> Applies only to the auditing of financial intermediaries that are directly subject to supervision by FINMA. Self-regulatory organisations may define differing conditions for audit firm licensing with respect to their members.

<sup>170</sup> Mortgage Bond Act (MBA) of 25 June 1930 (MBA; SR 211.423.4).

<sup>171</sup> Federal Act of 25 June 1982 relating to Occupational, Survivors' and Disability Pensions (OPA; SR 831.40).

<sup>172</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; SR 831.441.1).

<sup>173</sup> Federal Act of 18 March 1994 relating to Health Insurance (HIA; SR 832.10).

<sup>174</sup> Casino Act of 18 December 1998 (CA; SR 935.52).

<sup>175</sup> Casino Ordinance of 24 September 2004 (CO; SR 935.521).

## 4 List of state-regulated audit firms

Position: 31 December 2011

### Fully licensed

500003	PricewaterhouseCoopers AG	Zürich
500012	T & R AG	Gümligen
500038	Bankrevisions- und Treuhand AG	Zürich
500149	OBT AG	St. Gallen
500168	Mäder + Baumgartner Treuhand AG	Neuhausen
500241	Mazars Coresa	Genève
500420	Deloitte AG	Zürich
500498	PKF Wirtschaftsprüfung AG	Zürich
500505	Treuhand- und Revisionsges. Mattig-Suter	Schwyz
500646	Ernst & Young AG	Basel
500705	BDO AG	Zürich
500762	Balmer-Etienne AG	Luzern
500770	Intercontrol AG	Zürich
501091	Provida Wirtschaftsprüfung AG	St. Gallen
501382	Berney & Associés SA	Genève
501403	KPMG AG	Zürich
501470	Ferax Treuhand AG	Zürich
501570	Fiduciaire FIDAG SA	Martigny
501839	Grant Thornton AG	Zürich

### Provisionally licensed

500436	Refidar Moore Stephens	Glattbrugg
502658	Treureva AG	Zürich

## 5 Registration of Swiss audit firms in the EU<sup>176</sup>

Position: 31 December 2011

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)	Deloitte AG, Ernst & Young AG, KPMG AG, PwC AG (4)
Finland (The Auditing Board of the Central Chamber of Commerce of Finland)	Ernst & Young AG (1)
France (Haut Conseil du Commissariat aux Comptes)	Ernst & Young AG, KPMG AG, PwC AG (3)
Ireland (Irish Auditing & Accounting Supervisory Authority)	Ernst & Young AG, KPMG AG, PwC AG (3)
Italy (CONSOB)	Ernst & Young AG, KPMG AG, PwC AG (3)
Liechtenstein (Finanzmarktaufsicht FMA)	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)
Netherlands (Netherlands Authority for the Financial Markets)	Ernst & Young AG (1)
Spain (Accounting and Auditing Institute ICAC)	PwC AG (pending) (1)
Sweden (Swedish Supervisory Board of Public Accountants)	Ernst & Young AG, KPMG AG, PwC AG (pending) (3)

<sup>176</sup>Source: Reports submitted to the FAOA by the audit firms concerned. 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).

## 6 Financial statements of the FAOA

### Balance sheet

(in CHF)

	Note	31.12.2011	31.12.2010
Cash and cash in hand	5	5'943'113	6'016'301
Receivables	6	176'192	178'904
Work-in-progress	7	314'000	155'357
Prepayments	8	70'288	65'957
<b>Current assets</b>		<b>6'503'593</b>	<b>6'416'519</b>
Tangible fixed assets	9	307'807	299'725
Intangible fixed assets	10	63'036	120'174
Investments	11	71'236	71'091
<b>Non-current assets</b>		<b>442'079</b>	<b>490'990</b>
<b>Total assets</b>		<b>6'945'672</b>	<b>6'907'509</b>
Short-term liabilities relating to services		116'698	48'784
Liabilities to state-regulated audit firms	12	723'440	–
Social security liabilities		19'903	45'604
Short-term provisions	13	157'500	200'020
Accruals	14	273'591	238'314
Accrued licensing fees	16	615'060	1'832'240
<b>Current liabilities</b>		<b>1'906'192</b>	<b>2'364'962</b>
Accrued licensing fees	16	539'480	1'053'440
<b>Non-current liabilities</b>		<b>539'480</b>	<b>1'053'440</b>
Reserves	17	4'500'000	3'489'107
<b>Capital and reserves</b>		<b>4'500'000</b>	<b>3'489'107</b>
<b>Total liabilities</b>		<b>6'945'672</b>	<b>6'907'509</b>

## Income statement

(in CHF)

	Note	1. 1. 2011 –31. 12. 2011	1. 1. 2010 –31. 12. 2010
Oversight charges		2'036'560	2'890'001
Inspection fees		1'202'203	1'215'657
Licensing fees	18	585'200	698'400
Commission on internet payments		-34'276	-39'684
Reimbursement of licensing fees		-41'600	-148'350
Accrual of licensing fees 2011		-100'800	-558'620
Release of accrued licensing fees from prior years		1'831'940	1'692'560
Other income		66'737	91'800
<b>Net revenues</b>		<b>5'545'964</b>	<b>5'841'764</b>
Personnel expense	19	-3'781'867	-4'083'053
Operating expense	20	-660'714	-742'160
Depreciation	9, 10	-147'773	-132'776
<b>Operating profit</b>		<b>955'610</b>	<b>883'775</b>
Financial income		55'283	71'281
<b>Financial result</b>		<b>55'283</b>	<b>71'281</b>
Transfer to reserves (net)	17	-1'010'893	-955'056
<b>Profit/loss</b>		<b>–</b>	<b>–</b>

**Cash flow statement**

(in CHF)

	Note	1.1.2011 – 31.12.2011	1.1.2010 – 31.12.2010
Transfer to reserves	17	1'010'893	955'056
Depreciation of fixed assets	9, 10	147'773	132'776
Release of licensing fees (long-term)	16	-513'960	-1'273'520
Increase/decrease in debtors	6	2'712	-63'843
Increase/decrease in work-in-progress	7	-158'643	20'643
Increase/decrease in prepayments	8	-4'331	15'525
Increase/decrease in liabilities	12	765'653	-125'757
Increase/decrease in short-term provisions	13	-42'520	-89'551
Increase/decrease in accruals	14	35'277	164'814
Increase/decrease in accrued licensing fees (short-term)	16	-1'217'180	139'680
<b>Net cash flows from operating activities</b>		<b>25'674</b>	<b>-124'177</b>
Acquisition of tangible fixed assets	9	-78'235	-68'193
Acquisition of intangible fixed assets	10	-20'481	–
Acquisition of investments	11	-146	-163
<b>Net cash flows from investing activities</b>		<b>-98'862</b>	<b>-68'356</b>
<b>Change in cash and cash in hand</b>		<b>-73'188</b>	<b>-192'533</b>
Cash and cash in hand at the start of the year	5	6'016'301	6'208'834
<b>Cash and cash in hand at year end</b>	<b>5</b>	<b>5'943'113</b>	<b>6'016'301</b>

**Change in capital and reserves**

(in CHF)

	1.1.2011 – 31.12.2011	1.1.2010 – 31.12.2010
Opening balance per 1.1.	3'489'107	2'534'050
Transfer to reserves	1'035'893	980'057
Pension fund contribution	-25'000	-25'000
<b>Balance per 31.12.</b>	<b>4'500'000</b>	<b>3'489'107</b>

## Notes to the 2011 financial statements

### 1 Operating activities

The Federal Audit Oversight Authority (FAOA) has its registered office at Bundesgasse 18 in Berne. It serves as a licensing body and administers a public register of the individuals and firms who provide audit services as defined by the Audit Oversight Act (AOA). Further, it oversees the audit firms that provide audit services to public companies.

The FAOA was founded on 1 November 2006 and began its operating activities on 1 September 2007. The FAOA is a public-law institution and a separate legal entity. The FAOA conducts its activities independently, organises itself, and finances itself entirely from the fees paid by service users and the charges paid by state-regulated audit firms. The FAOA is autonomous in its organisation and management and maintains its own accounts.

Its function is regulated by the Audit Oversight Act of 16 December 2005 (AOA; SR 221.302). The aim of the Audit Oversight Act is to ensure the proper provision and quality of audit services.

The FAOA employed 17 full-time equivalents as at 31 December 2011 (prior year 21). The reduction compared to the prior year is due primarily to a reduction in traineeships.

### 2 Accounting policies

#### 2.1 Introduction

This financial report of the FAOA was prepared in accordance with the requirements of the International Public Sector Accounting Standards (IPSAS), subject to Article 662a–663b of the Swiss Civil Code (according to Art. 35 para. 2 AOA).

This financial report was approved by the Board of Directors on 27 February 2012. The attached financial statements are the entity financial statements for the financial year comprising calendar year 2011 with a balance sheet date of 31 December 2011, and include comparatives. The reporting currency is Swiss Francs (CHF).

Unless otherwise stated, assets and liabilities are valued at historical cost, which normally represents nominal value. Revenues and expenses are booked in the period in which they accrue.

The amounts stated in the financial statements are rounded to the nearest Swiss Franc and can therefore include immaterial rounding differences.

#### 2.2 Cash and cash in hand

Cash and cash in hand comprises of petty cash, current accounts at financial institutions and an investment account at the Federal Finance Administration (FFA). Under Art. 36 para. 1 AOA the FAOA is obliged to deposit excess funds with the Federal Administration.

The amounts are stated at nominal values.

#### 2.3 Receivables relating to services

Receivables are stated at nominal values after allowance for possible impairments.

#### 2.4 Work-in-progress

Work-in-progress relating to inspections is valued using the applicable daily rates per Art. 39 para. 2 AOO.

#### 2.5 Tangible fixed assets

Tangible fixed assets are accounted for at cost less accumulated depreciation. Depreciation is calculated on a linear basis over the expected useful life of the asset.

Asset category	Useful life (years)
Furniture and furnishings	10
Office equipment, IT equipment (hardware)	3
Fixtures and fittings	10

The residual value, useful life and method of depreciation of a tangible fixed asset is checked at each balance sheet date and amended if appropriate.

Where the book value of a tangible fixed asset exceeds the recoverable amount of that asset the difference is booked to the income statement as an impairment charge.

Tangible fixed assets disposed of are written-off at book value. Revenues arising upon the disposal of tangible fixed assets are disclosed separately in the income statement.

## 2.6 Intangible fixed assets

Intangible fixed assets are accounted for at purchase or production cost, less required write-downs. Depreciation is calculated on a linear basis over the expected useful life of the asset.

Asset category	Useful life (years)
Licensing register software	5
Other software	3

The residual value, useful life and method of depreciation of an intangible fixed asset is checked at each balance sheet date and amended if appropriate.

Where the book value of an intangible fixed asset exceeds the recoverable amount of that asset the difference is booked to the income statement as an impairment charge.

Self-generated goodwill cannot be capitalised.

## 2.7 Investments

Investments are accounted for at market value.

## 2.8 Taxes

The FAOA is exempt from all federal, cantonal and municipal taxes.

## 2.9 Provisions

Provisions include, in particular, short-term liabilities relating to personnel expense.

## 2.10 Leasing

Operating leases which cannot be terminated within one year are disclosed in the notes to the financial statements.

## 2.11 Capital and reserves

The FAOA accumulates reserves necessary for the exercise of its oversight activities, up to a maximum of an annual budget (Art. 35 para. 3 AOA). The accumulation of the reserve takes place over a period of 5 years. This period was completed at the end of 2011. The FAOA received no donated capital upon foundation.

## 2.12 Revenues (fees and oversight charges)

The FAOA charges fees for its rulings, inspections and other services and levies a charge upon state-regulated audit firms to cover any costs not covered by such fees. The fees and charges are set out in section five of the Audit Oversight Ordinance (AOO).

Fee income for the licensing of audit firms is accrued over a period of 5 years. Fee income for the licensing of individuals is taken directly to income as from 2011 and not, as previously, accrued over a period of 5 years. Fee reimbursements are charged directly to income.

Oversight charges are booked to income upon invoicing.

## 2.13 Financial result

The financial result comprises interest income and interest expense. Interest is booked on an accrual basis. The FAOA holds no derivative financial instruments and does not use hedging.

## 2.14 Change in accounting policies

Fees for the licensing of individuals are now taken directly to income upon receipt and not, as previously, accrued over a period of 5 years (see section 2.12 above).

### **3 Information regarding risk assessment (Art. 663b CO)**

#### **3.1 Information regarding risk assessment**

The Executive Board is responsible for the internal control system and for the risk assessment related to this. The Executive Board performed and documented a risk assessment on 19 December 2011. This resulted in no adjustment to the previous assessment made with an external advisor. The internal control system of the FAOA is amended to take account of the risk assessment as appropriate.

The following financial risks are relevant to the FAOA:

#### **3.2 Credit risk**

The revenues of the FAOA are generated by charges and fees on those providing audit services. Reminders are sent in the case of late payment. Legal action is taken if appropriate.

#### **3.3 Liability risk**

There are no liability exclusions provided by law.

### **4 Estimation uncertainty**

In line with generally accepted accounting standards, the preparation of the financial statements requires the use of estimates and assumptions. These affect the stated amounts of assets and liabilities and the disclosed amounts of contingent assets and liabilities as at the balance sheet date, as well as the stated amounts of income and expense. Although the Executive Board makes these estimates to the best of their knowledge, having due regard for current events and possible future FAOA measures, actual results could differ from the amounts estimated.

## Explanatory information on individual financial statement items

### 5 Cash and cash in hand

	2011	2010
Cash in hand	260	206
PostFinance accounts	89'397	245'414
Investment account at Federal Finance Administration FFA	5'853'456	5'770'681
<b>Total cash and cash in hand</b>	<b>5'943'113</b>	<b>6'016'301</b>

### 6 Receivables

	2011	2010
Licence fee receivables	103'038	102'250
Yellowpay receivables	72'939	75'526
Other receivables	215	1'128
<b>Total receivables relating to services</b>	<b>176'192</b>	<b>178'904</b>

No debts were written-off and no bad debt provisions were established in either the financial year 2011 or the prior year.

### 7 Work-in-progress

	2011	2010
Work-in-progress	314'000	155'357
<b>Total work-in-progress</b>	<b>314'000</b>	<b>155'357</b>

Work-in-progress comprises of inspection fees yet to be invoiced.

### 8 Prepayments

	2011	2010
Prepayments	70'288	65'957
<b>Total prepayments</b>	<b>70'288</b>	<b>65'957</b>

Prepayments represent payments made in advance for expenses of the following year.

## 9 Tangible Fixed assets

	Furniture and furnishings	Office equipment, IT equipment (hardware)	Fixtures and fittings	Total 2011	Total 2010
<b>Acquisition costs</b>					
Opening balance	281'110	57'702	149'173	487'985	419'792
Acquisitions	17'269	60'966	–	78'235	68'193
Disposals	–	-42'447	–	-42'447	–
<b>Closing balance</b>	<b>298'379</b>	<b>76'221</b>	<b>149'173</b>	<b>523'773</b>	<b>487'985</b>
<b>Accumulated depreciation</b>					
Opening balance	-98'554	-52'628	-37'078	-188'260	-131'694
Acquisitions	-29'838	-25'398	-14'917	-70'153	-56'566
Disposals	–	42'447	–	42'447	–
<b>Closing balance</b>	<b>-128'392</b>	<b>-35'579</b>	<b>-51'995</b>	<b>-215'966</b>	<b>-188'260</b>
<b>Net book value</b>	<b>169'987</b>	<b>40'642</b>	<b>97'178</b>	<b>307'807</b>	<b>299'725</b>

At the balance sheet date there was no indication that tangible fixed assets were impaired.

There are currently no tangible fixed assets that are restricted, subject to rights of disposal or pledged.

The fire insurance value of tangible fixed assets at 31 December 2011 was CHF 400'000 (prior year CHF 400'000).

The increase of CHF 60'966 in the cost of office and IT equipment is due to the purchase of new IT hardware. The fully depreciated hardware this replaced was booked out.

## 10 Intangible fixed assets

	Software register and administration	Other software	Total 2011	Total 2010
<b>Acquisition costs</b>				
Opening balance	343'741	93'818	437'559	437'559
Acquisitions	–	20'482	20'482	–
Disposals	–	-13'374	-13'374	–
<b>Closing balance</b>	<b>343'741</b>	<b>100'926</b>	<b>444'667</b>	<b>437'559</b>
<b>Accumulated depreciation</b>				
Opening balance	-225'611	-91'774	-317'385	-241'175
Acquisitions	-68'748	-8'872	-77'620	-76'210
Disposals	–	13'374	13'374	–
<b>Closing balance</b>	<b>-294'359</b>	<b>-87'272</b>	<b>-381'631</b>	<b>-317'385</b>
<b>Net book value</b>	<b>49'381</b>	<b>13'654</b>	<b>63'036</b>	<b>120'174</b>

At the balance sheet date there was no indication that intangible fixed assets were impaired.

There are currently no intangible fixed assets that are restricted, subject to rights of disposal or pledged.

The increase of CHF 20'482 in the cost of other software is due to the purchase of standard software (Windows 7). The fully depreciated software this replaced was booked out.

## 11 Investments

In connection with the rent of offices at Bundesgasse 18 the FAOA has a tenant deposit account at the Valiant Bank AG to the amount of CHF 71'236.

## 12 Liabilities to state-regulated audit firms

The FAOA levies an annual oversight charge upon state-regulated audit firms (see section 2.12). An on account amount is charged at the beginning of the year. Unused on account amounts are refunded to the state-regulated audit firms in the following year. The amount of CHF 723'440 (prior year CHF 0) will be credited to the state-regulated audit firms in 2012.

### 13 Short-term provisions

	2011	2010
Personnel expense liabilities	150'000	200'020
Provision for third party compensation	7'500	–
<b>Total short-term provisions</b>	<b>157'500</b>	<b>200'020</b>

Holiday, accrued flexible working hour and overtime entitlements are calculated and accrued according to individual employment terms.

A provision for compensation was established in connection with FAOA rulings subject to third party appeal (in particular, licence application rejections).

### 14 Accruals

	2011	2010
Various accruals	273'591	238'314
<b>Total accruals</b>	<b>273'591</b>	<b>238'314</b>

Accruals include, in particular, accruals in relation to personnel expense and accruals for the Activity Report 2011.

### 15 Operating leases

	2011	2010
Minimum payments within one year	10'740	14'940
Minimum payments in years 2 to 6	52'805	6'225

Operating leases comprise contracts made with Triumph-Adler for multi-purpose equipment. The contracts which expired in 2011 could be re-negotiated to significantly more favourable terms. The operating leases have a total term of 6 years (prior year 5 years).

The FAOA has no finance leases.

### 16 Accrued licensing fees

	2011	2010
Accrued licensing fees (short-term)	615'060	1'832'240
Accrued licensing fees (long-term)	539'480	1'053'440
	<b>1'154'540</b>	<b>2'885'680</b>

Fee income from the licensing of audit firms, as well as individuals (2007 to 2010), is accrued over a period of 5 years.

### 17 Reserves

	2011	2010
Reserves	4'500'000	3'489'107
<b>Total reserves</b>	<b>4'500'000</b>	<b>3'489'107</b>

According to Art. 35 para. 3 AOA the FAOA may accumulate a reserve for the exercise of its oversight activities, up to a maximum amount of an annual budget. As at 31 December 2011 the reserve had reached its planned level of CHF 4.5 million.

### 18 Licensing fees

	2011	2010
Licensing fees individuals	456'200	506'400
Licensing fees audit firms	129'000	192'000
<b>Total licensing fees</b>	<b>585'200</b>	<b>698'400</b>

### 19 Personnel expense

	2011	2010
Staff compensation and Board member fees	2'881'960	3'224'169
Employer contributions	565'074	533'927
Other personnel expense	253'258	238'231
Third party personnel costs	81'575	86'726
<b>Total personnel expense</b>	<b>3'781'867</b>	<b>4'083'053</b>

Employer contributions comprise payments relating to national insurance (state pension, invalidity, income compensation), occupational pension schemes, work-related accident insurance and daily sickness allowance insurance. A contribution of CHF 25'000 made to the employer contribution reserve of the FAOA pension fund is included above.

In the reporting year third party personnel costs include, in particular, external translation service charges.

## 20 Operating expense

	2011	2010
Accommodation	177'040	175'002
Minor capital expenditure, fixed asset maintenance and leasing	18'087	25'988
Administrative expense	88'573	85'972
IT expense	199'575	244'853
Other operating expense	177'439	210'345
<b>Total operating expense</b>	<b>660'714</b>	<b>742'160</b>

The reduction in other operating expense is primarily due to the expense of CHF 45'000 incurred in connection with the FAOA seminar of 17 November 2010. The corresponding revenue, also amounting to CHF 45'000, was shown as «other income» in 2010. As in the prior year, a membership fee of around CHF 13'000 was paid to the International Forum of Independent Audit Regulators (IFIAR).

## 21 Contingencies

At the balance sheet date there were no contingent liabilities and in particular no pending or threatened claims for damages.

## 22 Related party transactions

### 22.1 Definition of «related parties»

Related parties can be entities or individuals who can influence the FAOA or can be influenced by them. At the FAOA the following groups are defined as related:

- The Federal Administration within the meaning of Art. 6 Government and Administration Ordinance (RVOV)
- Swisscom, Post, Swiss Federal Railways
- Members of the Board of Directors
- Members of Management, respectively the Executive Board

All transactions with related individuals and entities were entered into on the basis of normal customer, respectively supplier, relationships and at arm's length terms.

### 22.2 Particular relationship to the Federal Administration

The Federal Audit Oversight Authority, a public-law institution with separate legal identity, is organisationally attached to the Federal Administration. As such, the Federal Administration can influence the FAOA in many ways:

- The AOA is a federal law. The AOO and other regulations are enacted by the Federal Council.
- The Federal Council elects the Board of Directors, appoints the Chairman and Vice-Chairman, determines compensation and approves the choice of Chief Executive Officer.
- As auditor of the FAOA, the Swiss Federal Audit Office audits the oversight authority in accordance with the Federal Auditing Act.
- The Federal Audit Oversight Authority is required to invest excess funds with the Federal Administration at market interest rates (Art. 36 para. 1 AOA).

If required for liquidity reasons, the Federal Administration grants the FAOA loans at market interest rates (Art. 36 para. 2 AOA). The FAOA is exempt from all federal, cantonal and municipal taxes (Art. 37 AOA).

## 22.3 Remuneration of the Board of Directors and Management

In CHF thousands

	2011	2010
<b>Board of Directors</b>		
Fees of Chairman	110	110
Fees of Vice-Chairman	75	75
Fees of other members	90	90
Social security contributions <sup>1</sup>	0	0
<b>Total compensation of the members of the Board of Directors</b>	<b>275</b>	<b>275</b>
<b>Chief Executive Officer and Executive Board</b>		
Salary of Chief Executive Officer	247	247
Other benefits of Chief Executive Officer <sup>2</sup>	32	27
Salaries of other members <sup>3</sup>	326	338
Other benefits of other members	32	36
Social security contributions <sup>4</sup>	107	112
<b>Total compensation of the members of the Executive Board</b>	<b>744</b>	<b>760</b>

As at 1 January 2012, staff salaries were increased by a general inflation adjustment of 1%. Individual performance-based salary increases were made in addition.

### 23 Events after the balance sheet date

No events have occurred since the balance sheet date (31 December 2011) which would impact the informational value of the 2011 financial statements.

- <sup>1</sup> All social security contributions (employer and employee) are borne by the members of the Board of Directors.
- <sup>2</sup> Includes additional taxable benefits such as bonuses and non-mandatory child allowances. Prior year amounts have been adjusted for comparability purposes.
- <sup>3</sup> Mr. Sébastien Derada has been a member of the Executive Board since 1 June 2011.
- <sup>4</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.



## ***Report of the statutory auditor on the limited statutory examination***

### ***to the Board of Directors of the Federal Audit Oversight Authority in Bern***

As statutory auditor according to art. 32 of the Auditor Oversight Act (SR 221.302), we have examined the financial statements (balance sheet, income statement, cash flow statement, statement of changes in equity, and notes) of the Federal Audit Oversight Authority for the year ended 31 December 2011.

These financial statements are the responsibility of the Management. Our responsibility is to perform a limited statutory examination on these financial statements. The Swiss Federal Audit Office is independent according to the Swiss Federal Audit Office Act (SR 614.0).

We conducted our examination in accordance with the Swiss Standard on the Limited Statutory Examination. This standard requires that we plan and perform a limited statutory examination to identify material misstatements in the financial statements. A limited statutory examination consists primarily of inquiries of company personnel and analytical procedures as well as detailed tests of company documents as considered necessary in the circumstances. However, the testing of operational processes and the internal control system, as well as inquiries and further testing procedures to detect fraud or other legal violations, are not within the scope of this examination.

Based on our limited statutory examination, nothing has come to our attention that causes us to believe that the financial statements do not comply with Swiss laws and regulations.

Bern, 1 March 2012

SWISS FEDERAL AUDIT OFFICE

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Licensed Audit Expert

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Original text German





