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Federal Audit Oversight Authority FAOA

# Activity Report 2013



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# Activity Report 2013

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## Foreword

The FAOA has the duty to safeguard and foster audit quality within the scope of its licensing and oversight activities. In this way the FAOA protects investors and other users of audit reports and contributes to the reliability and credibility of financial reporting.

The FAOA defined how it would meet this statutory duty in its strategy 2012–2015. By the end of 2013 the half-way point in this four year strategic period had been reached. The commentary in this Activity Report shows the progress made by the FAOA in reaching the targets set.

In connection with the strategic aims of the FAOA it should be noted that the FAOA is primarily a legal authority that enforces the audit, independence and quality control standards developed by the profession. Current regulatory projects are aimed not at supplementing professional standards, but rather at making audit oversight more efficient and effective or clarifying the applicability of professional standards.

### State-regulated audit firms

The FAOA currently oversees 22 state-regulated audit firms that are entitled to audit public companies. In this segment trends already seen in prior years have been accentuated further. The large audit firms are using various strategies to counter the largely saturated audit market. On the one hand, costs are being reduced by outsourcing work within Switzerland or abroad. On the other, it is evident that stronger growth is being sought in neighbouring areas, through the acquisition of advisory firms amongst other things. In this environment the FAOA will have to remain alert to ensure that such developments do not negatively impact audit quality in the short or long term. The main instrument will remain the FAOA inspection, with which it is ensured that relevant professional standards are complied with consequently and consistently. The inspections will be coordinated to a greater degree with foreign partner authorities and international organisations in order to protect home and foreign investors participating in the Swiss capital market.

Regulators and investors are increasingly critical of the provision of additional services by audit firms to their audit clients. As of 1 January 2014 the FAOA will therefore amend the duty to report the relationship between audit and additional services, existing since 2010, from the previous 1:3 to 1:1. This will improve the recognition of risk in the independence area. The total prohibition of certain additional services, as is currently being discussed in the European Union, is not up for discussion in Switzerland as at the end of 2013.

FAOA experience shows that the quality of the audit, and consequently the benefit it brings, is generally greater within an appropriate corporate environment. Here the audit committee is very influential. Professional audit committees make sure that the auditor can perform his work independently, with the necessary professional scepticism and without restriction (materiality, audit scope etc.). In this regard, the FAOA still believes that the regulation of audit committees, essential for the Swiss capital market, is lagging behind internationally.

### Independence remains a point of focus

There is no question that the principle of independence is of fundamental importance to the auditing profession. Both the legislator and the general public make high demands on auditor independence. In the reporting year the FAOA has again unfortunately found numerous and sometimes grave breaches of independence. The FAOA will continue to forcefully sanction breaches at all licensed audit firms.

### Limited audit is of great importance

The limited audit has generally proved its worth in Switzerland and has become much more significant due to the threshold increases as per 1 January 2012. The standard on limited audits, jointly developed by the Swiss Association of Certified Accountants and TREUHANDISUISSE, was drafted under the old thresholds. Besides the provision of training seminars and audit handbooks by the professional associations, the FAOA believes that the standard

on limited audits should be reviewed for possible required amendments. As the FAOA has no regulatory competence in this area only the professional associations can together ensure that the standard is updated and applied consistently.

For the limited audit to remain a success there are, however, also challenges for the users of the applicable standards, the auditors. Tests of detail not foreseen under statutory provisions or professional law are still sometimes performed in practice. The additional audit comfort gained often goes beyond the dimensions envisaged by the legislator. This is contrary to the basic idea of the limited audit and should therefore be avoided.

Berne, 23 January 2014



Thomas Rufer  
Chairman of the Board of Directors

### Peer Review

The consultation process on the partial revision of the audit oversight law did not result in a majority in favour of the proposed conceptual reorientation of quality control. This would, on the one hand, have brought relief to audit firms that perform limited audits. On the other, state oversight of audit firms that perform ordinary audits would have been slightly extended. The experience of the FAOA in renewing licences and sanctioning audit failures shows that there is a definite need for action to ensure adequate audit quality at audit firms performing ordinary audits. The FAOA therefore supports every initiative that contributes to this goal (e.g. implementation of a peer review system). Appropriate proposals from the affected professional associations are expected in this regard.



Frank-Oliver Schneider  
Chief Executive Officer



## Key activities 2013

### International cooperation

Following the signature of Memorandums of Understanding with the audit oversight authorities of the USA (PCAOB), Germany and the Netherlands, in 2013 agreements on international cooperation could also be completed with the oversight authorities of France, Liechtenstein and Luxembourg. The agreed upon principle of home oversight that also applies to cooperation with each of these countries provides considerable relief to internationally active Swiss audit firms. Further negotiations are expected to be concluded in 2014.

With regard to the USA, a further joint inspection was performed with the PCAOB in Switzerland. Conversely, under agreed reciprocity the FAOA performed an on-site inspection in the USA of the work of a US audit firm, as it related to a subsidiary of a Swiss group. Against this background, the relationship between the two authorities continued to deepen and develop positively. In the long run the FAOA is striving for the greatest possible PCAOB reliance on its work. After a three year term the Statement of Protocol with the PCAOB expires in April 2014. Early in 2014 the PCAOB Board is expected to decide on the extent of reliance for possible future inspections in Switzerland. The FAOA will first re-assess the situation after this decision.

### Oversight of state-regulated audit firms

In the oversight area the focus remains on the risk-based enforcement of legal and professional requirements. Within the scope of inspections at the 22 state-regulated audit firms the FAOA pays particular attention to required professional scepticism and to strict compliance with independence requirements.

In the reporting year the FAOA completed a total of six inspections at state-regulated audit firms. The three largest audit firms, that each audit more than 50 public companies (so-called «Big 3»), continue to be inspected annually (at 31 December 2013 one inspection was well advanced but not yet complete). In addition to the «Big 3», four other state-regulated audit firms were inspected. Within the scope of the inspections a total of 16 public company audit engagements were inspected (file reviews) alongside internal firm processes.

Of the 20 largest Swiss public companies within the Swiss Market Index (SMI), the FAOA has inspected 15 since the audit oversight law came into force. This represents coverage of 75 percent, or 60 percent based on market capitalisation. Since 2013 the FAOA is annually assessing the quality of the financial audit at the two, from a global perspective, systematically important Swiss banks (G-SIFIs), UBS AG und Credit Suisse Group AG. As mentioned in the last Activity Report, the FAOA has exercised oversight authority over the financial audit in this area since 1 September 2012, in coordination with FINMA.

### Licensing

In contrast to the licensing of individuals, the licensing of audit firms is time-limited and subject to renewal every five years. As the first audit firm licences were granted in 2008 the first licence renewals were pending in 2013. The inspection of internal systems of quality control is central to the renewal process and is performed using a risk-based approach. Audit firms who perform ordinary audits are inspected thoroughly due to the higher professional standards requirements and greater public interest.

In order to make the nature and extent of the internal and external quality control systems of audit firms transparent, the quality control standards they apply are publicised in the public register of the FAOA. One aim of this transparency is to encourage the use of modern quality control systems.



### **Court rulings**

In the reporting year the Federal Administrative Court and the Federal Supreme Court dealt with the practices of the FAOA in six and three rulings respectively. All the decisions of the FAOA were confirmed, though in one case only in the final instance by the Federal Supreme Court.

### **Third party information**

In the reporting year the FAOA received 33 (prior year 35) third party notifications of possible breaches of law or professional law. The notifications led to FAOA fact-finding in each case. Various failures to exercise due care were found and sanctioned. Independence failures and auditing without a proper licence were again the most common types of breach.

«There is no question that the principle of independence is of fundamental importance to the auditing profession.»

# 1 Regulatory developments

## 1.1 Current legislative procedures

### 1.1.1 Bundling of audit oversight

The responsibilities of audit firms from a FAOA perspective differ from those from a FINMA perspective. From a FAOA perspective audit firms check whether the annual financial statements materially comply with accounting standards. For FINMA, however, audit firms constitute an important regulatory instrument, checking whether financial institutions comply with regulatory requirements. Under current law audit firm oversight is still administered by two oversight authorities:

- The FAOA is responsible for the licensing of individuals and firms that provide statutory audit services. In addition, the FAOA exercises oversight over all audit firms entitled to audit public companies.
- FINMA exercises oversight over audit firms that audit financial institutions. FINMA also issues various special law licences for audit services specific to the financial markets, as an extension to the FAOA licence<sup>1</sup>.

In carrying out their respective responsibilities FINMA and the FAOA largely oversee the same audit firms, though the audits performed are in different industries and relate to different roles. To avoid unnecessary duplication both authorities are obliged to coordinate their oversight activities (Art. 22 AOA, Art. 28 FMSA). After around five years' practical experience the cooperation between FINMA and the FAOA certainly shows some successes, but also systemic weaknesses that cannot be eliminated by coordination alone.

The consolidation of oversight responsibilities within one authority will eliminate these basic weaknesses. The FAOA will have new sole responsibility for the oversight of audit firms. Staff resources and technical expertise will be bundled, further professionalising oversight over the audit industry. At the same time, FINMA will gain independence in its dealings with audit firms, which will improve the interchange between the audit firms and FINMA over problems at financial institutions under oversight. Furthermore, duplication can be eliminated and efficiency gains achieved for audit firms.

On 28 August 2013 the Federal Council approved a submission (Message) to the Federal Assembly on the bundling of oversight over audit firms<sup>2</sup>. Parliamentary deliberations began on 24 October 2013. Depending on the progress of discussions, the enactment of the submission can be expected in 2015 at the earliest.

### 1.1.2 Modernisation of the commercial register

The preliminary draft on the amendment of the Swiss Code of Obligations (modernisation of the commercial register) was put out for consultation by the Federal Council from 19 December 2012 to 5 April 2013. Two subject areas within the appendix to the preliminary draft include proposals to change the AOA:

- Quality control: Existing law stipulates that an audit firm may only be licensed if it has an internal system of quality control (Art. 6 para. 1 indent d AOA and Art. 9 para. 1 AOO). Professional law envisages the same obligation. However, an internal system of quality control requires at least two professionals, both of whom have at least the same licence as their audit firm. If only one individual holds such a licence the work of this auditor cannot be inspected by an adequately qualified professional. That being said, audit firms with only one licensed individual can make good the lack of an internal system of quality control by joining, on or before 31 August 2016, an external system of quality control that provides for the regular inspection of audit services by a professional of equal standing (Art. 9 para. 2 in conjunction with Art. 49 para. 2 AOO; so-called «peer review» system).

<sup>1</sup> Cf. in addition Appendix 3

<sup>2</sup> Federal Law Gazette 2013 6857 f. (Message) und 6909 f. (Draft).

Given the most recent developments this rule should be reconsidered: With effect from 1 January 2012 the legislator significantly increased the thresholds separating the ordinary from the limited audit; from CHF 10 million balance sheet total, CHF 20 million sales and 50 full-time employees averaged over the year («10-20-50») to CHF 20 million balance sheet total, CHF 40 million sales and 250 full-time employees averaged over the year («20-40-250», Art. 727 para. 1 section 2 CO). Against this background it can rightly be questioned whether it is sensible to require audit firms with only limited audit engagements and one licensed individual («lone warrior») to subject themselves to external quality control while there is no external quality control at audit firms with ordinary audit engagements, the size and complexity of which generate much greater risk.

For this reason the preliminary draft proposed to widen the scope of FAOA state oversight to cover all audit firms that perform ordinary audits. In return, a waiver from the statutory requirement for internal quality control at firms that perform only limited audits was contemplated. Since it has been evident for some time from the FAOA register whether, and in what way, internal quality control is being conducted, the market is able to draw its own conclusions in relation to audit quality. However, audit firms that do not perform ordinary audits at public companies and financial institutions would have been subject to less rigorous oversight in as much as they would not have been inspected with the same frequency (only every five years instead of three). In addition, the five year licensing requirement within existing legislation would have been waived. Furthermore, the FAOA uses a risk-based approach, which means that the size and complexity of audit engagements is taken account of when determining the scope and depth of an inspection. In other words, more resources are assigned to public company and financial institution engagements than to other engagements.

Most of those participating in the consultation have welcomed the relief proposed for audit firms that provide only limited audits. One professional

association, however, regarded the proposal as a dangerous step back towards the layman audit, which the establishment of the AOA was intended to prevent. Opinions differed on the limited extension of state oversight to cover audit firms that provide ordinary audits. While some responses explicitly or implicitly welcomed this, others were critical, primarily on cost grounds. Although the preliminary draft takes an overall view, many participants commented only on individual aspects of the subject. In this respect the responses are quite heterogeneous.

Based on the results of the consultation the Federal Council concluded on 23 October 2013 that there was currently no majority in favour of a conceptual re-design of audit firm quality control requirements and that the question should be considered separately from the current submission. In the coming months an alternative proposal should be prepared together with the professional associations. In particular, it is to be examined whether audit quality can be assured through a so-called peer review. In such a system the work of the auditor would be assessed by professionals of equal standing under the principle of self-regulation.

- Extra-territorial scope of the AOA: To protect investors in the Swiss capital market, and in line with comparable foreign regulations, the AOA displays extra-territorial properties. Foreign audit firms are subject to FAOA oversight if they audit foreign companies that draw on the Swiss capital market. The scope of domestic audit oversight is thereby reproduced internationally. Article 8 AOA forms the basis of this extra-territorial scope. However, the provision is not yet in force as discussions over cooperation and mutual recognition must first take place with the most significant foreign partner authorities.

The extra-territorial scope of the AOA results in the auditor of an international group being subject to the audit oversight of several countries. To avoid duplication, the licensing requirement and FAOA oversight is waived in two exceptional cases: On the one hand 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); on the other where outstanding bonds are guaranteed by a company whose auditor is subject to audit oversight by the FAOA or a foreign oversight authority recognised by Switzerland (Art. 8 para. 3 AOA).

From the practical experience of the last five years it is apparent, however, that the oversight systems of the affected countries are very heterogeneous in design and that Switzerland is unlikely to be able to recognise the oversight authorities of various countries; in certain countries there is either no oversight authority or there are serious doubts as to whether the authority can be recognised.

It is therefore to be assumed that more foreign audit firms will fail to meet the exception conditions (Art. 8 paras. 2 and 3 AOA) than was originally anticipated by the legislator and will consequently fall under the direct oversight of the FAOA. The exercise of oversight authority abroad may though come up against political, legal and practical (including language) difficulties. Being licensed as a state-regulated audit firm and being inspected abroad by the FAOA will also involve certain costs for the foreign audit firm and therefore also indirectly for the listing of shares and bonds in Switzerland. The interests of investor protection, the exercise of effective and efficient oversight and the competitiveness of the Swiss capital market are thus, to an extent, in conflict with one another.

The preliminary draft aims for modest de-regulation of the extra-territorial scope, particularly for significant subsidiaries and for the issuers of unlisted bonds, without weakening investor protection unnecessarily. All consulted parties favoured the proposed de-regulation. However, the requirements on the auditors of foreign issuers with listed bonds go too far for the majority of respondents as it is feared that this might lead to the market in Swiss Franc-denominated bonds shifting abroad. Investors should therefore be informed «in the appropriate way» (listing prospectus or stock exchange homepage) if the audit of a bond issuer was not performed by a state-regulated audit firm.

With respect to the oversight of foreign auditors, the Federal Council has decided to examine the possibility of additionally using a differentiated approach towards the differing risks of shares and bonds. The corresponding Message can be expected in the summer of 2014. Parallel to this, and also by the summer of 2014, it is to be separately examined whether part of Article 8 AOA (e.g. Art. 8 para. 1 indent a AOA regarding the auditors of foreign share issuers) can be enacted earlier in order to strengthen investor protection in a targeted way and gather initial implementation experience.

## 1.2 Regulatory cost analysis

Businesses create employment and economic value. In so doing they depend on the existence of attractive general conditions. One factor determining the attractiveness and dynamism of a business location is having low strain from state intervention, after taking due account of the benefits of regulation. The Federal Council is constantly seeking to limit the costs businesses incur through regulation. In connection with this and the acceptance of the Fournier and Zuppiger postulates<sup>3</sup> a major project was launched to estimate the costs of regulation in various areas.

In the report of 13 December 2013 on the cost of regulation<sup>4</sup> the Federal Council summarised the results of 13 studies in 15 sectors. The area of accounting and audit was examined by the Zurich University for Applied Sciences (ZHAW), Institute for Public Management, on behalf of the Federal Department of Justice. The increased thresholds (20-40-250), applicable since 1 January 2012, as well as the new accounting law, applicable since 1 January 2013, were thereby already taken into account.

<sup>3</sup> Cf. postulates 10.3429 and 10.3592.

<sup>4</sup> Cf. in addition the summary report of the Federal Council on the costs of regulation at <http://www.seco.admin.ch/themen/02860/04913/04914/index.html?lang=de>.

The introduction to the ZHAW study recalls the purpose and benefits of accounting and audit. It is noted, in particular, that bookkeeping and accounting have been basic management tasks for hundreds of years, not as a «regulatory invention», but rather as an economic necessity. Thus accounting fulfils a range of important functions, whether it is as a way of reducing information asymmetries, as an analytical tool to assess the economic potential of a business, or as the basis for resource allocation. Additionally, many further fields of law are tied to accounting law, e.g. family, inheritance, social security, tax, subvention, oversight and criminal law. Tax law, in particular, is based on the commercial financial statements (authoritative principle) and can, with few exceptions, dispense with its own provisions. Audit law also has various protective goals: At public companies and economically significant businesses the audit serves investor protection in the first instance. Public interest demands an audit in all other economically important businesses. At private companies audits can be required to protect individuals with minority interests. For legal forms with limited liability the audit serves to protect creditors. The estimated gross annual cost of accounting and audit law amounts to CHF 12.4 billion. However, as a major part of this cost is assessed to be an «anyway» cost (a cost that the affected business would have anyway in one form or another), the (net) cost of regulation is significantly lower at around CHF 1.66 billion.

- The largest cost element relates to accounting law. The gross costs are around CHF 11.5 billion. However, around 90 per cent of the gross cost is assessed to be an «anyway» cost, with the result that the cost of regulation is approximately CHF 1 billion. The analysis confirms that accounting law contains relatively few legal regulations and is particularly directed to the requirements of SMEs. With the new accounting law (in force since 1 January 2013) the SME segments are relieved even further. Given the largely low cost of regulation, the low density of regulation and the future administrative relief for SMEs there is no room for improvement with respect to accounting law.

- The gross cost of audit law was estimated to be around CHF 800 million, of which a major part relates to external audit fees (CHF 727 million). Around a quarter of the cost was identified to be an «anyway» cost, since the audit unquestionably serves to safeguard accounting quality. The high proportion of «opting-outs» shows, however, that many SMEs abstain from having an audit on cost grounds. The financial audit finds itself in the conflict between the costs incurred by the audited business and the individual and social benefits resulting from it. The current ordinary audit thresholds, high in comparison with those abroad, take account of this situation as they are based on the economic significance of the business. The majority of SMEs requiring an audit consequently require a limited audit. The costs of a limited audit are substantially lower than those of an ordinary audit, though in some businesses they are nonetheless seen as significant. The costs appear justifiable, however, from a stakeholder protection viewpoint and in terms of general social benefits. In the absence of an audit the board of directors and management would have to carry out considerable control measures of their own to meet their responsibilities, at least within medium to large businesses. Based on this consideration a further increase in thresholds does not appear reasonable.

- The annual cost of regulation with respect to audit oversight law was estimated to be around CHF 5.8 million (oversight CHF 4.6 million, licensing CHF 1.2 million), of which a significant part related to the annual oversight and inspection fees of the FAOA (CHF 3.9 million). Audit oversight is not contested by the consulted audit firms. It is recognised that oversight is a consequence of the inherent independence issue and is linked with cost. The cost of licensing individuals and audit firms is justifiable and relates primarily to licensing fees. The fees and internal costs of state-regulated audit firms as regards licensing, inspection and compliance with quality requirements are significant for the individual firms concerned but generally accepted as a consequence of regulation. Finally, it is to be noted that for the five largest Swiss state-regulated audit firms significant costs arise through the US regulator (PCAOB), as American oversight

is enforced directly under certain circumstances. Recognition of Swiss oversight by the American regulator would result in significant savings here, but this is not within the competence of the Swiss legislator.

The investigations are concerned not only with estimating the costs of regulation but also with identifying measures to reduce those costs. Specifically, in the area of accounting and audit a proposal is made to reconsider the book value consolidation of large, unlisted groups (Art 963b para. 3 CO) and either require compliance with a recognised set of accounting standards (true and fair view), if need be also increasing the relevant thresholds, or abolish the book value consolidation. The question is expected to be taken up within the consultation draft on the 2014 company law revision.



## 2 Oversight

### 2.1 Introduction

The FAOA currently oversees 22 state-regulated audit firms that are permitted to audit public companies<sup>5</sup>. This represents an increase of one audit firm compared to last year. At year end two state-regulated audit firm licence applications were in process. Regulatory changes at FINMA<sup>6</sup> account for this increase, the first since the FAOA began its activities in 2007.

The market structure of the state-regulated audit firms changed only insignificantly in 2013. The three largest audit firms in Switzerland – Ernst & Young AG, KPMG AG and PricewaterhouseCoopers AG – continue to audit the vast majority of Swiss quoted public companies<sup>7</sup>, that is, around 84 percent by number or around 95 percent by market capitalisation. The two mid-sized Swiss audit firms – Deloitte AG und BDO AG – together audit around 10 percent of public companies by number. Six firms are under FAOA oversight voluntarily or due to special law provisions.

To ensure the effectiveness and efficiency of oversight the FAOA continually revises its inspection processes. In so doing account is taken of insights gained from completed inspections and from involvement in international working groups<sup>8</sup>. In this connection, the FAOA contacted individual members of public company audit committees for the first time in 2013. The aim of the discussions was to assess compliance with legal and professional standards<sup>9</sup> on auditor communication with those charged with governance.

### 2.2 Review of inspections 2008 to 2013

#### 2.2.1 Introduction

The second three year FAOA inspection cycle ended with the completion of the 2013 inspections. The big three audit firms had already been inspected six times. The remaining state-regulated audit firms are subject to extensive inspection at least once every three years. As a rule, these had therefore been inspected twice by the FAOA by the end of 2013, though in certain cases more frequent inspections had taken place based on risk considerations.

<sup>5</sup> See Appendix 4 for a complete list of state-regulated audit firms.

<sup>6</sup> Audit firms that audit asset managers of collective investment companies (Art.126 para. 1 indent e CISA; SR 951.31) must hold a licence as a state-regulated audit firm by 28 February 2014 at the latest.

<sup>7</sup> Per FAOA register entries there are 482 public companies (status 16.12.2013). This also includes significant subsidiary companies and issuers of listed bonds.

<sup>8</sup> Cf. section 3.5

<sup>9</sup> Swiss Auditing Standards (SAS) of the Swiss Institute of Certified Accountants, Standards of the PCAOB and the American Institute of Certified Public Accountants (AICPA).



**Figure 1:**

Overview of FAOA inspections and Comment Form findings 2008 to 2013

Categories	Big 3		Other <sup>10</sup>		Total	
	01.04.2008 – 31.12.2013 <sup>11</sup>	of which in 2013	01.04.2008 – 31.12.2013	of which in 2013	01.04.2008 – 31.12.2013	of which in 2013
Number of inspections	18	2 <sup>12</sup>	38	4	56	6
Firm review Comment Form findings	55	2	202	12	257	14
File review Comment Form findings	263	26	257	17	520	43
Number of files inspected <sup>13</sup>	73	11	38	5	111	16

The FAOA had carried out 56 inspections by the end of the reporting period. In so doing files were selected for inspection based on risk. One of the selection criteria was the market capitalisation of public companies. By 31 December 2013 15 out of 20 SMI companies<sup>14</sup> had been subject to a file review, which equates to around 60 per cent of SMI market capitalisation. As from 2013 the quality of the financial audit at the two, from a global perspective, systemically important Swiss Banks (G-SIBs<sup>15</sup>), UBS AG und Credit Suisse Group AG, is being assessed annually by way of a file review. Since 1 September 2012 the FAOA has exercised oversight authority in this area, in coordination with FINMA<sup>16</sup>.

The FAOA already reported in detail on its firm and file review findings in its Activity Reports of 2007 to 2012. The FAOA summarises the findings of the last six years below.

<sup>10</sup> 19 state-regulated audit firms as per Appendix 4.

<sup>11</sup> The FAOA began its inspection activities on 01.04.2008.

<sup>12</sup> The inspection of the third Big 3 audit firm was well advanced in 2013 but the final Comment Form findings are yet to be communicated.

<sup>13</sup> In each file review the FAOA selects the working papers that relate to the audit of the consolidated financial statements (including holding company) and the audit of a significant subsidiary.

<sup>14</sup> As a blue-chip share index the SMI is the most significant Swiss share index and embraces the 20 largest shares from the SPI. Around 85 % of total Swiss market capitalisation falls within the SMI (Cf. <http://www.six-swiss-exchange.com>).

<sup>15</sup> Cf. [www.financialstabilityboard.org](http://www.financialstabilityboard.org) on the definition of «Global Systemically Important Banks (G-SIBs)». The G-SIBs and the «Global Systemically Important Insurers (G-SIIs)» are sub-categories of the «Global Systemically Important Financial Institutions (G-SIFIs)».

<sup>16</sup> Cf. section 1, FAOA Activity Report 2012

## 2.2.2 Quality control trends

Each of the five largest Swiss audit firms basically has a robust quality control system. In comparison with the first inspection cycle (2008–2010) the FAOA now has only isolated findings. Room for improvement occasionally remains in the application of the quality control system or the effectiveness of the quality control guidelines.

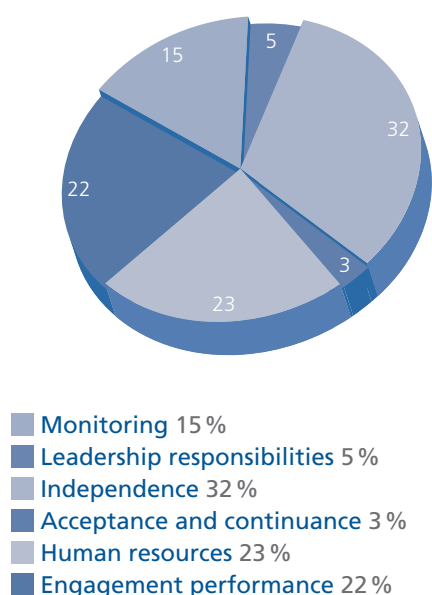
At the other state-regulated audit firms the design quality and effectiveness of quality control systems still varies. An eye particularly needs to be kept on systems maintenance and enhancement. Additionally, more time and staff resources should be allocated to the quality control area in some cases.

### 2.2.2.1 Analysis of firm review findings 2008 to 2013

Firm review findings from all inspections to date are assessed in summary below according to the elements of a quality control system per ISQC 1<sup>17</sup> and statutory licensing conditions:

**Figure 2:**

Type and number of findings at the five largest audit firms (total 108 findings)



The largest number of findings at the five largest audit firms was in the **independence** area. This is a focus area of the firm review. Weaknesses were found particularly in the internal procedures and controls to ensure independence within the client and engagement acceptance and continuance process.

The **human resources** area also produced numerous findings in the past, especially in the areas of goal setting and performance evaluation for partners and staff. In some cases the quality of work performed was not taken account of sufficiently.

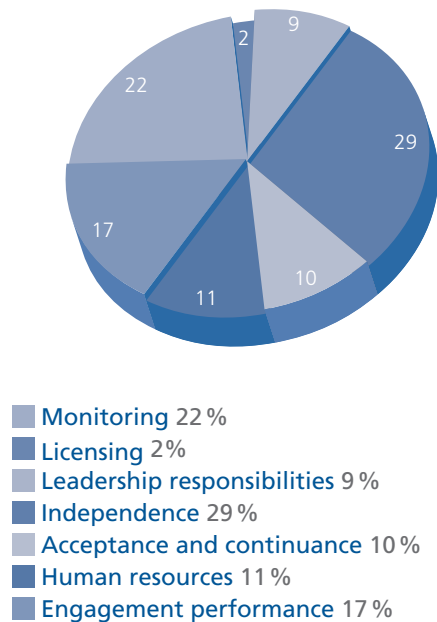
**Engagement performance** findings were raised with respect to process design and internal control effectiveness in the archiving and audit documentation retention areas, and as regards the consultation process. With respect to the latter, more attention should be paid to the appropriateness of form, timing and responsibilities, amongst other things. Findings were also raised repeatedly as regards the objectivity and technical competence of EQCRs on public company audits.

In relation to **monitoring** processes, the FAOA often finds that the scope of monitoring is inappropriate and that the results of monitoring are not adequately taken account of within staff performance evaluations.

<sup>17</sup> «Quality control for audit firms that perform audits and reviews of financial statements, and other assurance and related services engagements», issued by the International Auditing and Assurance Standards Board (IAASB).

**Figure 3:**

Type and number of findings at the smaller state-regulated audit firms (total 149 findings)<sup>18</sup>.



At the smaller audit firms the scope of the FAOA firm review inspection is less than at the five largest audit firms. The reduced scope results from the less complex nature of the quality control processes at these audit firms.

The proportion of findings in the area of **leadership responsibilities for quality within the firm** is almost twice that seen at the five largest audit firms. Beside economic goals, firm leadership does not always give audit quality the necessary attention. Quality matters are to some extent not adequately discussed and communicated.

As at the five largest audit firms, the largest number of findings at the smaller audit firms is in the **independence** area. Here though, the proportion of formal and conceptual deficiencies in independence procedures is far higher. In many cases the design and application of client and engagement acceptance procedures is insufficient.

The proportion of findings in the **monitoring** area is high. Controls to assess the effectiveness of the quality control system are absent or insufficient. With respect to engagement reviews, there are often deficiencies in the method for selecting the engagements for inspection, the scope of the inspection and the composition of the inspection team. Furthermore, in some cases only formalities (such as the existence of a checklist) are checked, more substantive aspects thus being neglected.

The audit programmes and other working aids of the smaller audit firms are sometimes insufficient to implement the requirements of the standards completely. This is often the cause of **engagement performance** deficiencies. There is also often no consultation where this would be expected, no specialist involvement, insufficient engagement quality control review and deficient audit documentation (for example, archiving and retention).

### 2.2.3 Audit quality

Over the last six years there has generally been a steady improvement in audit quality within the inspected files of the five largest audit firms. However, there are sometimes major differences within the same audit firm. Audit quality depends heavily on the partners and staff involved. State-regulated audit firms should therefore place more focus on the consistency of audit quality. On the whole the situation is different at the smaller firms.

Irrespective of audit firm size the findings made in 2013 were not pleasing overall. Areas that had produced numerous findings in the first years of FAOA oversight, such as audit procedures relating to fraud, actually saw significant improvement in subsequent years. In 2013, however, the number of findings in this area increased again. Suitable steps should hence be taken to ensure that agreed improvement measures lead to a lasting, rather than temporary, improvement in audit quality.

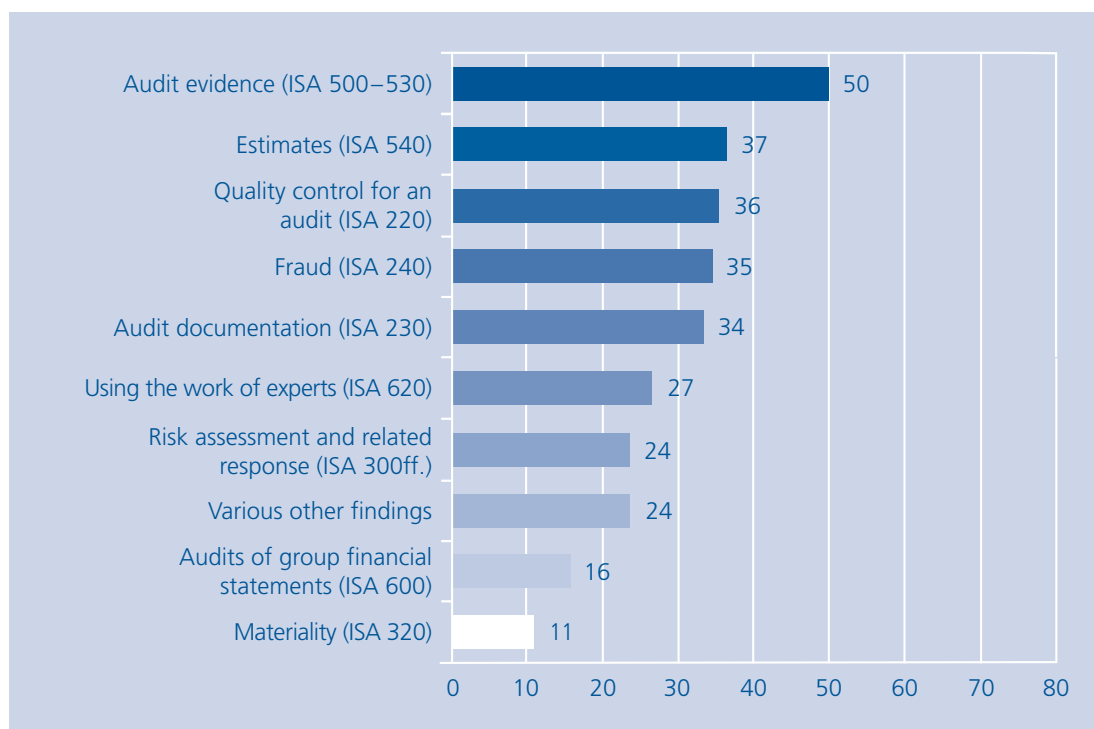
<sup>18</sup> At 31 December 2013 these include the remaining 17 state-regulated audit firms shown in Appendix 4.

### 2.2.3.1 Analysis of file review findings 2008 to 2013

Below is a causal analysis of file review findings<sup>19</sup>.

#### Figure 4:

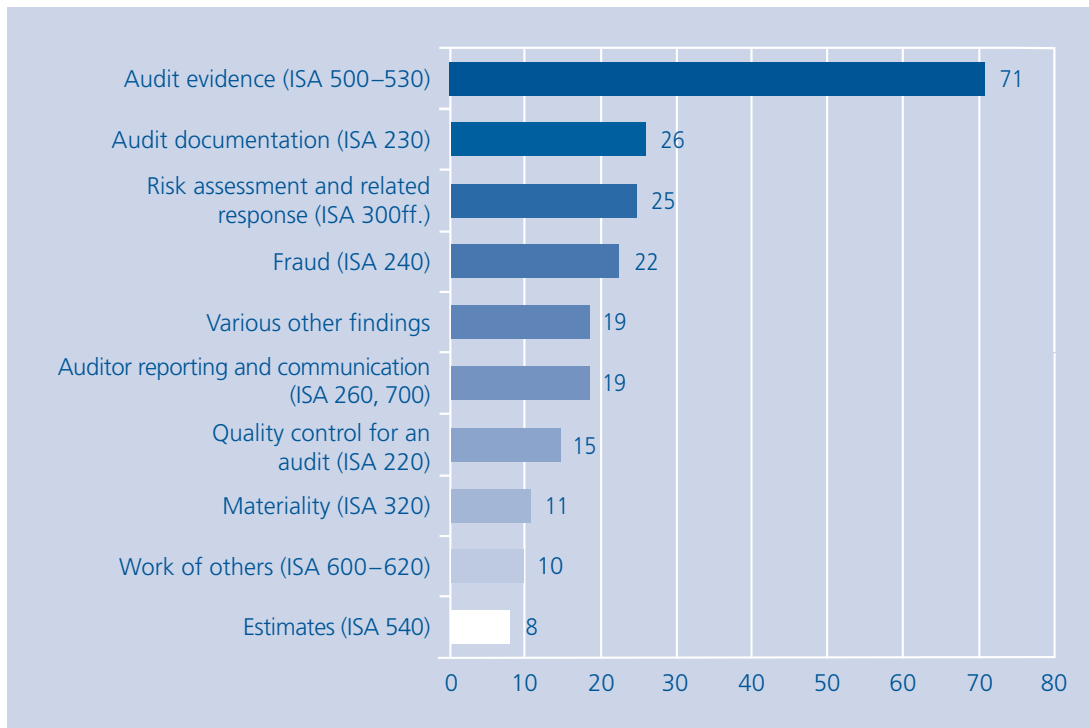
Type and number of findings from the file reviews  
2008–2013 at the five largest audit firms (total 294  
Findings)



<sup>19</sup> For comparability purposes the findings in Figures 4 and 5 that relate to Swiss Auditing Standards or US auditing standards have been allocated to the identical or comparable ISA. The various other findings include findings relating to ISA 200, 210, 260, 550–570, 610 and 700.

**Figure 5:**

Type and number of findings from the file reviews 2008–2013 at the smaller state-regulated audit firms (total 226 Findings)



Findings were most common with respect to audit evidence (ISA 500–530), though the proportion of such findings was higher at the smaller audit firms. Often insufficient or inappropriate audit evidence was gathered to support the audit conclusion.

Deficiencies in audit documentation (ISA 230) and fraud (ISA 240) were found repeatedly at both the large and smaller audit firms. Over the last few years the FAOA has reported significantly less findings in the audit documentation area as these are generally an indication of insufficient audit evidence. Here the international standards' maxim «not documented not done» still applies. The FAOA continued to have numerous findings in relation to the auditor's responsibilities with respect to fraud. On the one hand they relate to fraud risk assessment and on the other to the responses to fraud risks. They include having insufficient discussions with the management of the audited entity and deficient journal entry testing.

There are more findings in the quality control area (ISA 220) at the five largest audit firms than at the smaller audit firms. This is due particularly to the greater complexity of client engagements and the size of the audit team. In such situations engagement performance requirements, for example with regard to direction, supervision, consultation and engagement quality review, are more difficult and consequently more prone to error. The proportion of findings relating to estimates (ISA 540) is also more significant at the larger audit firms. This is because more complex audit areas that include estimates (e.g. financial instruments, intangible assets, provisions) are often selected for detailed inspection at the large public companies.

At the smaller audit firms the proportion of findings relating to risk assessment and response (ISA 300, 315, 330) is greater, fundamental deficiencies in the application of the risk-based audit approach being found consistently. At the largest audit firms findings generally relate to deficiencies in the audit of general IT controls and inappropriate reliance upon tested controls to reduce the level of substantive testing.

As can be seen in figures 4 and 5, findings are also common as regards the audit of consolidated financial statements (ISA 600), the use of experts (ISA 620) and materiality (ISA 320). The audit of consolidated financial statements and materiality are among the inspection focus areas for 2014<sup>20</sup>.

The following areas are often regarded as the cause of FAOA findings («root cause analysis»):

#### – Professional scepticism<sup>21</sup>

The professional scepticism of the auditor is of utmost importance. Given that it represents the fundamental attitude of the auditor it ultimately affects many areas of the audit. The FAOA findings shown in Figures 4 and 5 are often in areas where professional scepticism is particularly significant. It is therefore important that audit firms use targeted measures to promote the professional scepticism of the auditor more strongly.

#### – Team roles

Insufficient or untimely involvement of the engagement leader and the engagement quality reviewer (EQCR) is often noted. This is especially critical in situations where the audit team is not made up of sufficiently qualified staff members. Insufficient industry experience is one possible example, which has a particularly negative impact on audit quality in regulated industries.

#### – Education and training

Inadequate technical knowledge of auditing and accounting standards is a frequent cause of FAOA findings. Tailored and practical staff education and training is a basic pre-requisite for high quality audit services. The size of the audit firm and the number of engagements is thereby often decisive.

#### – Policies and measures

Policies and measures (e.g. rules, guidelines and work programmes) must ensure the application of statutory and professional requirements. If these are inconsistent, vague or inadequate audit quality can be negatively affected.

<sup>20</sup> Cf. section 2.8.

<sup>21</sup> Cf. section 1.4.4.1 FAOA Activity Report 2011.









## 2.3 2013 inspections

The FAOA completed six inspections in the reporting year. As at 31 December 2013 five inspections were not fully complete, which explains the reduction compared to the prior year (13 inspections). In addition, a substantial joint inspection with the PCAOB was carried out at a state-regulated audit firm<sup>22</sup>. The FAOA also carried out an inspection in the USA for the first time. In this case the work of a significant component auditor and the interaction of the component auditor with the Swiss group auditor were assessed as part of a file review.

16 file reviews were performed and completed in 2013. This number was slightly greater than in the prior year taking on-going file reviews into account<sup>23</sup>. The slight increase is explained by the assumption of certain FINMA responsibilities.

### 2.3.1 Firm review findings

A total of 14 firm review findings resulted from the six inspections in 2013. The number of findings was slightly lower than in the prior year.

To supplement the general analysis of firm review findings, some selected findings and trends are discussed below.

#### – Efficiency measures<sup>24</sup>

As a result of stagnating audit fees, audit firms are seeking to adapt their processes to the changed general conditions. In 2013 the FAOA noted a significant increase in internal initiatives to increase efficiency. The outsourcing of homogeneous audit processes to a shared service centre within the network in the home country («on-shoring») or abroad («off-shoring») has shown significant development. The nature and scope of this outsourcing varies considerably between the state-regulated audit firms.

The outsourcing of simple audit work can be advantageous. However, there are also risks. For example, lack of customer contact and cultural differences between individual staff members are factors that could negatively impact quality. In addition, compliance with statutory provisions (data protection, auditor confidentiality etc.) must

be safeguarded. To counter these risks the FAOA assesses the nature and scope of outsourced audit work and the controls associated with it. Internal controls must ensure that the outsourced services meet prevailing quality standards and statutory requirements. The trend towards outsourcing is probably still in a starting phase. The FAOA will therefore examine the outsourcing of work as a focus area in its 2014 inspections<sup>25</sup>.

#### – Provision of additional services

Compared to the prior year the ratio of additional fees to audit fees at the 100 largest public companies changed little in 2013. However, fees for additional services were still higher than audit fees at certain public companies<sup>26</sup>.

In Switzerland the provision of additional services to audit clients is not forbidden in principle. However, if the audit fee is disproportionate to additional fees the auditor may have an excessive interest in continuing to provide lucrative additional services. Auditor independence is thus threatened and, at least in appearance, the willingness of the auditor to challenge the audit client at the appropriate time may be questioned. This risk must be eliminated or reduced to an acceptable level.

In an environment in which the consulting business of the larger state-regulated audit firms is expanding significantly it is necessary to have robust processes and controls over the acceptance of additional services. Further efforts on the part of audit firms are essential in this area given that the FAOA has consistently identified deficiencies here. The amended reporting requirement, effective as per 1 January 2014, will enable the FAO to carry out targeted, risk-based examinations<sup>27</sup>.

<sup>22</sup> Cf. section 3.3.2 and 3.3.3.

<sup>23</sup> Cf. section 1.7 FAOA Activity Report 2012.

<sup>24</sup> Cf. section 1.3.2 FAOA Activity Report 2011.

<sup>25</sup> Cf. section 2.8.

<sup>26</sup> This analysis is based on the fees for 2012 disclosed in the annual reports of the audited public companies.

<sup>27</sup> Cf. section 2.7.1.2.

### 2.3.2 File review findings

The number of findings per file review fell slightly from 2.8 to 2.7 in 2013. To supplement the general analysis of file review findings, some selected findings and trends are discussed below:

#### – Audit of consolidated financial statements

The FAOA identified various findings with respect to the role of the auditor as group auditor. Further efforts are needed here to ensure a robust audit of the consolidated financial statements. This relates particularly to gaining an understanding of components, determining significant components and materiality, as well as to the assessment of audit evidence obtained<sup>28</sup>.

In auditing letter-box companies<sup>29</sup> auditing standards are inadequately applied to some extent. The FAOA has in part found that audit firm guidelines contain requirements that contradict the standards on group audits (e.g. ISA 600). For instance, non-transferable responsibilities with respect to the direction, supervision and performance of the engagement were delegated to one or more component auditor. The auditing standards on quality control (ISA 220) and documentation (ISA 230) were only partly met. On 23 October 2013 the FAOA published an FAQ to clarify the roles and duties of the group auditor in the audit of letter-box companies<sup>30</sup>. The audit of letter-box companies will be a special focus area for the 2014 FAOA inspections<sup>31</sup>.

#### – Audit of banks and insurance companies

The FAOA findings from audits in the financial services market are similar in many respects to those from audits in other industries. However, differing findings did result in the following areas:

– In case of mass transactions, common in the financial services industry, the auditor has to perform extensive controls testing. Furthermore, information technology and related controls play a major role. By assessing the effectiveness of these controls the auditor can reduce the nature and scope of substantive testing. During its inspections the FAOA has found, however, that in individual cases control reliance was inappropriate. In such cases the substantive testing performed was consequently insufficient.

– At the larger banks and insurance companies extensive reliance is often placed on internal audit. It was found that the objectivity, competence and work of internal audit were not always assessed sufficiently. It is especially important that a comprehensive assessment of internal audit is made where reliance is placed upon their work in significant risk areas.

– The auditor often involves a specialist in the audit of significant financial statement line items (e.g. insurance technical reserves). In individual cases, however, the manner and extent to which specialist work was directed, supervised and documented were inappropriate.

<sup>28</sup> Cf. section 1.4.4.2 FAOA Activity Report 2011.

<sup>29</sup> Letter-box companies are companies domiciled in Switzerland whose business transactions and accounting and management functions, amongst other things, mostly take place or are situated abroad.

<sup>30</sup> See [www.revisionsaufsichtsbehoerde.ch](http://www.revisionsaufsichtsbehoerde.ch) (Dienstleistungen/Häufige Fragen/staatlich beaufsichtigte Revisionsunternehmen).

<sup>31</sup> Cf. section 2.8.

## 2.4 Proceedings and preliminary fact-finding

In addition to routine inspections the FAOA also conducts event-driven preliminary fact-finding and proceedings at state-regulated audit firms. In doing so the FAOA considers, in particular, plausible information from third parties.

In the reporting year the FAOA received four notifications from third parties relating to state-regulated audit firms. Compared to the prior year (eight notifications) the number of notifications was greatly reduced.

Since inspection activities began in 2008, 22 proceedings have been conducted as part of the FAOA's oversight of state-regulated audit firms<sup>32</sup>:

- Six proceedings were against audit firms. In three cases the FAOA had identified breaches of independence requirements. In two cases measures agreed with the FAOA after its first inspection were not implemented or not implemented on a timely basis. In one case the statutory reporting obligation<sup>33</sup> was not met.

- 16 proceedings were against individuals with a FAOA licence. Ten cases involved breaches of independence requirements. In six cases the FAOA sanctioned the auditor-in-charge for not exercising proper duty of care.

## 2.5 Audit Quality Measures

Every year the FAOA collects from the largest audit firms audit quality measures relating to various areas relevant to ISQC 1<sup>34</sup>. These allow for trend analyses, as well as for comparison between the individual audit firms. In addition, the audit quality measures enable the timely identification of possible negative influences on audit quality.

### Figure 6:

Audit quality measures relating to the audit function of the five largest state-regulated audit firms<sup>35</sup>:

Audit quality measure	2010		2011		2012		2013	
	from	to	from	to	from	to	from	to
Average annual turnover per audit partner (CHF m)	1.5	4	1.4	4	1.4	4.1	1.4	4
Average number of chargeable hours per partner	699	1,060	761	1,007	786	1,000	772	1,004
Ratio of additional fees to audit fees	0.1	0.7	0.1	0.5	0.1	0.4	0.1	0.4
Number of staff per audit partner	7.5	11.4	8	11.5	7.6	11.9	8.4	11.9
Staff turnover in %	15	27	16	23	16	28	12	26
Average number of EQCR hours per public company audit	4	16	9	20	7	22	4	22

<sup>32</sup> These proceedings include already completed and on-going proceedings.

<sup>33</sup> Cf. Art. 14 para. 2 AOA.

<sup>34</sup> In part, the calculation of the audit quality measures was made using unaudited data. In individual cases simplifications 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>35</sup> The FAOA collected 12 audit quality measures relating to the individual elements of ISQC 1. These audit quality measures were collected from the five largest state-regulated audit firms. It should be noted that some firms also amended their prior year calculation basis to account for known errors.



The most important observations from the analysis of the audit quality measures are as follows:

- Compared to prior years, the **average annual turnover per partner** and the **average chargeable hours per partner** hardly changed, both overall and within individual audit firms. The audit firm with the highest revenue per partner discloses the lowest number of chargeable hours per partner. Average annual revenue depends particularly on the staff to partner ratio and the client structure of the firm.
- The ratio of **additional fees to audit fees** at public companies has tended to fall in the last few years.
- The **number of staff per audit partner** did not increase at two firms at the upper end of the range. As the ratio increased at the other three firms the tendency is towards convergence at the maximum values.
- Compared to the prior year, **staff turnover** hardly changed at one firm, increased significantly at two firms and decreased significantly at two firms. The lowest staff turnover has been achieved by the same audit firm since the key audit measures were first collected. The highest levels of staff turnover rotate amongst each of the other audit firms.
- The **average number of EQCR hours per public company** has hardly changed over the last years. The percentage of hours is higher at firms with large engagements. The FAOA continues to view the number of EQCR hours per public company as insufficient.

## 2.6 Cooperation with other Swiss 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>36</sup>.

In the year under review one joint inspection was performed with FINMA. Given the respective oversight activities of the FAOA and FINMA, and the assumption of particular FINMA oversight responsibilities by the FAOA<sup>37</sup> regular interaction took place.

The SIX Exchange Regulation (SER) is responsible for ensuring that companies listed on the SIX Swiss Exchange comply with accounting standards. The FAOA and SER coordinate their activities to avoid duplication. The FAOA assesses the audit activities of audit firms. SER, on the other hand, assesses issuers' compliance with their responsibilities under the listing regulations. The focus of FAOA fact-finding is upon auditor compliance with legal and professional requirements, and not upon compliance with accounting standards. In the reporting year the FAOA received two notifications from SER. Should the FAOA find material breaches of accounting standards during its inspections it notifies the responsible exchange. In the year under review there were no such notifications.

Since 2013 there has also been regular interaction with the Supervisory Commission for Occupational Pension Schemes. The interaction is focussed on the discussion of audit related questions and FAOA preliminary fact-finding and proceedings in the pension fund audit area.

## 2.7 Standard-setting

The FAOA places great importance on the continued development of international and national auditing standards as this is an important element in improving audit quality. The FAOA works actively as a member of international working groups towards the further development of international standards<sup>38</sup>. These working groups make it possible for regulators to interact periodically and to prepare joint responses to drafts of new or revised standards.

<sup>36</sup> Cf. Art. 22 and 23 AOA.

<sup>37</sup> Cf. section 1.1.1.

<sup>38</sup> Cf. section 3.5.1 (IFIAR), 3.5.2 (EAIG) and 2.7.3.

## 2.7.1 FAOA circulars

### 2.7.1.1 Recognition of auditing standards

On 15 December 2013 revised Circular No. 1/2008 on the recognition of auditing standards came into force. With this the FAOA declared the Swiss Auditing Standards of the Swiss Institute of Certified Accountants (SAS 2013), also effective as from 15 December 2013, to be binding for the provision of audit services to public companies. Changes to ISA that became effective on the same date were also included within the Circular.

### 2.7.1.2 Regulatory reporting

Circular no. 1/2010 governs the reporting and notification duties of state-regulated audit firms towards the FAOA. These enable the FAOA to recognise risks relevant to oversight on a timely basis. The following improvements came into force on 1 January 2014:

#### – Notification requirement regarding additional services

There is a new requirement to report audit engagements to the FAOA where the ratio between fees for additional and audit services exceeds 1:1 in a business year. There is also a new requirement to disclose the type of additional services provided (margin note 22 indent b). The FAOA abstains from its own definition of audit and additional services. The unaudited annual report disclosures made by the public company remain decisive.

#### – Notification requirement upon change of auditors

The FAOA has consistently criticised the pressure on audit fees at public companies<sup>39</sup>. Significant audit fee reductions are seen particularly when audits are put out to tender or there is a change of auditor. Even if there is nothing to be said against exhausting certain potential efficiencies, an audit fee that is too low carries the risk of reduced audit quality. To counter this risk the FAOA considers audit fee development, amongst other things, in selecting engagements for inspection. To be informed of significantly reduced audit fees in good time, a new duty to notify has been established (margin note 22 indent d). As from 1 January 2014 the FAOA is to be notified of each new public company audit engagement, including the estimated audit fee, as soon as the auditor is appointed by the general meeting.

## 2.7.2 Swiss Auditing Standards

The new Swiss Auditing Standards (SAS; 2013 edition) are to be used for the audit of statutory and consolidated financial statements that end on or after 15 December 2013<sup>40</sup>. ISA amendments made in the meantime, relating to the identification and assessment of the risk of material misstatement (ISA 315) and the use of the work of internal audit (ISA 610), have not been carried over to this revision. Additionally, state-regulated audit firms whose quality control system previously accorded with SAS 220 had to implement the quality control standard (QS 1) by 15 December 2013.

As the revised SAS are first mandatory for 2013 financial statements no comment can be made for the time being on the quality of implementation. However, considerable change was required to audit methodologies and working aids. The implementation of QS1 is also being assessed as part of the on-going inspections.

<sup>39</sup> Cf. foreword to FAOA Activity Report 2012.

<sup>40</sup> Cf. section 1.9.1 FAOA Activity Report 2012.

### 2.7.3 International Auditing Standards

Together with other European audit oversight authorities, the FAOA submitted three comment letters on various proposals of the IAASB during the reporting year<sup>41</sup>:

- On 14 March 2013 a comment letter was submitted on the revision of the standard regarding other information published with the audited financial statements (ED ISA 720). The FAOA welcomes the IAASB proposal overall.
- On 20 November 2013 a comment letter was submitted on the IAASB draft concerning the revision of auditor reporting («Reporting on Audited Financial Statements»). The IAASB's proposal to create reporting that is more comprehensive and tailored to the needs of investors is generally welcome. The disclosure of important information concerning the audit (so-called «Key Audit Matters», KAM) within the auditor's report to the general meeting is a significant step towards increasing the transparency of auditor reporting. The KAM disclosures should enable addressees of the report to understand the key elements of the audit and thereby gain a better overall understanding of the financial statement audit. The KAM cover, in particular, areas in which management have made significant financial reporting estimates relevant to the audit. In addition to the comments of the European regulators, the FAOA believes it would be meaningful to disclose materiality within the audit report. The FAOA commented separately in this regard on 12 December 2013<sup>42</sup>.
- On 14 May 2013 the FAOA submitted a comment letter on the draft «Framework on Audit Quality». The framework describes the interaction of various factors that influence audit quality at the audit engagement, audit firm and national level. This proposal is also welcomed by the FAOA.

### 2.8 Points of focus for 2014 inspections

Within the scope of its regular 2014 inspections the FAOA will focus on the following points and assess them in detail:

- Conformity of firm-specific methodologies for determining materiality for the consolidated and entity financial statements and their application within the audit (ISA 320, ISA 600).
- Compliance with standards regarding the audit of letter-box companies (ISA 220, 230, 600).
- Processes for outsourcing audit work to «shared service centres» and the impact on the audit.

Further points of focus relating to the application of auditing or accounting standards will result from an individual analysis of the specific circumstances. As the FAOA does not perform «an audit of the audit» during its file reviews, only certain points of focus are selected in each case.

<sup>41</sup> See [www.revisionsaufsichtsbehoerde.ch](http://www.revisionsaufsichtsbehoerde.ch) (Dokumentation/Stellungnahmen der RAB).

<sup>42</sup> Cf. section 3.5.1 (IFIAR) and 3.5.2 (EAIG).



## 3 International

### 3.1 Introduction

The fragmentation of audit oversight across nation states is not highly compatible with the globalisation of the capital, services and goods markets. International cooperation consequently forms an important element of every effective audit oversight function and the FAOA sees such cooperation and networking as an important challenge.

While positioning the FAOA on the international stage and completing Memorandums of Understanding (MoU) with partner authorities took priority in the first years of the FAOA, instances of specific administrative assistance have increased notably in 2012 and 2013. Due to the registration of Swiss entities in the US and the presence of US groups in Switzerland, cooperation with the US remains the most intensive. At the same time though, the number of cross-border problems relating to EU member states also increased in 2013<sup>43</sup>. As the principle of «home oversight» has been agreed with the EU and EEA audit oversight authorities, those authorities generally do not carry out oversight activities in Switzerland. Cooperation therefore focuses on the exchange of oversight-relevant information.

### 3.2 Relations with the European Union

#### 3.2.1 Equivalence of Swiss oversight system

Since the so-called «adequacy decision» of 5 February 2010 concerning the Swiss administrative assistance apparatus<sup>44</sup>, and EU recognition of the equivalence of the Swiss audit oversight system on 19 January 2011<sup>45</sup>, the audit oversight authorities of EU member states have been able to place reliance on the oversight activities of the FAOA. The scope and conditions of such cooperation are, however, governed by cooperation agreements between the FAOA and the audit oversight authorities of the individual EU member states. The FAOA has been negotiating continuously with various EU and EEA audit oversight authorities since the equivalence decision.

#### 3.2.2 Memorandums of Understanding

In 2013 negotiations were successfully completed with the oversight authorities in France, Liechtenstein and Luxembourg. The number of Memorandums of Understanding (MoU) thereby rose to seven by the end of 2013<sup>46</sup>. Negotiations with other oversight authorities are expected to be concluded in 2014.

MoUs do not have the force of a state treaty as they do not contain legally enforceable obligations. A MoU is far more a means by which the involved parties can agree on cross-border issues and particularly on the specific conditions for information transfer. If, and how, administrative assistance will be provided is always first decided with respect to an individual specific case.

The MoU with the Principality of Liechtenstein is a special case compared to the other MoUs completed to date: This is due not so much to the EEA membership of Liechtenstein, but rather to the particularly close interdependence of the latter's economy and that of Switzerland: Liechtenstein law allows Swiss-domiciled audit firms to provide audit services in accordance with Liechtenstein law in Liechtenstein (so-called freedom of services)<sup>47</sup>. This situation led to the registration and oversight of Swiss audit firms that provide audit services in accordance with Liechtenstein law in Liechtenstein being at the forefront of negotiations. Consistent with the principle of home oversight, the Liechtenstein Financial Market Authority (FMA) does not carry out inspections in Switzerland. However, the FAOA can transfer parts of its inspection reports on Swiss audit firms to the FMA upon request. This is especially likely to concern results in the firm review area. By contrast, the FAOA will not generally share information that concerns the results of file reviews because the audited entities are mostly not under FMA oversight. Finally, the FMA will rely as much as possible on FAOA licences to avoid duplication.

<sup>43</sup> In 2013 a total of 19 requests for administrative assistance were submitted to the FAOA. Ten of these were from the oversight authorities of EU member states.

<sup>44</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, Official Journal of the European Union L35, of 6 February 2010, page 15 f.

<sup>45</sup> See also page 26 of the FAOA Activity Report 2011, and the EU Commission Decision 2011/30/EU of 19 January 2011 on the equivalence of third country public oversight, quality assurance, and penalty systems for auditors and audit entities and on a transitional period for audit activities of certain third country auditors and audit firms in the European Union, Official Journal of the European Union L15 of 20 January 2011, 12 f.

<sup>46</sup> Cf. Appendix 5 below for a summary of the MoUs completed by the FAOA.

<sup>47</sup> By contrast, according to Swiss law audit firms domiciled abroad may only provide audit services under Swiss law if they have a registered subsidiary in Switzerland (Art. 730 para. 4 CO in conjunction with Art. 8 para. 2 AOO).

### 3.2.3 Registration of Swiss audit firms

Appendix 6 provides a list of the Swiss state-regulated audit firms registered with European oversight authorities.

## 3.3 Cooperation with the USA

### 3.3.1 Statement of Protocol

On 4 April 2011 the FAOA and FINMA agreed a Statement of Protocol (SoP) with the PCAOB for cooperation in the oversight of audit firms<sup>48</sup>. Amongst other things, the SoP also forms the basis for joint inspections at Swiss audit firms. As a direct result of this agreement with the PCAOB, Swiss audit firms were removed from the PCAOB's so-called «grey list»<sup>49</sup>.

### 3.3.2 PCAOB inspections in Switzerland

After inspecting four Swiss audit firms in 2011 and 2012, accompanied by the FAOA, the PCAOB inspected a fifth audit firm in 2013. Since the SoP is limited to a term of three years or, as the case may be, one inspection of every Swiss audit firm registered with the PCAOB, this fifth inspection was the last joint inspection under the current SoP. The completion of the inspection cycle under the current SoP provides the opportunity to take a first look back at cooperation with the PCAOB.

The cooperation with the PCAOB generally went well and was further developed. The long-term goal is for PCAOB reliance on the work of the FAOA. Cooperation was intensified as regards the announcement of the inspection and the performance of firm review inspection procedures. The same applied to the file reviews. In 2013 a joint file review was performed at a Swiss audit firm for the first time. To date the PCAOB has performed file reviews on a total of 15 audit engagements. These relate to the audit of consolidated financial statements («issuer»), significant components («substantial role engagements») and non-significant components («referred work engagements»). In each case the PCAOB was in Switzerland for two to six weeks with a team of between five and twelve people. IT specialists were also involved alongside qualified auditors with specialist industry experience.

Although requiring considerable effort on the part of the audit firms and authorities, the inspections to date have been carried out without major problems. From a legal perspective, the strict separation of the processes for providing access to working papers on site and for transferring documents as evidence to support PCAOB findings proved its worth. In each case the transfer was made by the FAOA at the written request of the PCAOB, after completion of the inspection in Switzerland and with the agreement of the respective information owner.

The FAOA and PCAOB report separately. No final US inspection report on a Swiss inspection is available to date. However, as inspection processes are well advanced in many cases final reports are expected in 2014.

<sup>48</sup> Cf. section 1.4.2 and 2.3 FAOA Activity Report 2011.

<sup>49</sup> On 31 July 2009 the PCAOB first 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.

### 3.3.3 FAOA inspection in the USA

In enforcing the AOA and based on the authority provided by state treaty or the prior agreement of the respective foreign audit oversight authority, the FAOA may carry out oversight activities abroad (Art. 27 para. 1 AOA). Foreign inspections are not the primary aim of the FAOA given its limited resources and the need to avoid duplication of effort. However, against the background of risk-based oversight, extra-territorial activities can add value where large and complex Swiss public companies with significant operations abroad are concerned. In such cases, and under certain circumstances, it may be justifiable to inspect the work of the component auditor on site.

The SoP with the PCAOB<sup>50</sup> is based on reciprocity and therefore allows for FAOA inspections in the US. In 2013 the FAOA exercised this right and inspected the work of a US audit firm that concerned a significant component of a Swiss public company. The inspection in the US was carried out without major problems. The FAOA received unlimited access to the relevant documentation and the audit team. The PCAOB also transferred the necessary documents to Switzerland subsequently.

### 3.3.4 Reliance and possible new negotiations

The SoP with the PCAOB is limited to three years and therefore expires on 4 April 2014. As far as is known, the cooperation with foreign oversight authorities is not questioned by the parties affected. This also applies to the relationship with the USA. However, the possibility of having PCAOB joint inspections in Switzerland, as foreseen within the current SoP, is contentious. The FAOA sees the primary goal of joint inspections as being the creation of trust in the inspection activities of the respective partner authority. After the end of this transitional phase it is expected that the PCAOB will place reliance on the oversight activities of the FAOA to the appropriate extent, possibly using a phased approach.

The PCAOB has made known five general criteria for the recognition of inspections carried out by foreign oversight bodies (adequacy and integrity, independence, financing, transparency and services provided<sup>51</sup>). Before every inspection the Board of the PCAOB decides whether, and to what extent, reliance will be placed on the foreign oversight authority. In no case to date has the PCAOB placed substantial reliance on the work of another oversight authority.

Discussions between representatives of the PCAOB and the FAOA took place in November 2013. It is expected that the Board of the PCAOB will decide at the beginning of 2014 on the degree of reliance for possible future inspections in Switzerland. The FAOA will first review the situation after the above decision has been made. For the FAOA it is important whether the decision produces authentic elements of a joint development towards reliance and specific potential efficiency gains.

In this regard it is noteworthy that the European Commission extended the adequacy decision relating to cooperative arrangements with the PCAOB for a further three years, to 31 July 2016<sup>52</sup>. The Netherlands and Germany have already acted upon this decision and will allow further PCAOB joint inspections in their territories over the next three years.

### 3.3.5 PCAOB Regulatory Institute

In November 2013 representatives from the audit oversight authorities of 34 countries, including Switzerland, took part in the seventh PCAOB Regulatory Institute in Washington (USA). The aim of the three-day conference was to provide an overview of current oversight systems and inspection techniques, to discuss questions of mutual interest and to foster an exchange of experiences. The conference also gave the FAOA the opportunity to make contact with oversight authorities that are not yet members of IFIAR<sup>53</sup>.

<sup>50</sup> Section 3.3.1 above.

<sup>51</sup> PCAOB Rule 4012.

<sup>52</sup> Commission Implementing Decision of 11 June 2013 on the adequacy of the competent authorities of the United States of America pursuant to Directive 2006/43/EC, Official Journal of the European Union No. L161 of 13 June 2013, p. 4f.

<sup>53</sup> Cf. section 3.5.1 below.

### 3.4 Relationship with other countries

The assessment of FAOA equivalence started in 2009 by the Japanese audit oversight authority, the Certified Public Accountants and Auditing Oversight Board (CPA AOB), and the Financial Services Agency (JFSA) continued in 2013. The decision of the Japanese regulators is outstanding.

In September 2013, at the invitation of the Austrian Auditors Supervisory Authority (ASA), the FAOA took part in a meeting of the German-speaking audit oversight authorities (Germany, Liechtenstein, Austria and Switzerland). Common current challenges to audit oversight were discussed at the meeting, including developments within the EU.

### 3.5 Multilateral Organisations

#### 3.5.1 IFIAR

Founded in 2006, the International Forum of Independent Audit Regulators (IFIAR) had 46 members at the end of last year. The current President and Vice-President are from the US PCAOB and the Dutch Authority for the Financial Markets (AFM) respectively. The Chief Executive Officer of the FAOA acts as Treasurer. In 2013 IFIAR held a plenary meeting in Nordwijk (Netherlands), an interim meeting in Paris and an Inspection Workshop in Zurich.

As part of the regular exchange of ideas with representatives of the so-called «Big 6», respectively the Global Public Policy Committee (GPPC), experiences and possible solutions relating to recurring inspection findings were shared. A further important topic for IFIAR is to build awareness for audit quality amongst the various participants of the corporate governance system, be it through the exchange of ideas with investor representatives or increased dialogue with public company audit committees.

IFIAR remains an important platform for the FAOA, enabling contact with other oversight authorities and the discussion of different oversight strategies and their implementation in an international context. In 2013 the FAOA actively involved itself in the debates at IFIAR at various levels:

- As a member of the International Cooperation Working Group (ICWG) the FAOA collaborated specifically in the development of a Multi-lateral Memorandum of Understanding (MMoU). The aim of this long-term project is to improve cooperation between audit oversight authorities within IFIAR and to make it possible for oversight-relevant information to be exchanged between audit oversight authorities. In 2013 the working group also conducted a survey on the efficiency of ad-



ministrative assistance between IFIAR members. The resulting statistics are to be updated every two years.

- The FAOA is also a member of the Standard Coordination Working Group (SCWG). This working group monitors and comments on international standard-setting and shares with the IAASB and IESBA the application and compliance experiences oversight authorities have had with the current standards. In 2013 the SCWG adopted a procedure that allows for the development of joint comment letters by IFIAR. The first joint comment letter on an IAASB exposure draft was accordingly submitted in December 2013. This related to auditor reporting<sup>54</sup>.
- The FAOA is also a member of the newly-formed Enforcement Working Group (EWG). The aim of this working group is to exchange experiences gained in investigating and sanctioning breaches of standards by auditors and audit firms. In a first step a questionnaire will be developed and evaluated to gain an overview of the various enforcement instruments available in the legal jurisdictions of IFIAR members.

- The FAOA further organised the Inspection Workshop in Zurich, at which topics from the various IFIAR working groups were analysed and debated. Current audit technical questions were also discussed; amongst other things such discussions are helpful in building and refining the inspection activities of the FAOA.

<sup>54</sup> Cf. section 2.7.3.





### 3.5.2 European Audit Inspection Group (EAIG)

The FAOA has taken part in the meetings of the EAIG since 2011<sup>55</sup>. As part of its work, the EAIG analyses the anonymised findings from the inspections of member audit oversight authorities and performs root cause analyses of the identified deficiencies. Amongst other things, the results form the basis of follow-up meetings with representatives of the IAASB and the IESBA. In addition, current trends relating to audit and the organisation of audit firms are discussed, such as the various efficiency measures being taken and the audit of so-called letter-box companies<sup>56</sup>. Specific responses to such trends and risks are developed and discussed within the EAIG, for example, possible work programmes. Jointly with other EAIG members the FAOA has also submitted written comments on regulatory proposals of the IAASB and IESBA<sup>57</sup>.

As Switzerland is not a member of the EU the FAOA only has an observer status at the EAIG. The future involvement of the FAOA within the EAIG depends on the institutional development of the EAIG in the foreseeable future.

### 3.5.3 Colleges of Supervisors

The integration of various audit firm network members at the European-level led several years ago to the formation of «Colleges of Supervisors» from the regulatory side<sup>58</sup>. Many regulatory authorities coordinate their individual oversight activities within these colleges. The FAOA supports these colleges and took part in 2013 as follows:

- The FAOA was very actively involved in discussions at the Colleges of Supervisors for KPMG Europe LLP (KPMG ELLP). For the first time common inspection procedures relating to specific elements of the internal control system were planned and performed by the regulators. The results of these inspection procedures will be discussed in Zurich at the start of 2014. Further measures will be derived from an analysis of the findings.
- The involvement of the FAOA in the College of Supervisors for Ernst & Young Europe Co LLP (EY ELLP) is currently at a low level. The FAOA attended a presentation of EY ELLP on trends in quality control.

### 3.5.4 International Monetary Fund (IMF)

The economic crisis that shook the world recently demonstrated clearly the significant extent to which the state of the financial sector influences the home and international economy. The IMF Financial Sector Assessment Program (FSAP), established in 1999, provides for a complete and thorough analysis of the financial sectors of individual countries. In light of the financial crisis, the IMF Board decided in September 2010 that from then on the 25 largest financial sectors in the world should be subject to a thorough IMF examination every five years. In 2013 the IMF examined 16 countries, including Switzerland. Its assessment includes a section on financial audit and audit oversight, in respect of which the FAOA actively participated. The final IMF report on the state of the Swiss financial sector in general, and on the soundness of the Swiss audit oversight system in particular, will be published in spring 2014.

### 3.6 Extra-territorial scope of the AOA

Reference is made to remarks on the corresponding legislative project<sup>59</sup>.

<sup>55</sup> See in addition section 1.8 FAOA Activity Report 2011 and section 2.2.4 FAOA Activity Report 2012.

<sup>56</sup> Cf. section 2.3.1 and 2.3.2.

<sup>57</sup> Cf. section 2.7.3.

<sup>58</sup> Cf. section 2.2.4 FAOA Activity Report 2012.

<sup>59</sup> Section 1.1.2 above, second lemma.

## 4 Licensing

### 4.1 Introduction

An audit firm licence is limited to a period of five years and expires automatically if no renewal application is received or the licence cannot be renewed based on the checks made. Since the FAOA granted the first definitive audit firm licences at the beginning of 2008, a first wave of licence renewal applications was noticeable in 2013.

In the reporting year 543 applications for new licences were also submitted.

### 4.2 Obligation to report and cooperate

All licensed individuals and firms are subject to various obligations to report and cooperate from the time of submitting their licence application and during the licence period<sup>60</sup>. For example, every change to the facts recorded within the FAOA register is to be reported to the FAOA (Art. 15 para. 3 AOA). Furthermore, the FAOA must be informed immediately of every fact that is important to the assessment of licensing conditions (Art. 13 para. 1 AOO) and all requested documentation and information must be supplied (Art. 14 AOO). Amongst other things, for instance, changes in the name of the firm, the deletion of an audit firm from the commercial register after commencement of trading, as well as civil and criminal law decisions and judgements or loss certificates, are to be reported immediately in writing to the FAOA. The obligation to report is taken as met where the individual or firm updates their on-line entry **within 10 working days** using the relevant FAOA user account. The experience of the FAOA shows that adherence to this obligation and the maintenance of the register data could still be improved in many cases. For example, details of leavers and joiners are time and again not updated or not updated on a timely basis. This results in the electronic link between the individual and their respective firm no longer being up to date, which can have major consequences for the calculation of quotas in accordance with Art. 6 AOA. To rectify this problem responsibility for the electronic links is to be transferred in the near future from individuals to audit firms. Audit firms will be notified in good time. In addition to the issue of leavers and joiners, firms are regularly identified that have not updated their data despite changes in the leadership structure or highest management body.

From time to time contact details are also not updated to reflect changed circumstances, such as a change 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 can do so only with considerable research. There is therefore a danger that important information cannot be communicated to the licence holder. The FAOA is reliant on being able to contact the licence holder quickly, particularly as regards licence renewal.

All of the information within the FAOA register is needed for licence maintenance. It is therefore important that this data is always kept up to date. It should also be remembered that contravention of the obligation to report and cooperate is punishable by law (Art. 39 AOA, Art. 45 AOO)<sup>61</sup>.

<sup>60</sup> For details of the communication requirements see section «Häufige Fragen» of the FAOA website.

<sup>61</sup> Contraventions of the obligation to report and cooperate can be subject to a fine of up to CHF 100,000 and represent contraventions of audit law. Alongside possible consequences under criminal law, repeated or, as the case may be, serious contraventions of audit law can also have consequences under administrative law and, for individuals, can affect the assessment as to whether that individual assures the proper conduct of audit services. Should an audit firm contravene its obligation to report and cooperate this would call into question whether the quality control system of the firm meets legal requirements and operates effectively.



## 4.3 Statistics

### 4.3.1 Licences

**Figure 7:**

Licensed individuals and audit firms as at 31 December 2013<sup>62</sup>:

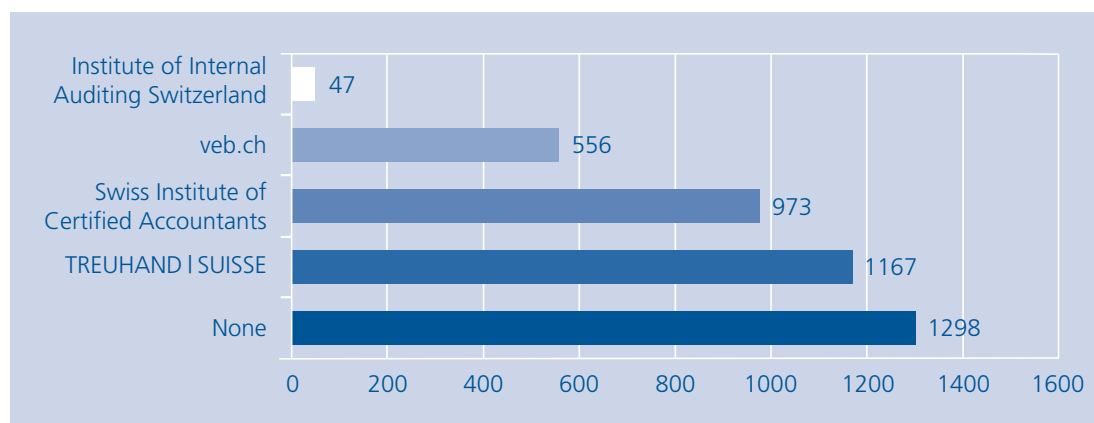
Type of licence	Auditor	Audit expert	Total at 31.12.2013	Total at 31.12.2012
Individuals	2,324	6,016	8,340	8,008
Sole proprietorships	375	408	783	848
Audit firms	890	1,803	2,693	2,766
State-regulated audit firms <sup>63</sup>	–	22	22	21
<b>Total licences</b>	<b>3,589</b>	<b>8,249</b>	<b>11,838</b>	<b>11,643</b>

Comparison between reporting years 2012 and 2013 shows that the trend in licence numbers is relatively stable overall. A small reduction in firm licences was noted, mainly due to several firms abstaining from renewing their licences<sup>64</sup>. By contrast, the number of state-regulated firm licences rose from 21 to 22<sup>65</sup>.

### 4.3.2 Membership of professional organisations<sup>66</sup>

**Figure 8:**

Audit firm memberships of professional associations as at 31 December 2013



The proportion of licensed audit firms that were not members of a professional association was stable compared to the prior year at 37%. These firms do not subject themselves to the controls over training established by the associations. 1,696 audit firms have declared one membership. 465 firms are simultaneously members of two professional associations. 39 firms are in three associations.

<sup>62</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 2013.

<sup>63</sup> Cf. Appendix 4.

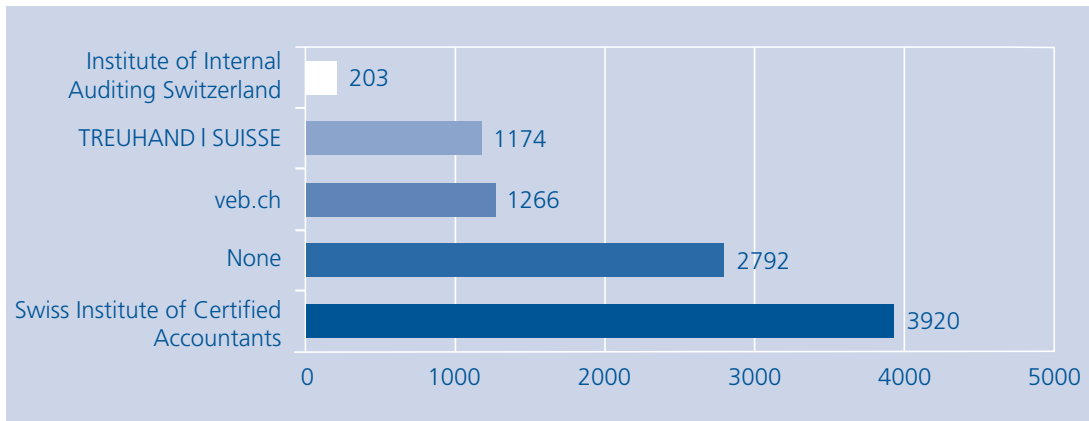
<sup>64</sup> Cf. section 4.4.2.

<sup>65</sup> Cf. section 2.1.

<sup>66</sup> All numbers are derived from the self-declarations of the audit firms and individuals, respectively their online entries.

**Figure 9:**

Audit firm memberships of individuals as at 31 December 2013

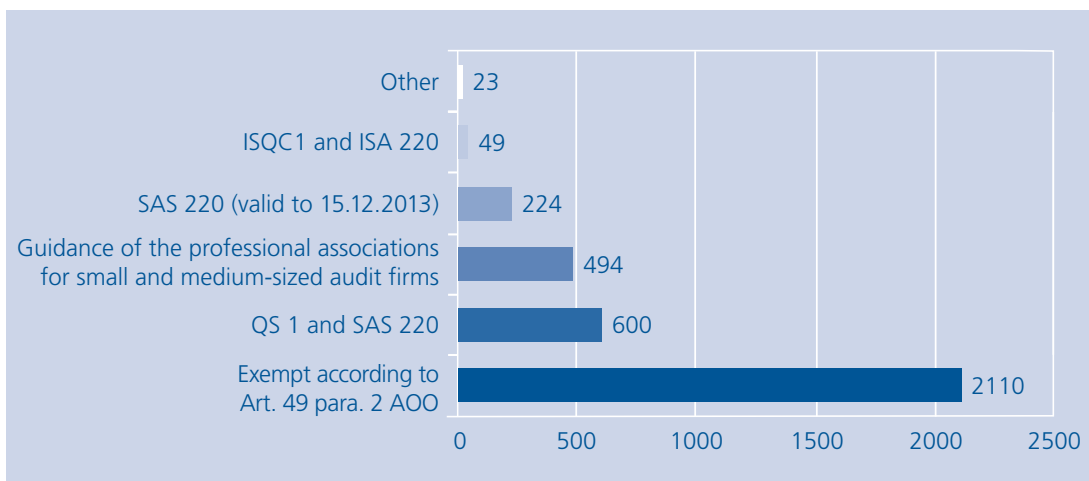


Of the total 8,340 licensed individuals, 4,612 disclosed one membership. 858 individuals are members of two associations, 77 of three associations and one even of all four associations.

#### 4.3.3 Applied quality control standard

**Figure 10:**

Audit firm declarations as to applied standard of internal quality assurance at 31 December 2013<sup>67</sup>



<sup>67</sup> All information is derived from the self-declarations of the audit firms, respectively their online entries.

## 4.4 Licence renewal

### 4.4.1 Introduction

In contrast to individuals, audit firms are licensed for a period of five years (Art. 3 para. 2 AOA). The granted licence expires automatically at the end of these five years. For this reason timely action should be taken towards renewal before the end of the expiry period. The audit firms concerned are informed by the FAOA around six months before licence expiry and asked to provide the necessary information and documentation. The active participation of audit firms is particularly important in ensuring the efficient and timely handling of the renewal application. The following paragraphs summarise the experiences of the FAOA with the first licence renewals.

### 4.4.2 Procedure

In one out of four cases the holder of a licence expiring in 2013 did not submit their renewal documentation within the timeframe stipulated by the FAOA. Latecomers face the risk that their renewal applications cannot be assessed before licence expiry.

In many other cases the information or submitted documentation was incomplete. The additional interactions associated with this delayed the final assessment of the licence renewal.

In 2014 more than 2,000 licences will expire. Since the FAOA will have significantly less time available, if the proportion of incomplete or late applications remains unchanged many firms risk not having a licence. Firms are therefore urgently recommended to prepare their renewal applications and to submit them to the FAOA, together with all required documentation, as early as possible. To avoid unnecessary expense firms not wishing to renew their licences should explicitly notify the FAOA of this decision.



#### 4.4.3 Statistics

**Figure 11:**

Number of audit firm licence renewals as at 31 December 2013:

Licence type	Auditor	Audit expert	Total at 31.12.2013
Sole proprietorships	37	73	110
Audit firms	61	186	247
<b>Total licence renewals in 2013</b>	<b>98</b>	<b>259</b>	<b>357</b>

During the reporting year 357 audit firm licences were renewed, 98 being auditor licences and 259 audit expert licences.

81 of the firms granted a licence in 2008 waived their renewal as part of the licence renewal process initiated by the FAOA in 2013. They were deleted from the FAOA register upon the expiry of their existing licence. Certain firms waived their licence renewal due to the stricter requirements now applying, particularly the quality control standards defined by the profession.

In 19 cases licences were cancelled due to the lack of responses from the firm or the lack of documentation and information for the assessment of the renewal application. 15 audit firms withdrew their applications during the licence renewal process. Five audit firms requested a change in licence type as part of the licence renewal.

#### 4.4.4 Findings from the assessment of quality control questionnaires

Audit firms that are required to have a quality control system must provide the FAOA with a summary of that system when applying for a licence for the first time or when renewing the licence (Cf. Art. 6 AOA and Art. 49 AOO). This is done using a standard questionnaire. The FAOA makes a formal assessment based on this.

The requirements for quality control systems were updated in 2013: The Swiss Institute of Certified Accountants declared the use of the new Swiss Quality Control Standard QS1, together with the new Swiss Auditing Standards (2013 edition), to be manda-

tory for the ordinary audit of financial statements ending after 15 December 2013. At the same time the amended regulations relating to quality control at audit firms came into force (Cf. Art. 49 para. 1 AOO). Accordingly, all audit firms that perform ordinary audits must now have a quality control system that complies with QS1. As a result, those audit firms that offer ordinary audits and have only one individual with the necessary licence must call on an additional licensed audit expert for internal control purposes. Audit firms that perform only limited audits and that have at least two licensed individuals must design their internal control system according to the guidelines on internal control for SME businesses. The voluntary application of QS1 is allowed.

The first licence renewal applications were processed in 2013. During the process quality control systems under QS1 were also assessed. Although the Swiss Institute of Certified Accountants declared the use of QS1 to be mandatory for all members as from 1 September 2016<sup>68</sup>, only in exceptional cases was QS1 adopted voluntarily in 2013.

The following are general insights and findings arising from the assessment of the QS questionnaires:

- Within the licence renewal applications received in 2013 it was found that certain audit firms referred to applying SAS 220 (2010), as withdrawn on 15 December 2013, for quality control purposes. Audit firms who perform ordinary audits and whose licences expired after QS1 came into force were asked to correct their information in the FAOA register and to provide the FAOA with a summary of their quality control system under QS1. It is to be noted that since QS1 came into force on 15 December 2013 the withdrawn SAS 220 (2010 edition) may no longer be used as a QS standard.
- In some cases audit firms did not include a report on internal monitoring within their licence renewal application, even though they had operated an quality control system according to SAS 220 (2010 edition) and had carried out ordinary audits. These firms were asked to supply such a report. For the licence renewal of audit firms applying QS 1 the FAOA will also require a report in the future to evidence that internal monitoring procedures have been performed. In principle, this also applies when QS1 is applied voluntarily.

- The FAOA asked audit firms that had indiscriminately copied existing standard text to revise the relevant passages and supply details of binding rules and arrangements tailored to the specific circumstances of the firm.

- It was noted that a few audit firms did not have a documented quality control system. One pre-condition for the existence of a quality control system is documentation of the rules and arrangements stipulated by the audit firm for the purposes of internal control, generally in the form of a handbook.

- The training-related rules and arrangements of audit firms have been the subject of repeated objections. For ordinary as well as limited audits an audit firm is required to ensure independently, within the scope of its quality control system, that employees have the necessary technical competence to perform the audit. The training guidelines of the professional associations generally only apply to particular groups of people. The audit firm has to formulate its own training policies for all other staff involved in the audit.

- In the independence area the lack of rules and arrangements for checking personal independence has been criticised. This is in relation to the annual request for a written confirmation of independence, a measure that is often implemented and explicitly required by QS 1 (Cf. QS 1.24).

<sup>68</sup> Since 15 December 2013 QS 1 is mandatory for audit firms that perform ordinary audits. Voluntary application by audit firms that perform only limited audits is, however, possible.

In examining the QS questionnaires of audit firms that apply QS 1 for quality control purposes, the following points were objected to:

- The lack of defined criteria for determining the engagements requiring an engagement quality review, other than public company audits (f. QS 1.35a).
- With respect to monitoring of the quality control system, either the lack of defined worksteps and reporting procedures or a simple listing of possible examples (f. QS 1.48a and QS 1.A65).
- In the internal monitoring area, the lack of rules stipulating that every engagement leader is inspected periodically (QS 1.48a) and that the individual performing the inspection is not to have been previously involved in the audit or in the engagement quality control review of the audit (QS 1.48c).
- In the area of engagement documentation, the lack of a rule requiring that the assembly of the final audit file is to be completed within a reasonable timeframe (as defined by the audit firm).

## 4.5 Auditor independence

### 4.5.1 Introduction

The principle of independence is fundamental to the auditing profession. The auditor must be independent and reach an objective audit opinion. The independence of the auditor may not be impaired either in fact or appearance (Art. 728 para. 1 and Art. 729 para. 1 CO). As the FAOA has, also in the reporting year, still found numerous and in some cases serious breaches of independence, the most important points are recapitulated here:

Bearing in mind the goal of reliable accounting and audit, independence in appearance is of central importance to third parties. 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>69</sup>. The audit of a clean set of accounts by a subjectively (i.e. effectively) unbiased, and accordingly independent, auditor is of no value to third parties if independence is seen as compromised when viewed

from the outside. Of relevance is not what the average 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 to be aware of the relevant facts. In practice though, it is consistently argued that a breach of independence in appearance is less serious than an actual breach. From the point of view of the law, respectively the duty of care that every auditor is subject to, this is incorrect: There is a legal obligation to avoid any appearance of dependence. Where this is neglected through carelessness, or even intent, it will have the relevant consequences.

The goal of the statutory independence requirements is naturally the same for ordinary and limited audits. For the limited audit the legislator makes only two exceptions to this general rule: On the one hand there is no engagement leader rotation (Cf. in addition Art. 730a para. 2 CO). On the other it is permissible to provide bookkeeping and other services to the audited entity if suitable organisational and staffing arrangements are made to ensure that a reliable audit takes place where there is a risk of self auditing (Art. 729 para. 2 CO). Over and above these two exceptions there are no further privileges according to current case law and despite some legal literature. In particular, there is no legal basis for a general «more generous» independence benchmark for limited audits as opposed to ordinary audits. This would also be impractical as it would hardly be possible to create two comprehensible and separately identifiable measures of independence. Any attempt would lead to spurious precision and unnecessary legal uncertainty.

<sup>69</sup> Cf. in addition BBI 2004 4018.



Breaches of auditor independence requirements are relevant in assessing whether it is assured that proper audit services will be provided, a licensing condition to be adhered to at all times. 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. According to the circumstances, breaches of independence can therefore result in a reprimand (Art. 18 AOA) or a licence withdrawal (Art. 17 AOA).

Auditor independence requirements are compulsory in nature and are thus always to be complied with. As a consequence, the interpretation and implementation of independence requirements cannot be the subject of a private autonomous agreement. In particular, it is thus forbidden for the auditor and the audited entity to agree that certain breaches of independence are acceptable, to agree on a certain interpretation or application of independence requirements or to promise each other not to press such liability claims as might arise from (possible) breaches of independence. Such agreements are null and void (Art. 20 para. 1 CO) because the audit and auditor independence protects not only the audited entity (respectively the Board of Directors or the shareholders) but also other parties<sup>70</sup>. Against this background, a contractual reduction in the level of independence protection would amount to a contract detrimental to third parties (cf. Art. 111 CO).

#### 4.5.2 Most common findings

As noted, in the course of its activities the FAOA consistently finds breaches of independence. Around a half of all preliminary information gathering exercises and proceedings relate to (possible) independence breaches. It would go too far to present all matters of fact that are problematical in terms of independence. A number of the scenarios that are seen most often, or are otherwise to be borne in mind, are presented below.

On various occasions the acceptance procedures of the auditor for new audit clients and additional services engagements have been found to be patchy. In particular, questions as to whether non-audit service engagements can be accepted alongside audit engagements, and as to the risks and safeguards that

exist or need to be implemented, have been considered insufficiently or too late<sup>71</sup>.

It is still relatively common to find a case in which a member of the board of directors of the auditing firm or another person in a decision-making function (e.g. a director) is at the same time a member of the board of directors or trustees of the audited entity or is employed by that entity (Art. 728 para. 2 section 1 CO). With regard to the problem of appearance<sup>72</sup> it is often overlooked that it is irrelevant whether the individual concerned is a member of the audit team (Art. 728 para. 3 CO), whether the function of the director or trustee at the audited entity is only exercised in a fiduciary capacity, or whether the signatory authority has only been entered into the commercial register «pro forma». Also falling into this category is the case seen in 2013 of the fiduciary exercise of shareholder and director voting rights by the audit engagement leader.

Relatively rarely a case arises in which there is a direct interest in, or loan to, an audited entity (Art. 728 para. 2 section 2 CO)<sup>73</sup>.

Often there is also a close business relationship between the engagement leader and a member of the board of directors of the audited entity (Art. 728 para. 2 section 3 CO). The most common cases in practice are those in which a joint occupation (e.g. joint partnership in an audit firm) or a joint investment (e.g. control over an entity that does not actually provide audit services but does, for example, provide accounting services) exists.

Over time it is rarer to find an audit in which parties related to the engagement leader or a member of the audit team exercise a decision-making role at the audited entity or have a direct interest in that entity (Art. 728 para. 5 in conjunction with para. 2 sections 1, 2 and 3 CO). Cases were found involving the spouse, parents and siblings.

<sup>70</sup> Cf. in addition BBl 2004 3975 f., 3989 f.

<sup>71</sup> Cf. in addition section 2.3.1 above.

<sup>72</sup> Section 4.5.1 above.

<sup>73</sup> FAC Decision No. B-5373/2012 of 25 July 2013.

In connection with the prohibition of self-auditing (Art. 728 para. 2 section 4 CO), it is mainly accounting assistance breaches (primarily payroll accounting) that are seen on ordinary audits. A sub-category of this type of case exists where the audit of entity A and accounting services for entity B are performed, respectively provided, and both entities are under the same management, either factually or in appearance (Art. 728 para. 6 CO). To date there have been no sanctions with respect to the generally permitted provision of accounting services in the limited audit area.

Relatively rarely cases occur in which the auditor is economically dependent on audited entities that are together controlled by the same board of directors (Art. 728 para. 2 section 5 CO). It is also incompatible with economic independence for the auditor to have high personal debts, since these may lead to the performance of audits for favours, the blind acceptance of as many clients as possible, insufficient audit procedures or even extortion.

Not within the law, but within case law since 1997<sup>74</sup> and explicitly mentioned in professional law since 2010<sup>75</sup>, is the prohibition of mutual audits: The audit of entity A by entity B and vice versa can easily lead to a conflict of interest and is particularly suited to inducing audit bias through mutual consideration. The danger exists, at least in appearance, that both firms do not carry out their statutory audit duties with the necessary impartiality. In the meantime this category of case is practically never encountered.

Given the importance of independence to the profession, the FAOA will again pay particular attention to compliance with independence requirements in 2014.

<sup>74</sup> FSC Decision 123 III 31 f.

<sup>75</sup> Section IV indent C para. 3 of the Independence Guidelines 2007, version of 6 December 2010.

## 5 Enforcement and court rulings

### 5.1 Enforcement

In the reporting year eleven applications were rejected. Seven applicants withdrew their applications or licences. Five applications were not proceeded with due to incomplete documentation. Additionally, 15 licence withdrawals were imposed and five reprimands issued.

### 5.2 Court rulings

As last year, the federal courts (Federal Administrative Court [FAC] and Federal Supreme Court [FSC]) addressed cases that were primarily concerned with the condition of good reputation in conjunction with breaches of independence requirements. The federal courts (in one case in the second instance) supported the decisions of the FAOA as such (application rejection or licence withdrawal) and, in the case of withdrawal, the length of withdrawal. This demonstrates that the enforcement policy of the FAOA is supported by the judicial bodies and is seen as fair and reasonable.

In judging the length of an FAOA licence withdrawal the FSC specified that it would be difficult to imagine an audit licence withdrawal of less than one year as the audit of the financial statements takes place annually, and as the AOA only foresees reprimands for individuals working for a state-regulated audit firm<sup>76</sup>.

In another case, in which the applicant applied for a licence as audit expert, there were payment enforcement orders for many millions of Swiss Francs, as well as certificates of unpaid debt, threatened bankruptcy proceedings and pledges. The FAC specified that caution was needed when considering payment enforcement orders. It specified further in this respect that the issuance of payment enforcement orders by a private creditor did not provide a definitive conclusion about possible borrowings. If, however, many payment enforcement orders had been issued by various parties, in particular state bodies, this could be taken as an indication of a tight financial situation. In addition, with high borrowings economic independence is no longer guaranteed. Furthermore the payment enforcement orders indicate that the applicant had carried on his private business badly, which called into question his ability to manage a professional business<sup>77</sup>.

In a further case, in which an applicant applied for a licence as audit expert, the applicant audited the financial statements of five companies whose directors included a person with whom the applicant had a close relationship. The FAC specified that the limited activities of these companies did not alter the fact that they required an audit and that independence requirements must be respected in this regard<sup>78</sup>.

In another ruling the FAC was required to judge various breaches of independence requirements. It noted that a loan of CHF 800,000 to the audit engagement leader, respectively «co-reviewer», represented a significant loan under Art. 728 para. 2 section 2 CO and thereby breached independence requirements when given by a member of the board of directors of nine audited companies<sup>79</sup>. In a similar matter the court found that sanctions based on Art. 44 FMSA called into question the condition of good reputation under the AOA<sup>80</sup>.

In ruling as to whether an applicant possessed sufficient professional practice to be licensed as an audit expert, the FAC was of the view that professional experience gained before the start of a recognised training course should also be counted to the extent that it met all legally defined quality requirements<sup>81</sup>. Following an appeal lodged by the Federal Office of Justice and Police (in close cooperation with the FAOA) the FSC overturned the ruling of the FAC and sent the matter back for reconsideration, as it was clear from the law that professional experience gained before the start of a recognised course of training could not be taken account of<sup>82</sup>.

<sup>76</sup> FSC Decision No. 2C\_1182/2012 of 29 May 2013, E. 4.4.

<sup>77</sup> FSC Decision No. 2C\_709/2012 of 20 June 2013, E. 6.2.

<sup>78</sup> FAC Decision No. B-2274/2012 of 19 June 2013, E. 4.3.2.3; see also FAC No. B-4251/2012 of 23 September 2013, E. 4.2.1.

<sup>79</sup> FAC Decision No. B-5373/2012 of 25 July 2013, E. 4.1.

<sup>80</sup> FAC Decision No. B-5348/2012 of 25 July 2013, E. 5.

<sup>81</sup> FAC Decision No. B-4277/2012 of 18 June 2013, E. 6.6

<sup>82</sup> FSC Decision No. 2C\_738/2013, E. 4.6

## Appendices

### 1 Organisation of the FAOA<sup>83</sup>

Legal form	Public-law institution with separate legal identity	
Incorporation within the 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>Thomas Rufer (Chairman)</b> , Graduate in Business Administration and Swiss Certified Accountant
		<b>Sabine Kilgus (Vice-Chairman)</b> , PD Dr., lawyer
		<b>Renato Fassbind</b> , Dr., US CPA
		<b>Conrad Meyer</b> , Prof., Dr.
		<b>Daniel Oyon</b> , Prof., Dr.
	Executive Board	<b>Frank Schneider</b> , Chief Executive Officer, Swiss Certified Accountant
		<b>Reto Sanwald</b> , Deputy to Chief Executive Officer, Head of Legal & International, Dr. iur., attorney
		<b>Pascal Stirnimann</b> , Head of Oversight, Swiss Certified Accountant
		<b>Sébastien Derada</b> , Head of Licensing & Support
	Auditor	<b>Swiss Federal Audit Office (SFAO)</b>
Number of staff	27 staff members, representing 21 full-time equivalents (position 31.12.2013). At the end of the prior year 26 staff members, representing 20 full-time equivalents, were employed by the FAOA.	
Funding	The FAOA finances itself entirely from the fees and oversight charges levied on licensed individuals and audit firms under oversight. No taxpayers' money is used. The FAOA maintains its own accounts outside the Federal budget.	
Legal function	To ensure the proper provision and quality of audit services	
Responsibilities	Appraisal of licence applications, oversight of the auditors of public companies, and rendering of international administrative assistance in the audit oversight area.	
Independence/Oversight	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.	

<sup>83</sup> Further information can be found on the FAOA website ([www.revisionsaufsichtsbehörde.ch](http://www.revisionsaufsichtsbehörde.ch))

## 2 Index of abbreviations

AICPA	American Institute of Certified Public Accountants
AOA	Audit Oversight Act of 15 December 2005 (SR 221.302)
AOO	Audit Oversight Ordinance of 22 August 2007 (SR 221.302.3)
BBI	Federal Law Gazette
CO	Swiss Civil Code of 30 March 1911 (SR 220)
EAIG	European Audit Inspection Group
EEA	European Economic Area
EQCR	Engagement Quality Control Reviewer
EU	European Union
EWG	Enforcement Working Group
FAC	Federal Administrative Court
FCC	Federal Casino Commission
FINMA	Federal Financial Market Supervisory Authority
FJPD	Federal Department of Justice and Police
FMAO	Financial Market Auditing Ordinance of 15 October 2008 (SR 956.161)
FMSA	Financial Market Supervision Act of 22 June 2007 (SR 956.1)
FOPH	Federal Office of Public Health
FSC	Federal Supreme Court
GPPC	Global Public Policy Committees
G-SIBs	Global Systemically Important Banks
G-SIFIs	Global Systemically Important Financial Institutions
G-SIIs	Global Systemically Important Insurers
GwG	Anti-Money Laundering Act of 10 October 1997 (SR 955.0)
IAASB	International Auditing and Assurance Standards Board
ICWG	International Cooperation Working Group
IESBA	International Ethics Standards Board for Accountants
IFIAR	International Forum of Independent Audit Regulators
IMF	International Monetary Fund
ISA	International Standards on Auditing
ISQC 1	International Standard on Quality Control 1
MMoU	Multilateral Memorandum of Understanding

MoU	Memorandum of Understanding
OPSC	Occupational Pension Supervisory Committee
PCAOB	Public Company Accounting Oversight Board
QS 1	Swiss Quality Control Standard 1 (effective as from 15.12.2013)
SAS	Swiss Auditing Standards of the Swiss Institute of Certified Accountants
SCWG	Standards Coordination Working Group
SER	SIX Exchange Regulation
SME	Small and medium-sized enterprises
SMI	Swiss Market Index
SR	Classified Compilation of Federal Legislation
VSBG	Casino Ordinance of 24 September 2004 (SR 935.521)



### 3 Special-law licences

A special-law licence, based on a basic licence granted under the AOA, must be obtained for audit activities in the following areas (status: 31.12.2013):

Audit in the field of	Basic licence under the AOA: Audit firm	Basic licence under the AOA: Lead auditor	Special-law regulatory authority	Additional requirements
Banks/Securities traders	State-regulated audit firm	Audit expert	FINMA	Art. 26 FMSA Art. 3 FMAO
Collective investment companies	State-regulated audit firm <sup>84</sup>	Audit expert	FINMA	Art. 26 FMSA Art. 3 FMAO
Insurance	State-regulated audit firm	Audit expert	FINMA	Art. 26 FMSA Art. 3 FMAO
Anti-money laundering	Auditor	Auditor	FINMA	Art. 19b AMLA
Central mortgage bond institutions	State-regulated audit firm	Audit expert	FINMA	Art. 26 FMSA Art. 3 FMAO
Pensions companies	Audit expert <sup>85</sup>	Audit expert	(OPSC)	–
Health insurance companies	Audit expert	Audit expert	(FOPH)	–
Casinos	Audit expert	Audit expert	FCC	Art. 75 VSBG

<sup>84</sup> There are, however, two exceptions: First, audit firms that audit representatives of foreign collective investment companies «only» need to be licensed as audit experts. The lead auditor also requires a licence as an audit expert (Cf. Art. 5 FMAO). Secondly, an auditor licence is sufficient for audit firms who have to prove that they meet the conditions of Art. 2, para. 3 of the Collective Investment Schemes Act of 23 June 2006 (CISA; SR 951.31) with respect to investment companies (Cf. Art. 6 FMAO).

<sup>85</sup> There is, however, one exception: Only audit firms that are licensed as state-regulated audit firms can act as the auditors of investment foundations (Art. 9 of the Ordinance of 22 June 2011 relating to investment foundations, ASV; SR 831.403.2).

## 4 List of state-regulated audit firms

Status: 31 December 2013

500003	PricewaterhouseCoopers AG	Zürich
500012	T & R AG	Gümligen
500038	Bankrevisions- und Treuhand AG	Zürich
500149	OBT AG	St. Gallen
500241	MAZARS SA	Genève
500420	Deloitte AG	Zürich
500436	REFIDAR MOORE STEPHENS AG	Glattbrugg
500498	PKF Wirtschaftsprüfung AG	Zürich
500505	Treuhand- und Revisionsgesellschaft Mattig-Suter und Partner	Schwyz
500646	Ernst & Young AG	Basel
500705	BDO AG	Zürich
500762	Balmer-Etienne AG	Luzern
500770	Intercontrol AG	Zürich
500959	BDO Visura International AG	Zürich
501091	Provida Wirtschaftsprüfung AG	St. Gallen
501382	Berney & Associés SA Société Fiduciaire	Genève
501403	KPMG AG	Zürich
501470	Ferax Treuhand AG	Zürich
501570	Fiduciaire FIDAG SA	Martigny
501839	Grant Thornton AG	Zürich
502658	Treureva AG	Zürich
504689	SWA Swiss Auditors AG	Pfäffikon

## 5 Cooperation with foreign authorities

Status: 31 December 2013

Country	Authority	Form	Completion year
USA	Public Company Accounting Oversight Board (PCAOB)	Statement of Protocol (SoP)	2011
Germany	Abschlussprüferaufsichtskommission (APAK)	Letter of intent	2012
Netherlands	Netherlands Authority for the Financial Markets (AFM)	Memorandum of Understanding (MoU)	2012
France	French High Council for Statutory Auditors (H3C)	Cooperation Protocol	2013
Liechtenstein	Financial Market Authority, (FMA)	Letter of intent	2013
Luxembourg	Commission de Surveillance du Secteur Financier (CSSF)	Memorandum of Understanding (MoU)	2013

## 6 Registration of Swiss audit firms in the EU<sup>86</sup>

Status: 31 December 2013

Country	Registered Swiss audit firm
Germany (German Audit Oversight Commission, GAOC)	As a result of the MoU between Germany and Switzerland there is no registration obligation in Germany
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 (French High Council for Statutory Auditors)	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 (Financial Market Authority, FMA)	(21) <sup>87</sup>
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 (1)
Sweden (Swedish Supervisory Board of Public Accountants)	Ernst & Young AG, KPMG AG, PwC AG (3)

<sup>86</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 indent c section 1 of Circular 1/2010 of 31 March 2010 on reporting by state-regulated audit firms to the FAOA). No distinction is drawn between provisional and definitive registration. The authority of the Swiss audit firms to provide statutory audit services in these countries is decisive.

<sup>87</sup> Allemann, Zinsli & Partner AG, Bankrevisions- und Treuhand AG, BDO AG, Buchhaltungs- und Revisions-AG, Curator Revision AG, Ernst & Young AG, Fiduciaria Biaggini S.A., Haussmann & Partner, Haussmann Revision AG, KPMG AG, Lie Audit GmbH, Mittner + Partner, Treuhand Beratung Revision Kommanditgesellschaft, Ostschweizerische Revisionsgesellschaft AG, Ostschweizerische Treuhand-Gesellschaft AG, PricewaterhouseCoopers AG, Revigroup Lugano SA, Revion Treuhand AG, RRT AG Treuhand und Revision, TEAG Treuhandbüro Eggenberger AG, WPS Revision AG und Wälti Treuhand und Revisionen AG.

## 7 Complete list of court rulings 2013

Status: 31 December 2013

The following is a complete list of the decisions of the federal courts that are legally binding and relevant to interpretations in the licensing area. The decisions appear in chronological order, with a short note on the subject matter dealt with and on the conclusion of the court.

- FSC Decision 2C\_1182/2012 of 29 May 2013 (confirmation of FAC Decision No. TAF B-1723/2011 of 24 October 2012): Audit of a patronage fund by a licensed auditor rather than a licensed audit expert as required. One year withdrawal of auditor licence. Dismissal of appeal.
- FAC Decision No. B-4277/2012 of 18 June 2013: Consideration of professional experience gained prior to commencement of recognised training in calculating the number of years of professional experience (renunciation of previous case law). Acceptance of appeal. However, decision set aside by FSC on 27 November 2013 (2C\_738/2013).
- FAC Decision No. B-2274/2012 of 19 June 2013: Breach of independence requirements (audit of the financial statements of a company for which the auditor had performed accounting and controlling services; audit of the financial statements of companies whose directors included an individual with whom the auditor had a close relationship). Rejection of application for audit expert licence. Dismissal of appeal.
- FSC Decision No. 2C\_709/2012 of 20 June 2013 (Confirmation of FAC Decision No. B-8823/2010 of 13 June 2012): Financial instability and audit by unlicensed audit firm. Rejection of licence application. Dismissal of appeal.
- FAC Decision No. B-5348/2012 and B-5373/2012 of 25 July 2013: Breach of independence requirements (audit of companies despite a manager of the audit firm simultaneously being a director of the audited company; loan by a director of the audited company to a director of the audit firm). Additionally, sanctions under Art. 44 FMSA decisive in the assessment of good reputation. Respective withdrawal of audit expert licence for two years. Dismissal of appeal.
- FAC Decision No. B-4251/2012 of 23 September 2013: Breach of independence requirements (close relationship between auditor and managing director of audited company). Withdrawal of audit expert licence for one year. Dismissal of appeal.
- FAC Decision No. B-4758/2012 of 5 November 2013: Absence of reciprocity by USA. «Master of Business Administration» (MBA) not a recognised title under Art. 4 para. 2 indent c AOA. Hardship clause not applicable as training-related. Dismissal of appeal.
- FSC Decision No. 2C\_738/2013 of 27 November 2013: Inclusion of professional experience gained prior to commencement of recognised training in calculating the number of years of professional experience contrary to AOA. Acceptance of appeal of the Federal Department of Justice and Police.

## 8 List of equivalent foreign educational qualifications

Status: 31 December 2013

Country	Equivalent foreign educational qualifications
Germany	Bestellungsurkunde Wirtschaftsprüfer
France	Diplôme Supérieur de Comptabilité et de Gestion (frühere Bezeichnung: Diplôme d'études supérieures comptables et financières) und Diplôme d'expertise comptable
Great Britain	Chartered/Certified Accountant Memberships bei: ICAEW, ICAS, ICAI, ACCA, AIA + Audit permission
Ireland	Chartered/Certified Accountant Memberships bei: ICAEW, ICAS, ICAI, ACCA, ICPAI, IIPA + Audit permission
Italy	Dottore commercialista (Ragioniere e perito commerciale; Laurea/Dottore in economia e commercio; Dottore in economia aziendale; Dottore in economia delle istituzioni e dei mercati finanziari; Laurea in economia e professione)
India	Chartered Accountant
Netherlands	Registeraccountant
Norway	Studiet i revisjon (registered auditor, state authorised auditor)
Austria	Bestellungsurkunde Wirtschaftsprüfer
Philippines	Certified Public Accountant (CPA)
Sweden	Approved/Authorised public accountant
Turkey	Certified Public Accountant



## 9 Financial statements of the FAOA

### Balance sheet

in CHF

	Note	31.12.2013	31.12.2012
Cash at bank and in hand	5	5,158,830	4,618,090
Receivables	6	164,978	183,084
Work-in-progress	7	153,000	290,000
Prepayments	8	74,570	24,666
<b>Current assets</b>		<b>5,551,378</b>	<b>5,115,840</b>
Tangible fixed assets	9	459,182	403,310
Intangible fixed assets	10	362,193	311,276
Investments	11	93,984	93,887
<b>Non-current assets</b>		<b>915,359</b>	<b>808,472</b>
<b>Total assets</b>		<b>6,466,737</b>	<b>5,924,312</b>
Short term liabilities relating to services		90,164	165,585
Liabilities to state-regulated audit firms	12	46,736	54,193
Social security liabilities		109,507	67,541
Short-term provisions	13	203,000	205,000
Accruals	14	283,810	310,913
Accrued licensing fees	16	430,840	369,800
<b>Current liabilities</b>		<b>1,164,057</b>	<b>1,173,032</b>
Accrued licensing fees	16	802,680	251,280
<b>Non-current liabilities</b>		<b>802,680</b>	<b>251,280</b>
Reserves	17	4,500,000	4,500,000
<b>Capital and reserves</b>		<b>4,500,000</b>	<b>4,500,000</b>
<b>Total liabilities</b>		<b>6,466,737</b>	<b>5,924,312</b>

## Income statement

in CHF

	Note	01.01.2013 –31.12.2013	01.01.2012 –31.12.2012
Oversight charges	2. I	3,003,264	2,748,307
Inspection fees	2. I	1,297,483	1,231,064
Licensing fees	18, 2. I	963,241	992,535
Other income	19	337,422	32,578
<b>Net revenue</b>		<b>5,601,410</b>	<b>5,004,484</b>
Personnel expense	20	-4,595,307	-4,116,666
Operating expense	15, 21	- 880,720	-762,324
Depreciation	9, 10	-142,911	-140,654
<b>Operating profit</b>		<b>-17,528</b>	<b>-15,161</b>
Financial income		18,049	15,399
Financial expense		-521	-238
<b>Financial result</b>		<b>17,528</b>	<b>15,161</b>
<b>Profit/loss</b>		<b>–</b>	<b>–</b>

## Cash flow statement

in CHF

	Note	01.01.2013 – 31.12.2013	01.01.2012 – 31.12.2012
Depreciation of fixed assets	9, 10	142,911	140,654
Accrual/(Release) of licensing fees (long-term)	16	551,400	-288,200
(Increase)/decrease in debtors	6	18,106	-6,893
(Increase)/decrease in work-in-progress	7	137,000	24,000
(Increase)/decrease in prepayments	8	-49,904	45,622
Increase/(decrease) in liabilities		-82,878	-620,360
Increase/(decrease) in social security liabilities		41,966	47,640
Increase/(decrease) in short-term provisions	13	-2,000	47,500
Increase/(decrease) in accruals	14	-27,103	37,322
Increase/(decrease) in accrued licensing fees (short-term)	16	61,040	-245,260
<b>Net cash flows from operating activities</b>		<b>790,538</b>	<b>-817,974</b>
Acquisition of tangible fixed assets	9	-182,053	-180,768
Acquisition of intangible fixed assets	10	-67,647	-303,629
Acquisition of investments	11	-98	-22,653
<b>Net cash flows from investing activities</b>		<b>-249,798</b>	<b>-507,049</b>
<b>Change in cash and cash in hand</b>		<b>540,740</b>	<b>-1,325,023</b>
Cash and cash in hand at the start of the year	5	4,618,090	5,943,113
<b>Cash and cash in hand at year end</b>	<b>5</b>	<b>5,158,830</b>	<b>4,618,090</b>

## Change in capital and reserves

	01.01.2013 – 31.12.2013	01.01.2012 – 31.12.2012
Opening balance as of 1.1.	4,500,000	4,500,000
Transfer to reserves	0	0
<b>Balance as of 31.12.</b>	<b>4,500,000</b>	<b>4,500,000</b>

## Notes to the 2013 financial statements

### 1 Operating activities

The 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; SR 221.302). Further, it oversees audit firms who 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 oversight 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 AOA. The aim of the AOA is to ensure the proper provision and quality of audit services.

On 15 June 2012 the Federal Council decided, in principle, to merge the previously separate audit firm oversight functions within the financial markets area and, in two stages, to bundle them together within the FAOA. As a result of this decision, on 1 September 2012 oversight of the financial audits of listed banks, insurance companies and collective investment companies was already transferred from FINMA to the FAOA.

As at 31 December 2013 the FAOA employed 27 employees, representing 21 full-time equivalents. At the end of the prior year 26 employees, representing 20 full-time equivalents, worked at the FAOA.

### 2 Accounting policies

#### a. Introduction

These financial statements of the FAOA are prepared having regard to the requirements of the International Public Sector Accounting Standards (IPSAS), while complying with Article 662a–663b of the Swiss Civil Code (according to Art. 35 para. 2 AOA).

The attached statements are the entity financial statements for the financial year comprising calendar year 2013 with a balance sheet date of 31 December 2013 (including comparatives). The reporting currency is Swiss Francs (CHF).

Unless otherwise stated, assets and liabilities are valued at historical or production cost, which is normally the nominal value. Expenses and revenues are booked in the period in which they occur.

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

#### b. Cash at bank and in hand

Cash at bank and in hand comprises 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 value.

#### c. Receivables relating to services

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

#### d. Work-in-progress

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

#### e. Tangible fixed assets

Tangible fixed assets are accounted for at 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)
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 adjusted 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. Revenue arising upon the disposal of tangible fixed assets is disclosed separately in the income statement.

#### f. 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 adjusted 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.

#### g. Investments

Investments are accounted for at market value.

#### h. Taxes

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

#### i. Provisions

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

#### j. Leasing

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

#### k. 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 and is periodically adjusted for changes in the annual budget. The FAOA received no donated capital upon foundation.

#### l. Revenues (fees and oversight charges)

The FAOA charges fees for its rulings, inspections and services and levies an oversight charge upon state-regulated audit firms to cover any costs not covered by the fees. The fees and oversight charges are governed by section five of the 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. Fee reimbursements are charged directly to income.

Oversight charges are booked to income upon invoicing.

### **m. 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 hedge.

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

### **a. 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 16 December 2013. This resulted in no adjustment to the insurance coverage previously determined 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 risk is relevant to the FAOA:

### **b. 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.

## **4 Estimation uncertainty**

The preparation of the financial statements according to generally accepted accounting principles requires the use of estimates and assumptions. These affect the stated amounts of assets and liabilities and the disclosure of contingent assets and liabilities as at the balance sheet date, as well as the stated revenues and expenses. 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

in CHF

	2013	2012
Cash in hand	722	383
PostFinance account	772,261	449,439
Investment account at Federal Finance Administration FFA	4,385,847	4,168,268
<b>Total cash and cash in hand</b>	<b>5,158,830</b>	<b>4,618,090</b>

### 6 Receivables

	2013	2012
Licence fee receivables	53,775	126,570
Yellowpay receivables	69,704	50,962
Other receivables	41,499	5,552
<b>Total receivables relating to services</b>	<b>164,978</b>	<b>183,084</b>

No debts were written-off and no bad debt provisions established in either the financial year 2013 or the prior year.

### 7 Work-in-progress

	2013	2012
Work-in-progress	153,000	290,000
<b>Total work-in-progress</b>	<b>153,000</b>	<b>290,000</b>

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

### 8 Prepayments

	2013	2012
Prepayments	74,570	24,666
<b>Total prepayments</b>	<b>74,570</b>	<b>24,666</b>

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



## 9 Tangible fixed assets

in CHF

	Furniture and furnishings	Office equipment, IT equipment (hardware)	Fixtures and fittings	Total 2013	Total 2012
<b>Acquisition costs</b>					
Opening balance	357,172	77,973	263,384	698,529	523,773
Acquisitions	19,478	101,179	61,396	182,053	180,768
Disposals	–	–	–	–	-6,012
<b>Closing balance</b>	<b>376,650</b>	<b>179,152</b>	<b>324,780</b>	<b>880,582</b>	<b>698,529</b>
<b>Accumulated depreciation</b>					
Opening balance	-163,212	-53,674	-78,333	-295,219	-215,966
Acquisitions	-37,665	-56,038	-32,478	-126,181	-85,265
Disposals	–	–	–	–	6,012
<b>Closing balance</b>	<b>-200,877</b>	<b>-109,712</b>	<b>-110,811</b>	<b>-421,400</b>	<b>-295,219</b>
<b>Net book value</b>	<b>175,773</b>	<b>69,440</b>	<b>213,969</b>	<b>459,182</b>	<b>403,310</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 increase of CHF 101,179 in office equipment and IT equipment (hardware) is primarily attributable to new live and back-office servers, the development of a network in the Zurich office and related installation work.

The increase of CHF 61,396 in the acquisition cost of fixtures and fittings is attributable to the renovation of ceilings in the offices at Bundesgasse 18 in Bern.

The increase of CHF 19,478 in the acquisition cost of furniture and furnishings in 2013 is mainly attributable to the purchase of new furniture and filing cabinets.

The fire insurance value of tangible fixed assets at 31 December 2013 was CHF 550,000 (prior year CHF 400,000).

## 10 Intangible fixed assets

in CHF

	Software register and administration	Other software	Total 2013	Total 2012
<b>Acquisition costs</b>				
Opening balance	646,141	102,155	748,296	444,667
Acquisitions	42,853	24,794	67,647	303,629
Disposals	–	–	–	–
Closing balance	688,994	126,949	815,943	748,296
<b>Accumulated depreciation</b>				
Opening balance	-343,740	-93,280	-437,020	-381,631
Acquisitions	–	-16,730	-16,730	-55,389
Disposals	–	–	–	–
Closing balance	-343,740	-110,010	-453,750	-437,020
<b>Net book value</b>	<b>345,254</b>	<b>16,939</b>	<b>362,193</b>	<b>311,276</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 42,853 in the acquisition cost of software register and administration is attributable to work with respect to the modernisation of the IT environment (basic installations, migrations, hot-standby etc.).

## 11 Investments

In connection with the rent of offices the FAOA has two tenant deposit accounts to the total amount of CHF 93,984.

## 12 Liabilities to state-regulated audit firms

The FAOA levies an annual oversight charge upon state-regulated audit firms (see section 2.I). 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 46,736 (prior year CHF 54,193) will be credited to the state-regulated audit firms in 2014.

**13 Short-term provisions**

in CHF

	2013	2012
Personnel expense liabilities	198,000	197,000
Provision for compensation	5,000	8,000
<b>Total short-term provisions</b>	<b>203,000</b>	<b>205,000</b>

Holiday, accrued flexible working hours and overtime entitlements are calculated and accrued as at 31 December based on 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**

	2013	2012
Various accruals	283,810	310,913
<b>Total accruals</b>	<b>283,810</b>	<b>310,913</b>

Accruals include, in particular, accruals in relation to personnel expense and accruals for the cost of the Activity Report 2013.

**15 Operating leases (off-balance sheet)**

	2013	2012
Minimum payments within one year	10,740	10,740
Minimum payments in years 2 to 6	32,220	42,960

Operating leases comprise off-balance sheet liabilities relating to a contract with Triumph-Adler for multi-purpose equipment. The current contract has a total term of 6 years (1.1.2012–1.1.2018).

The FAOA has not entered into any finance leases which would be on the balance sheet.

**16 Accrued licensing fees**

	2013	2012
Accrued licensing fees (short-term)	430,840	369,800
Accrued licensing fees (long-term)	802,680	251,280
<b>Total accrued licensing fees</b>	<b>1,233,520</b>	<b>621,080</b>

Fee income from the licensing of audit firms is accrued over a period of 5 years.

**17 Reserves**

in CHF

	2013	2012
Reserves	4,500,000	4,500,000
<b>Total Reserves</b>	<b>4,500,000</b>	<b>4,500,000</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.

**18 Licensing fees**

	2013	2012
Licensing fees individuals	422,300	419,200
Licensing fees audit firms	1,227,800	102,000
Commission on internet payments	-33,269	-31,525
Reimbursement of licensing fees	-41,150	-30,600
Accrual of licensing fees	-982,240	-81,600
Release of accrued licensing fees from prior years	369,800	615,060
<b>Total licensing fees</b>	<b>963,241</b>	<b>992,535</b>

Audit firm licences are limited to a period of five years. Since the first audit firm licences were granted in 2008 the first licence renewals were granted in the reporting year. This resulted in a large increase in licensing fees from audit firms.

**19 Other income**

The increase in other income results, on the one hand, from income received in connection with the IFIAR Inspection Workshop held in Zurich in March 2013 (CHF 60,239). On the other, income was received in connection with the loan of two staff members to FINMA (CHF 210,458).

**20 Personnel expense**

in CHF

	2013	2012
Staff compensation and Board member fees	3,461,591	3,018,094
Employer contributions	732,424	685,055
Other personnel expense	308,852	263,668
Third party personnel costs	92,440	149,849
<b>Total personnel expense</b>	<b>4,595,307</b>	<b>4,116,666</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 (prior year 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 external translation service charges, as well as expenses incurred for consultancy services in connection with the modernisation of the IT environment.

The increase in personnel expense is, in particular, related to the assumption of additional responsibilities from FINMA as from 1 September 2012 (see Note 1).

**21 Operating expense**

	2013	2012
Accommodation	196,422	189,242
Minor capital expenditure, fixed asset maintenance and leasing	13,844	14,783
Administrative expense	106,091	108,414
IT expense	364,944	227,989
Other operating expense	199,419	221,896
<b>Total operating expense</b>	<b>880,720</b>	<b>762,324</b>

The increase in IT expense is attributable in particular to one-off expenses in connection with the modernisation of the IT environment. The IT expenses have also increased in particular due to higher maintenance and back-up costs.

**22 Contingencies**

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

## 23 Related party transactions

### a. Definition of term «related parties»

Related parties can be entities or individuals who can influence the FAOA or can be influenced by the FAOA. 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 strictly on arm's length terms.

### b. Particular relationship with the Federal Administration

The FAOA, 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 selection of the 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 FAOA 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).



## Remuneration of the Board of Directors and Management

In CHF thousands

	2013	2012
<b>Board of Directors<sup>1</sup></b>		
Fees of Chairman	75	75
Fees of Vice-Chairman	38	38
Fees of other members	52	52
<b>Total compensation of the members of the Board of Directors</b>	<b>165</b>	<b>165</b>
<b>Chief Executive Officer and Executive Board</b>		
Salary of Chief Executive Officer	253	250
Other benefits of Chief Executive Officer <sup>2</sup>	34	37
Salaries of other members	514	323
Other benefits of other members	51	43
Social security contributions <sup>3</sup>	157	107
<b>Total compensation of the members of the Executive Board</b>	<b>1,009</b>	<b>760</b>

In the reporting year individual, performance-related salary increases were granted. No general inflation adjustment was made.

The increase in the salaries of other members of the Executive Board is due to the increase in the number of Executive Board members. As per 1 January 2013 Pascal Stirnimann was appointed Head of Oversight. Previously this role was performed by the Chief Executive Officer in a dual capacity.

<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.

<sup>3</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.

### 24 Events after the balance sheet date

No events have occurred since the balance sheet date of 31 December 2013 that impact the informational value of the 2013 financial statements.





***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 2013.

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, 24 February 2014

SWISS FEDERAL AUDIT OFFICE

Walter Risler  
Licensed Audit Expert

Peter Küpfer  
Licensed Audit Expert





