



Federation of European Accountants  
Fédération des Experts comptables Européens

# Factsheet

*Standing for trust and integrity*



April 2014

## EU Directive on Statutory Audits of Annual and Consolidated Accounts and EU Regulation on Statutory Audit of Public Interest Entities

### Background

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The European Union (EU) audit market reform began in 2010 with a European Commission consultation Green Paper entitled "Audit Policy: Lessons from the Crisis"<sup>1</sup>. After this consultation process, the European Commission released its Proposals on 30 November 2011 including a **revision of the Statutory Audit Directive (SAD) (2006/43/EC)**<sup>2</sup> applicable to all statutory audits within the EU and a **Regulation**<sup>3</sup> applicable only to statutory audit of Public Interest Entities (PIEs).

The two texts were negotiated under the ordinary legislative procedure. After nearly three years of discussion, the final **Directive**<sup>4</sup> and **Regulation**<sup>5</sup> have been decided on and will formally become EU legislation after publication in the Official Journal (OJ) of the EU, expected by summer 2014.

With this Factsheet, FEE's objectives are to inform its Members and the public at large about the main provisions included in this **Directive** and **Regulation** to pave the way to smooth application and implementation. Although this Factsheet does not aim at expressing any FEE views, consistent application across EU Member States of the requirements, and especially the options available, would be instrumental for all stakeholders. There are 51 options available in the 2014 Directive and 32 in the 2014 Regulation. A link to an FEE document detailing these options is available in the 'Further information' section at the end of this document.

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- 1 [http://ec.europa.eu/internal\\_market/consultations/docs/2010/audit/green\\_paper\\_audit\\_en.pdf](http://ec.europa.eu/internal_market/consultations/docs/2010/audit/green_paper_audit_en.pdf)
  - 2 [http://ec.europa.eu/internal\\_market/auditing/docs/reform/directive\\_en.pdf](http://ec.europa.eu/internal_market/auditing/docs/reform/directive_en.pdf)
  - 3 [http://ec.europa.eu/internal\\_market/auditing/docs/reform/regulation\\_en.pdf](http://ec.europa.eu/internal_market/auditing/docs/reform/regulation_en.pdf)
  - 4 <http://www.europarl.europa.eu/sides/getDoc.do?type=AMD&reference=A7-2013-0171&format=PDF&language=EN&secondRef=066-066>
  - 5 <http://www.europarl.europa.eu/sides/getDoc.do?type=AMD&reference=A7-2013-0177&format=PDF&language=EN&secondRef=259-259>

## Scope and deadlines

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### Scope

The new legislation consists of a Directive and a Regulation:

- The **Directive** amends the Statutory Audit Directive (SAD) (2006/43/EC) and contains a series of amended and new requirements governing every statutory audit in the European Union, as well as some requirements applicable to PIEs only regarding audit committees (hereafter referred to in this Factsheet as “**the 2014 Directive**”);
- The **Regulation** contains additional requirements that relate specifically to statutory audits of PIEs in addition to the ones stated in the **Directive**. The provisions on mandatory audit firm rotation (MAFR), public tendering and the list of prohibited non-audit services (NAS) are included in the **Regulation** (hereafter referred to in this Factsheet as “**the 2014 Regulation**”).

The legislation will be applicable in all EU Member States and in the countries of the European Economic Area (EEA), being Iceland, Liechtenstein and Norway.

### Deadlines

As far as the deadlines are concerned, to come into effect, the **Directive** needs to be transposed by the respective EU and EEA Member States into their national law in order to become effective. Member states will have **two years to adopt and publish the provisions to comply with the Directive after its entry into force**, i.e. 20 days after publication in the OJ.

With regard to the **Regulation**, it technically comes into effect 20 days after publication in the OJ. Nevertheless, mainly due to the fact that the **Regulation** refers to the **Directive**, which – as explained above – provides two years for transposition into national law, there is also a two-year delay in the application of most provisions included in the Regulation. More specifically:

- All provisions included in the Regulation have a two-year delay in application, except Article 16 on the appointment of the auditor, which has a three-year delay; and
- The provisions on mandatory audit firm rotation become effective immediately, but with transitional arrangements that are further detailed below.

## Main changes – EU Directive on Statutory Audits of Annual and Consolidated Accounts

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Some articles of the 2006 SAD remain completely unchanged. The main amendments included in the **2014 Directive** relate to:

- Certain definitions, including the PIE definition which has been extended;
- The provisions on independence and objectivity of the auditor;
- The overall organisation of the auditor and the audit work;
- Quality assurance and new requirements in connection to penalties and sanctions;
- A new mechanism to adopt international auditing standards at EU level;
- Public auditor reporting; and
- Additional requirements for audit committees of PIEs.

### Definitions – Public Interest Entity (PIE) [Article 2]

A few definitions of the 2006 SAD have been updated, including the definition of PIEs [Article 2 (13)] which now states<sup>6</sup>:

“13. ‘public-interest entities’ means:

- (a) Entities governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC;
- (b) Credit institutions as defined in point 1 of Article 43(1) of Directive 2013/36/EU of the European Parliament and of the Council, other than those referred to in Article 2 of that Directive;
- (c) Insurance undertakings within the meaning of Article 2(1) of Directive 91/674/EEC or;
- (d) Designated by Member States as public-interest entities, for instance undertakings that are of significant public relevance because of the nature of their business, their size or the number of their employees;”

The definition itself has not significantly changed. **However, the identification of PIEs is now crucial to determine the entities which are in the scope of the 2014 Regulation.**

### Independence and objectivity [Articles 22, 22a and 22b]

The amended text of the **2014 Directive** is more specific than the 2006 SAD on the subject of independence and objectivity.

The requirement of independence from the audited entity is put not only on the statutory auditor or audit firm, but now also on “any natural person in a position to directly or indirectly influence the outcome of the statutory audit”<sup>7</sup>.

Some of the threats to independence are mentioned in the **2014 Directive** and include:<sup>8</sup>

- Self-review, self-interest and advocacy;
- Financial, personal, employment, business or other relationships with the audited entity;
- Holding a material and direct beneficial interest or engaging in any transaction with financial instruments of the audited entity (except interests owned indirectly through diversified collective investment schemes<sup>9</sup>);
- Acceptance of gifts with a value higher than considered trivial or inconsequential;

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<sup>6</sup> This definition is the same as in the 2013 Accounting Directive, Article 2 (1):  
<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:182:0019:0076:EN:PDF>

<sup>7</sup> 2014 Directive, Article 22 (1)

<sup>8</sup> 2014 Directive, Article 22 (2, 4, 5 and 6)

<sup>9</sup> i.e. often referred to as managed funds, such as pension funds or life insurance

- Acquisition by, merger with or acquisition of the audited entity by another entity which results in interests or relationships which may compromise the independence after the effective date of the merger or acquisition.

The fundamental independence requirements remained the same as stated in the 2006 SAD. The statutory auditor or audit firm shall adopt appropriate safeguards to minimise any threats to its independence.

The condition of independence has to be met at least for the period audited and the period in which the audit is performed. It is the responsibility of every statutory auditor or audit firm to implement all reasonable measures to maintain independence from the audited entity during such periods. Member States shall ensure that these measures are properly taken.

If matters arise based on which an “objective, reasonable and informed third party”<sup>10</sup> would conclude that the independence of the statutory auditor or audit firm is compromised, the statutory audit shall not be carried out.

The **2014 Directive** specifically addresses the independence issue with regard to the employment by the audited entity of former statutory auditors who provided their services during the audit engagement<sup>11</sup>. Until at least one year has elapsed since the former auditor took part in the audit engagement, he or she is not able to undertake the following functions in the audited entity: key management position, member of the audit committee or the body performing equivalent functions, non-executive member of the administrative body or member of supervisory body. The restricted period is prolonged to two years for statutory auditors and key audit partners of PIEs.

Prior to the acceptance of an audit engagement, the statutory auditor or audit firm shall assess and document the following indicators of independence<sup>12</sup>, which are consistent with the 2006 SAD:

- Compliance with the requirements stated in the **2014 Directive**;
- Threats to independence and measures taken to eliminate those threats;
- Availability of competent employees, time and resources to perform the audit appropriately;
- Approval of the key audit partner as a statutory auditor in the Member State (for audit firms only).

Member States are given an option to simplify the requirements for audits of small undertakings.

### Internal organisation of auditors and of their work [Articles 24a and 24b]

The 2006 SAD did not state any specific requirements on the internal organisation of the statutory auditor or audit firm or on the organisation of the work. The **2014 Directive** introduces two new articles placing new requirements upon the auditor about:<sup>13</sup>

- Maintaining objectivity and independence;
- Establishing an effective internal quality control mechanism, its monitoring and evaluation;
- Ensuring that the outsourcing of activities does not limit the ability of the competent authority to oversee them;
- Recording and dealing with accidents which could affect integrity;
- Establishing policies for performing the statutory audit and managing the audit file;
- Ensuring continuity and regularity of carrying out statutory audit activities; and
- Ensuring adequacy of remuneration policies, including profit-sharing.

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<sup>10</sup> 2014 Directive, Article 22 (1)

<sup>11</sup> 2014 Directive. Article 22a

<sup>12</sup> 2014 Directive, Article 22b (1)

<sup>13</sup> 2014 Directive, Article 24a (1)

According to the **2014 Directive**, at least one key audit partner needs to be assigned to each engagement and should actively participate in carrying out the audit. This partner needs to be provided with adequate resources and competent personnel. The **Directive** also states conditions relating to:<sup>14</sup>

- The independence and competence of the key audit partner;
- The recording and reporting of breaches and complaints;
- The content of client records; and
- The properties of an audit file.

### International auditing standards [Article 26]

As in the 2006 SAD, the **2014 Directive** requires **every statutory audit within the EU to be performed in accordance with international auditing standards adopted by the European Commission**. These standards have until now not been adopted by the European Commission and thus their implementation in Member States is not required.

The **2014 Directive** now specifies that:

- “[...]‘International auditing standards’ mean International Standards on Auditing (ISAs), International Standard on Quality Control (ISQC 1) and other related Standards issued by the International Federation of Accountants (IFAC) through the International Auditing and Assurance Standards Board (IAASB)”<sup>15</sup>; and
- The European Commission is empowered to adopt, by delegated acts<sup>16</sup>, international auditing standards in the area of audit practice, independence and internal quality controls.

International auditing standards adoptable by the European Commission must be<sup>17</sup>:

- Developed with proper due process, public oversight and transparency;
- Generally accepted internationally;
- Contributing to a high level of credibility and quality to the annual or consolidated financial statements;
- Conducive to the Union public good; and
- Not in conflict with any of the requirements of the **2014 Directive**.

The Member State option to apply national auditing standards dealing with subject matters, which are not covered by international standards adopted by the European Commission, remains unchanged. Two additional options are provided to Member States in connection to international auditing standards:

- Member States may impose audit procedures or requirements in addition to the international auditing standards adopted by the European Commission<sup>18</sup>. This option can be employed only if the additional requirements are necessary due to national legal requirements and only to the extent necessary to increase the credibility and quality of financial statements;
- Member States may take measures to ensure proportionate application of the auditing standards to the statutory audits of small undertakings<sup>19</sup>.

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<sup>14</sup> 2014 Directive, Article 24b

<sup>15</sup> 2014 Directive, Article 26 (2)

<sup>16</sup> The legislator delegates the power to adopt acts amending non-essential elements of a legislative act to the European Commission.

<sup>17</sup> 2014 Directive, Article 26 (3)

<sup>18</sup> 2014 Directive, Article 26 (4)

<sup>19</sup> 2014 Directive, Article 26 (5)

### Audit reporting [Article 28]

The basic requirements for the audit report are included in the 2013 Accounting Directive. The Article devoted to audit reporting in the **2014 Directive** includes a series of new measures to set minimum requirements that aim at enhancing investors' understanding of the audit, including:

- A statement on any material uncertainty relating to events or conditions that may cast significant doubt about the entity's ability to continue as a going concern;
- As referred to in Article 34 of the 2013 Accounting Directive<sup>20</sup>:
  - An opinion on the management report of consolidated accounts on:
    - Whether the management report is consistent with the financial statements for the same financial year; and
    - Whether the management report has been prepared in accordance with the applicable legal requirements;
  - A statement on whether, in the light of the knowledge and understanding of the undertaking and its environment obtained in the course of the audit, he, she or it has identified material misstatements in the management report, giving an indication of the nature of any such misstatements.

### Quality assurance, investigations and sanctions [Articles 29, 30 and 30a-e]

#### Quality Assurance

A quality assurance system should be established in every Member State and should comply with minimum criteria set out in the **2014 Directive**. Most of these criteria remain the same as in the 2006 SAD. The only change is linked to the frequency of the quality assurance where the maximum period between reviews used to be set at six years, whereas the **2014 Directive** now includes a risk-based analysis to determine the frequency of quality assurance reviews<sup>21</sup>. Nevertheless, quality assurance reviews are to be performed at least every six years.

Moreover, the **2014 Directive** specifies some further requirements on quality reviewers such as<sup>22</sup>:

- Professional education, relevant experience and specific training on quality assurance reviews;
- A minimum of three years to have elapsed since any association between the reviewer and the reviewed statutory auditor or audit firm; and
- No conflicts of interest between the reviewer and the reviewed statutory auditor or audit firm.

The requirements placed upon reviewers, as well as the overall scope of the quality review should reflect the scale and complexity of the statutory auditor or audit firm subject to review.

Quality assurance, as well as investigations and sanctions, can be subject to **delegation to professional bodies**. Reference is made to the relevant sections 'Public oversight and delegation to professional bodies' for the **2014 Directive** and 'Delegation to professional bodies' for the **2014 Regulation**, the latter including some specifications and restrictions regarding audits of PIEs.

#### Investigations and sanctions

The matters of investigations and sanctions were briefly mentioned in the 2006 SAD: it was stated that Member States shall establish an effective system of penalties for statutory auditors and audit firms that do not perform the audit in accordance with all legal requirements, and that the system, as well as the penalties imposed, shall be made publicly available.

<sup>20</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:182:0019:0076:EN:PDF>

<sup>21</sup> New Audit Directive, Article 29 (1) h

<sup>22</sup> New Audit Directive, Article 29 (2)

Sanctioning measures that should be in the power of the competent authority are included in the **2014 Directive**, such as<sup>23</sup>:

- A notice requiring the natural or legal person responsible for the breach to cease such conduct and to abstain from any repetition of that conduct;
- A public statement, which indicates the person responsible and the nature of the breach, published on the website of competent authorities. The information shall be published as soon as possible and shall remain available on the website at least for five years. It may be disclosed anonymously if the publication of personal data is not appropriate or could lead to inadequate damage to the institution or the natural person involved;
- A temporary prohibition of up to three years banning:
  - The statutory auditor, the audit firm or the key audit partner from carrying out statutory audits and/or signing audit reports;
  - A member of an audit firm or a member of an administrative or management body of a PIE from exercising functions in audit firms or in PIEs;
- A declaration that the audit report does not meet EU requirements; and
- Administrative pecuniary sanctions on natural and legal persons.

Member States have the option to add other sanctioning powers to this list.

When determining the level and type of sanction, the competent authority should consider all relevant circumstances<sup>24</sup>, including the gravity, duration or history of breaches. The **2014 Directive** demands that the sanction rules of each Member State and any amendments to them are communicated to the European Commission.

The competent authority shall be enabled to exercise its sanctioning powers directly, in collaboration with other authorities or by application of the competent judicial authorities. The right to appeal shall be given to every institution or individual on whom the sanction was imposed.

To enable the competent authority to impose sanctions when needed, it is important that an effective mechanism for reporting of breaches is established within each Member State. Such mechanisms should satisfy the following criteria<sup>25</sup>:

- The reporting of breaches and the follow-up process shall be executed in accordance with specifically defined procedures;
- Personal data of all persons involved in the process of reporting the breach are protected;
- The person accused of a breach must be enabled to exercise the right of defence and to be heard.

Specific procedures for reporting breaches via internal channels shall also be established within individual audit firms.

The annual overview of all sanctions imposed and administrative measures taken by the competent authority shall be communicated to the Committee of European Audit Oversight Bodies<sup>26</sup> (CEAOB), which will include this information in its annual report. The imposition of a ban on a statutory auditor or audit firm, as described in the list above, shall be communicated to the CEAOB immediately<sup>27</sup>.

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<sup>23</sup> New Audit Directive, Article 30a (1)

<sup>24</sup> 2014 Directive, Article 30b (1)

<sup>25</sup> 2014 Directive, Article 30e (2)

<sup>26</sup> For more information on the CEAOB, refer to the section 'Cooperation of audit oversight bodies and supervision' below.

<sup>27</sup> 2014 Directive, Article 30f

### Public oversight and delegation to professional bodies [Article 32]

As already required by the 2006 SAD, the system of oversight is to be organised by each Member State, but the responsibility for supervision shall be delegated to the competent authority. The competent authority shall be governed by non-practitioners, practitioners and experts may be called upon to assist the competent authority with specific tasks without being involved in any decision-making. The competent authority shall have the ultimate responsibility for the oversight of:

- The approval and registration of statutory auditors and audit firms;
- The adoption of standards (professional ethics, internal quality control of audit firms and auditing) – except when these are in the competence of other Member States' authorities; and
- The continuing education, quality assurance system, investigative and administrative disciplinary systems.

Member States now have the explicit option to “delegate or allow the competent authority to delegate any of its tasks to other authorities or bodies designated or otherwise authorised by law to carry out such tasks<sup>28</sup>.” The delegation should specify the conditions of delegation and tasks to be delegated and avoid conflicts of interest. The competent authority shall be able to reclaim its competences on a case by case basis.

It should be noted that the **2014 Regulation** specifies the tasks that cannot be delegated in respect of PIEs. Reference is made to the section ‘Delegation to professional bodies’ below.

### Audit committee [Article 39]

The requirements on audit committees laid down in the **2014 Directive** are based on the ones from the 2006 SAD. It should be noted that even though this article is in the Directive, it is applicable to PIEs only as it states: “Member States shall ensure that each public-interest entity has an audit committee<sup>29</sup>”. Exemptions from this obligation to have an audit committee may be granted to audited entities that are for instance:

- A small or medium-sized undertaking and the functions of the audit committee are performed by an administrative or supervisory body;
- PIEs with a body performing equivalent functions to an audit committee in accordance with legal provisions in the Member State in which the entity is registered.

The eligibility requirement of at least one member of the audit committee having competence in accounting and auditing has been carried over from the 2006 SAD. The independence requirement has been made more restrictive, since not ‘at least one’ but ‘the majority’ of members needs to be independent of the audited entity.

The list of functions assigned to the audit committee has been extended to<sup>30</sup>:

- Inform the administrative or supervisory body of the audited entity of the outcome of the statutory audit and explain its contribution to the integrity of the financial statements;
- Monitor the financial reporting process and submit recommendations;
- Monitor the effectiveness of the internal quality control and risk management system;
- Monitor the process of the audit of statutory or consolidated financial statements, mainly the findings and conclusions;
- Review and monitor the independence of the statutory auditor; and
- Be responsible for the procedure for the selection of the statutory auditor or audit firm.

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<sup>28</sup> 2014 Directive, Article 32 (4b)

<sup>29</sup> 2014 Directive, Article 39 (1)

<sup>30</sup> 2014 Directive, Article 39 (6)



## Main provisions - EU Regulation on Statutory Audit of Public Interest Entities

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The **2014 Regulation** is a new piece of legislation that applies to the statutory audit of Public Interest Entities (PIEs) only. The main areas of focus relate to:

- Restrictions on the provision of non-audit services to PIE audit clients, especially with the introduction of a list of prohibited non-audit services and the capping of the provision of 'permissible' non-audit services to a percentage of the total audit fees;
- New requirements with regard to mandatory audit firm rotation for PIEs;
- Auditor communication with regard to PIEs – external (to the public) and internal (to the audit committee) – which is now regulated in detail, including the requirement of certain disclosures;
- The oversight of auditors and audit firms at EU level;
- The set-up of a new body, the Committee of European Audit Oversight Bodies (CEAOB).

### Provision of non-audit services (NAS) [Articles 4 and 5]

#### List of prohibited non-audit services

The **2014 Regulation** introduces a list of prohibited non-audit services and thus prohibits the statutory auditor of a PIE to “directly or indirectly provide to the audited entity, to its parent undertaking or to its controlled undertaking within the Union any prohibited non-audit services”<sup>31</sup>. This prohibition applies in the period between the beginning of the period audited and the issuing of the audit report, as well as in the immediately preceding financial year regarding internal control related services.

The **prohibited NAS**, as stated in Article 5 of the **2014 Regulation**, are as follows:

- Tax services relating to preparation of tax forms, payroll tax, custom duties, identification of public subsidies and tax incentives, support regarding tax inspections by tax authorities, calculation of direct and indirect tax and deferred tax, provision of tax advice;
- Services that involve playing any part in the management or decision-making of the audited entity;
- Bookkeeping and preparing accounting records and financial statements;
- Payroll services;
- Designing and implementing internal control or risk management procedures or financial information technology systems;
- Valuation services;
- Legal services;
- Services related to the audit client's internal audit function;
- Services linked to the financing, capital structure and allocation, and investment strategy of the audit client;
- Promoting, dealing in, or underwriting shares in the audited entity;
- Human resources services such as high level management recruitment, structuring of the organisation or cost control.

Member States may take the option to extend the list of prohibited services.

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<sup>31</sup> 2014 Regulation, Article 5 (1)

The **2014 Regulation** also provides Member States with the option to allow the following services:

- Tax services relating to preparation of tax forms, identification of public subsidies and tax incentives, support regarding tax inspections by tax authorities, calculation of direct and indirect tax and deferred tax;
- Valuation services;

as long as their impact on the audited financial statements is immaterial or none, the evaluation of this impact on the financial statements is documented in the additional report to the audit committee and the principles of independence, as included in the **2014 Directive**, are applied by the statutory auditor. Reference is made to the related section 'Independence and objectivity' above.

#### Other non-audit services

The provision of other non-audit services, namely the ones that are not prohibited, are:

- **Subject to the approval of the audit committee** following an assessment of the threats to independence and the safeguards that can be applied to mitigate or eliminate those threats; and also
- **Limited to 70% of the average of statutory audit fees paid in the last three consecutive years**<sup>32</sup>. This 'cap' of 70% is calculated for the statutory auditor or audit firm; it applies to the audited entity, its parent and controlled undertakings. Services imposed by national or EU legislation shall not be included in the calculation. Member States are given an option to apply stricter conditions but may also allow temporary exceptions from this requirement.

#### Assessment of threats to independence [Article 6]

The **2014 Regulation** adds another layer of requirements to the **2014 Directive**<sup>33</sup> on the subject of independence for the audit of PIEs.

Amongst others, the independence of the statutory auditor(s) or partner(s), senior manager(s) and manager(s) of the audit firm should be confirmed to the audit committee in writing every year. Any possible threats to independence and measures adopted in order to limit those threats shall also be discussed with the audit committee.

#### International auditing standards [Article 9]

The adoption of international standards in relation to the audit of PIEs is subject to the conditions stated in the **2014 Directive**<sup>34</sup>. Reference is made to the section 'International auditing standards' in the Directive part above. A condition is added in that the international standards adopted for the audit of PIEs shall not amend any of the requirements of the **2014 Regulation**. The only areas of the **Regulation** that could be supplemented by the international auditing standards are:

- Irregularities [Article 7];
- Engagement quality control review [Article 8]; and
- Hand-over file [Article 18].

Moreover, the **2014 Regulation** establishes that the adoption of international standards and their technical examination shall be performed by the CEAOB<sup>35</sup>.

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<sup>32</sup> 2014 Regulation, Article 4

<sup>33</sup> See above, 2014 Directive, Article 22

<sup>34</sup> See above, 2014 Directive, Article 26

<sup>35</sup> 2014 Regulation, Article 30 (7). Refer to the section 'Cooperation of audit oversight bodies and supervision' below.

### Auditor communication [Articles 10 and 11]

The **Regulation** pays significant attention to auditor communication both externally – with the audit report<sup>36</sup> on the audit of the PIE and with the transparency report on the audit firm – and internally – with the report to the audit committee<sup>37</sup> of the PIE.

#### Audit report

According to the **2014 Regulation**, the audit report of PIEs has to comply with the requirements included in the **2014 Directive** (refer to the section ‘Audit reporting’ in the Directive part above), as well as with the following additional requirements:

- A statement indicating by whom or by which body the auditor or audit firm was appointed;
- A statement indicating the date of the appointment and the period of total uninterrupted engagement, including previous renewals and reappointments of the auditor;
- The audit opinion should be supported by a description of the **most significant assessed risks of material misstatements**, as well as a summary of the auditor’s response to those risks and, where relevant, key observations arising from those risks. Where relevant as well, the report should refer to the associated disclosure in the financial statements;
- An explanation as to the extent to which the statutory audit was considered capable of detecting irregularities, including fraud;
- A confirmation that the audit opinion is consistent with the additional report to the audit committee (see below);
- A declaration that none of the prohibited non-audit services were provided to the audited entity and that the independence of the auditor was maintained. In connection to this statement, any other services provided by the statutory auditor or audit firm to the audited entity and its controlled undertaking(s) should be disclosed in the audit report if not already disclosed in the management report or financial statements.

#### Additional report to the audit committee

An additional report to the audit committee used to be required by the 2006 SAD for PIE audits where the statutory auditor or audit firm reports to the audit committee on key matters arising from the statutory audit, and in particular on material weaknesses in internal controls with regard to the financial reporting process. The **2014 Regulation** expands the content of the report with the following main additional requirements<sup>38</sup>:

- A description of the frequency and nature of communication between the statutory auditor or audit firm and the audit committee, management and/or supervisory board, including dates of meetings;
- A description of the methodology used, including which categories of the balance sheet have been directly verified and which have been based on system and compliance testing;
- A disclosure of the quantitative level of materiality applied to perform the statutory audit for the financial statements as a whole and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures;
- An explanation on the judgments about events or conditions identified during the course of the audit that may cast significant doubt on the entity’s ability to continue as a going concern and whether they constitute a material uncertainty;
- A report on any significant deficiencies in the internal financial control system, as well as in the accounting system. For each significant deficiency, the additional report shall state whether or not the deficiency in question has been resolved by the management;
- A report on any significant matters involving actual or suspected non-compliance with laws and regulations or articles of association, which were identified during the course of the audit, in so far as they are considered to be relevant in order to enable the audit committee to fulfil its tasks;

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<sup>36</sup> 2014 Regulation, Article 10

<sup>37</sup> 2014 Regulation, Article 11

<sup>38</sup> 2014 Regulation, Article 11 (2)

- An assessment of the valuation methods applied to the various items in the annual or consolidated financial statements, including any impact of changes of such methods;
- A report on any significant difficulties encountered during the audit, any significant matters arising from the audit that were discussed, or subject to correspondence with management or any other matters arising from the statutory audit that in the auditor's professional judgement are significant to the oversight of the financial reporting process.

### Audit firm's transparency report

The annual transparency report could also be seen as a part of the auditor's communication. This report should be publicly available on the website of the statutory auditor or audit firm which carries out audits of PIEs. The requirements placed upon the content of the transparency report were already included in the 2006 SAD; only a few additional points arise from the **2014 Regulation**, such as a disclosure of the total turnover of the network and a statement on the firm's independence<sup>39</sup>.

### Mandatory audit firm rotation (MAFR) [Article 17]

#### Provisions regarding the duration of the audit engagement

One of the most important issues covered by the **2014 Regulation** is the duration of the audit engagement. Article 17 of the **Regulation** sets the **duration of the audit engagement to a maximum of ten years. The minimum duration is one year**. Member States are provided with an option regarding both of these deadlines:

- Member States are allowed to set the minimum duration longer than one year; and
- Member States are allowed to set the maximum duration shorter than ten years.

Member States are also given two options for prolonging the maximum duration of an audit engagement – by imposing 'public tendering' or 'joint audit'. Enabling one of these approaches may result in setting the maximum duration of an audit engagement up to:<sup>40</sup>

- **A total period of 20 years**, but only if a **public tender** takes effect upon the expiry of the first ten year period (or a shorter period if decided by the Member State);
- **A total period of 24 years**, but only if two auditors - i.e. via a **joint audit** - are simultaneously appointed after the expiry of the first ten year period and present a joint report.

**The 'cooling-off' period**, during which the statutory auditor, audit firm or any member of their network shall not undertake the statutory audit of the same PIE after expiration of the maximum duration of the engagement, is **four years**.

#### Transitional arrangements

Transitional arrangements vary depending on the length of the audit appointment at the date the new legislation comes into force:

- If the auditor has been in place for 20 years or more, the first rotation under this new legislation must take place within six years;
- If the auditor has been in place for between 11 and 20 years, the first rotation under this new legislation must take place within nine years;
- Otherwise, the new regime will apply two years from the legislation implementation date.

<sup>39</sup> 2014 Regulation, Article 13

<sup>40</sup> 2014 Regulation, Article 17 (4)

### Delegation to Professional Bodies *[Article 24]*

As mentioned above, the competent authorities are enabled to delegate some tasks and competences to other bodies. However, as stated in the **2014 Regulation**, in respect of PIEs, tasks related to the following areas cannot be delegated<sup>41</sup>:

- The quality assurance system referred to in Article 26;
- Investigations referred to in Article 23 of the **2014 Regulation** and Article 32 of the **2014 Directive** arising from that quality assurance system or from a referral by another authority; and
- Sanctions and measures related to the quality assurance reviews or investigation of statutory audits of PIEs.

The general requirements of the **2014 Directive**, as stated above, also apply. Refer to the section 'Public oversight and delegation to professional bodies' above.

### Quality assurance *[Article 26]*

The quality assurance inspection of statutory auditors and audit firms of PIEs shall be performed more often than is required by the **2014 Directive**, and at least every three years. This requirement does not apply to PIEs which are small and medium-sized undertakings, for which the maximum period between quality assurance inspections remains six years.

The **Regulation** defines the minimum scope of inspection as<sup>42</sup>:

- An assessment of the design of the internal quality control system of the statutory auditor or audit firm;
- Adequate compliance testing of procedures and review of audit files of PIEs in order to verify the effectiveness of the internal quality control system; and
- In the light of the findings from the above testing, an assessment of the content of the most recent annual transparency report.

### Cooperation of audit oversight bodies and supervision *[Articles 24 and 30]*

The competent authorities of the Member States should cooperate with each other, where necessary, for the purpose of carrying out their supervisory duties regarding statutory audits. They should respect the principle of home-country regulation and oversight by the Member State in which the statutory auditor or audit firm is approved and the audited entity has its registered office.

The cooperation between competent authorities should be organised within the framework of a new body, the Committee of European Auditing Oversight Bodies (CEAOB) that will be composed of high level representatives from the national competent authorities (one representative per Member State), and one member appointed by the European Securities and Markets Authority (ESMA), the latter having no voting rights. The Chair will be elected amongst the representatives of the national competent authorities and the Vice Chair appointed by the European Commission. All active tasks of the European Group of Audit Oversight Bodies (EAOB) will be assumed by this new Committee.

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<sup>41</sup> 2014 Regulation, Article 24 (1)

<sup>42</sup> 2014 Regulation, Article 26 (6)

The CEAOB will be responsible for coordinating the activities of the national competent authorities and shall mainly be involved in the following:<sup>43</sup>

- In order to enhance consistent application of the **2014 Directive** and **Regulation**, the CEAOB may adopt non-binding guidelines or opinions that shall be published by the European Commission. It also has a role of coordination of tasks when required by the new legislation;
- It should facilitate the exchange of information, provide advice to the European Commission and contribute to the technical assessment of public oversight systems of third countries and technical examination of the international auditing standards, including the processes for their elaboration, with a view for their adoption at EU level;
- It should contribute to the improvement of cooperation mechanisms for the oversight of PIEs' statutory auditors, audit firms and networks.

If relevant, the CEAOB may request assistance from ESMA, the European Banking Authority (EBA) or the European Insurance and Occupational Pensions Authority (EIOPA).

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<sup>43</sup> 2014 Regulation, Article 30 (7)

## Further information

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- Frequently Asked Questions – Audit Policy<sup>44</sup>
- **Options available to Member States and Competent Authorities in the European Directive on statutory audits of annual and consolidated accounts**<sup>45</sup>
- **Options available to Member States and Competent Authorities in the European Regulation on statutory audit of public-interest entities**<sup>46</sup>
- Unofficial advance version of the amended Directive 2006/43/EC on Statutory Audits of Annual and Consolidated Accounts, approved in April 2014<sup>47</sup>

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<sup>44</sup> [http://www.fee.be/index.php?option=com\\_content&view=article&id=1410&Itemid=396](http://www.fee.be/index.php?option=com_content&view=article&id=1410&Itemid=396)

<sup>45</sup> [http://www.fee.be/images/publications/auditing/Option\\_Table\\_-\\_Audit\\_Directive\\_2014.pdf](http://www.fee.be/images/publications/auditing/Option_Table_-_Audit_Directive_2014.pdf)

<sup>46</sup> [http://www.fee.be/images/publications/auditing/Option\\_Table\\_-\\_Audit\\_Regulation\\_2014.pdf](http://www.fee.be/images/publications/auditing/Option_Table_-_Audit_Regulation_2014.pdf)

<sup>47</sup> [http://www.fee.be/index.php?option=com\\_content&view=article&id=1418:option-comparison-table-european-directive-on-statutory-audits-of-annual-and-consolidated-accounts-and-regulation-on-statutory-audit-of-public-interest-entities-2&catid=32:audit-assurance&Itemid=106](http://www.fee.be/index.php?option=com_content&view=article&id=1418:option-comparison-table-european-directive-on-statutory-audits-of-annual-and-consolidated-accounts-and-regulation-on-statutory-audit-of-public-interest-entities-2&catid=32:audit-assurance&Itemid=106)

### About FEE

FEE (Fédération des Experts-comptables Européens – Federation of European Accountants) is an international non-profit organisation based in Brussels that represents 48 institutes of professional accountants and auditors from 36 European countries, including all of the 28 EU member states.

FEE has a combined membership of more than 800.000 professional accountants, working in different capacities in public practice, small and large accountancy firms, businesses of all sizes, government and education – all of whom contribute to a more efficient, transparent and sustainable European economy.

### FEE and its Members

