

# Policy Statement

*Standing for trust and integrity*

July 2012



## The Provision of Non-Audit Services to Audit Clients that are Public Interest Entities (PIEs)

FEE issued a Briefing Paper on the Provision of Non-Audit Services to Audit Clients in June 2011<sup>1</sup> further to the European Commission Green Paper on Audit.

Following the publication of the European Commission Proposal for a Regulation on specific requirements regarding Statutory Audit of Public-Interest Entities (PIEs)<sup>2</sup> in November 2011, FEE is supplementing its Briefing Paper with the present document by considering in further detail the prohibition of the provision of non-audit services to audit clients that are PIEs as proposed by the European Commission.

### Non-audit services should not be dealt with by Regulation

As the representative organisation of the European accountancy profession, FEE is committed to advancing audit policy across the European Union (EU) and globally. This would require striking a proper balance between the need to provide consistent common principles and requirements while acknowledging the (sometimes significant) differences in size, structure, complexity and type of economies of EU Member States. While we recognise the importance of fostering harmonisation in accordance with the EU legal competences, we believe that EU intervention in these matters and especially as regards company law, needs to continue complying with the principles of subsidiarity and especially proportionality.

Therefore, FEE recommends the European Institutions to reassess the choice of a European Regulation as the legal instrument to change statutory audit of public interest entities. In line with the choice made regarding the current Statutory Audit Directive (2006/43/EC), it would be more appropriate and proportionate to continue dealing with the provision of statutory audit services to companies which are public interest entities in a European Directive. Furthermore, in view of the objective – that FEE supports – of enabling new entrants on the market of statutory audit services for public interest entities, it does not appear opportune to split the legislation of statutory audit in two different instruments, a Directive and a Regulation, as this may increase barriers to entry on the public interest entities audit market.

Our recommendations below are therefore not aimed at endorsing the legal instrument of a Regulation, but intend to encourage a common approach on non-audit services by other legislative and non-legislative means.

### Independence rules are already in place in EU Member States

Article 22.4 of the 2006 Statutory Audit Directive (2006/43/EC) already created a legal basis for the European Commission to adopt implementing measures in relation to independence and objectivity. Many EU Member States have in the meantime implemented a robust system of independence rules without awaiting a European initiative.

### International solutions for the provision of non-audit services are preferable

The application of the principles and requirements of the current Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA)<sup>3</sup>, in particular Section 290 of the Code dealing with Independence requirements, could facilitate further harmonisation in this area, especially if the provisions and the concept of materiality of the IESBA Code of Ethics<sup>4</sup> would be brought in.

The IESBA is an independent standard-setting board of IFAC<sup>5</sup> with at least half of its members being non-practitioners including public members. The Board follows a rigorous due process to ensure that a public interest perspective is taken into account. The views of stakeholders affected by its standards are thoroughly considered resulting in high quality global common standards, which are currently applied by many IESBA members – including in European Union Member States. On this basis FEE identifies a series of recommendations in order to better align the European Commission proposals with the global standards in the Independence Section 290 of the IESBA Code of Ethics.

The principle of objectivity is imposed on all auditors and in respect of all services they perform, which is the obligation not to compromise their professional or business judgment because of bias, conflict of interest or the undue influence of others. The concept of independence is a proxy to deal with objectivity in a regulatory, practical and measurable way.

Some non-audit services will compromise an auditor's independence and should be prohibited when combined with the audit. This is already the case in most EU Member States. Other services do not pose a threat to auditors' independence in many circumstances and should thus be allowed in such circumstances.

<sup>1</sup> See <http://www.fee.be/fileupload/upload/Briefing%20Paper%202002%20Provision%20of%20Non%20Audit%20Services%201106306201112257.pdf>

<sup>2</sup> See [http://ec.europa.eu/internal\\_market/auditing/docs/reform/regulation\\_en.pdf](http://ec.europa.eu/internal_market/auditing/docs/reform/regulation_en.pdf)

<sup>3</sup> IESBA, the International Ethics Standards Board for Accountants, an independent board under the auspices of IFAC setting the global ethical and independence standards for professional accountants.

<sup>4</sup> See <http://www.ifac.org/publications-resources/2010-handbook-code-ethics-professional-accountants>

<sup>5</sup> IFAC is the International Federation of Accountants

In order to assess whether the provision of a particular non-audit service will, may, or will not compromise the auditor's independence, the non-audit services can be categorised as follows:

- To be generally prohibited;
- To be either prohibited or permitted depending on a case by case analysis; or
- Generally permitted.

Further explanation on the differences between the three types is given below. Most EU Member States have used a similar approach to regulate the provision of non-audit services by auditors and their network, although there are local differences as far as the categorisation of individual services is concerned.

## Public interest entities versus non-public interest entities

Public interest entities are under heightened public scrutiny and are subject to additional governance, transparency and other requirements when compared with non-public interest entities. The independence requirements imposed on auditors of PIEs are more rigorous which results in more prohibitions of non-audit services for auditors auditing PIEs than for those auditing other companies.

The rigorous requirements for the prohibition or provision of non-audit services for PIEs are less justifiable or relevant for non-PIEs, including Small and Medium-Sized Entities (SMEs) as there is a reduced perception issue regarding auditor independence. The stricter PIE requirements should not result in additional burdens or unnecessary pressure for auditors of non-PIEs. This is especially important in an era where simplification, reduction of administrative burdens and deregulation for SMEs is a crucial objective within the EU.

## Prohibited non-audit services to audited Public Interest Entities

Certain non-audit services would be seen to be such a significant threat to the independence of the auditor that the only possible solution is to prohibit the provision of such services to audit clients, if they have an impact on the

financial statements to be audited; in some cases even if the service has no such impact. These include the following<sup>6</sup>:

To be generally prohibited	
The EC Proposed Regulation intends to prohibit	IESBA Code of Ethics prohibits
<ul style="list-style-type: none"> <li>• General management services</li> </ul>	<ul style="list-style-type: none"> <li>• Assuming a management responsibility</li> </ul>
<ul style="list-style-type: none"> <li>• Legal services</li> </ul> <p><i>Note: As provided for in the IESBA Code, it is recommended that legal services be generally prohibited if they relate to "Serving as General Counsel", "Negotiating for the audit client", or "Acting as an advocate for the audit client in case its outcome would have a material impact on the financial statements to be audited" (see below under case by case analysis in the IESBA list of prohibited services if material to the financial statements).</i></p>	<ul style="list-style-type: none"> <li>• Serving as General Counsel</li> <li>• Negotiating for the audit client</li> </ul>
<ul style="list-style-type: none"> <li>• Broker or dealer, investment adviser, or investment banking services</li> </ul>	<ul style="list-style-type: none"> <li>• Promoting, dealing in, or underwriting client shares</li> </ul>
<ul style="list-style-type: none"> <li>• Bookkeeping</li> </ul>	<ul style="list-style-type: none"> <li>• Bookkeeping and accounting services</li> </ul>
<ul style="list-style-type: none"> <li>• Human resources services, including recruiting senior management<sup>7</sup></li> </ul> <p><i>Note: As per the IESBA Code of Ethics, it is recommended that these services be generally prohibited if relating to recruiting senior management who would have significant influence over accounting records or financial statements.</i></p>	<ul style="list-style-type: none"> <li>• Recruiting directors/officers, or senior management who will have significant influence over accounting records or financial statements</li> </ul>
<ul style="list-style-type: none"> <li>• Preparing accounting records and financial statements</li> <li>• Designing and implementing internal control or risk management procedure related to the preparation and/or control of financing information included in the financial statements</li> </ul>	<ul style="list-style-type: none"> <li>• The preparation of financial statements and related financial information</li> </ul>
	<ul style="list-style-type: none"> <li>• Payroll services</li> </ul>
<p><b>FEE Recommendation: To be generally prohibited as provided for in the IESBA Code of Ethics (Independence Section 290)</b></p>	

## Case by case analysis - for non-audit services to audited Public Interest Entities creating a potential threat to auditor independence

Certain non-audit services *potentially* pose a threat to the independence of the auditor. It may be possible in many cases to reduce such threats to an acceptable level by introducing specific measures to safeguard auditor independence. This requires a deeper and individualised analysis by the auditor and those charged with governance, generally the audit committee, to understand if the provision of these services may and to what extent they could compromise the auditor's objectivity.

It is clear that, for example, assisting the client with a litigation on an *insignificant* matter does not affect the auditor's objectivity and independence as there will be no conflict of interest at the time of performing the audit and formulating conclusions. This would thus become an *allowed service*.

However, determining the value of an asset for an audit client will raise an independence issue when the value of such asset has a *significant* impact on the

<sup>6</sup> Note that per the IESBA Code of Ethics the prohibition of the provision of some of these services applies for all audited entities and not only PIEs.

<sup>7</sup> As per the European Commission Proposed Regulation on Audits of PIEs, these services may be provided by the statutory auditor or the audit firm subject to prior approval by the audit committee.

financial statements to be audited. This would thus become a *prohibited service*. Certain other services like consultancy, advisory and some tax services also require an in-depth analysis. There are many different types of such services. If they form part of the function of management they will be prohibited (see above). However, if they do not, the provision of such services by an auditor

should be considered case by case as it will depend on the specific type of service, its dependence on an accounting treatment, the significance of its impact on the financial statements as well as for example the tax regime in a particular country whether the auditor can or cannot perform a certain service.

Case by case analysis	
The EC Proposed Regulation intends to prohibit without regard to materiality	IESBA Code of Ethics: prohibited if material to the financial statements
• Resolution of litigation	• Estimating damages or other amounts as part of litigation support services
• Valuation services, providing fairness opinions <sup>8</sup> or contribution-in-kind reports <sup>9</sup>	• Valuation services involving subjectivity
• Tax consultancy and other advisory services	• Tax or corporate finance advice that depends on a particular accounting treatment and financial statement presentation
	• Acting as an advocate before a public tribunal or court
• Actuarial services	• Certain actuarial services which are in effect valuation services
• Participating in the audit client's internal audit and the provision of services related to the internal audit function	• Internal audit services relating to internal controls over financial reporting or systems or financial statement amounts/disclosures
• Designing and implementing financial information technology systems for some public-interest entities (all except listed entities)	• Designing and implementing financial reporting IT systems
• Designing and implementing financial information technology systems for some public-interest entities (listed entities) <sup>10</sup>	• Designing and implementing financial reporting IT systems
• Expert services unrelated to the audit <sup>11</sup>	
• Advice on risk	
<b>FEE Recommendation: Depending on a case by case analysis, to be either</b> <b>• Generally prohibited if material to the financial statements as provided for in the IESBA Code of Ethics (Independence Section 290)</b> <b>or</b> <b>• Permitted only if, following rigorous analysis, appropriate safeguards are in place as well as appropriate audit committee involvement, to mitigate or even eliminate any threat to auditor independence to an acceptable level</b>	

These assessments are not black or white in practice and will require a deep, objective and documented assessment of the services on a case by case basis. This analysis is based on a solid rationale for applying criteria to determine which safeguards would be appropriate (or not) to mitigate the identified threats.

In PIEs, the audit committee also often plays a determining role in the procurement of significant non-audit services from the auditor. A provision

## Allowed services

Some other non-audit services are audit-related and other assurance services. The performance of such services by the auditor may either be required due to legal, regulatory or contractual reasons, or the auditor is best placed to provide them to the audit client because the service is closely connected to the audit work. Though apparently, in line with this understanding, the EC proposed Regulation intends to allow services referred to as "related financial audit services": however, FEE does not support an approach that would provide within legislation an exhaustive list of assurance and audit-related services which are permissible.

It should be noted that as far as the provision of assurance is concerned it is already a requirement for the auditor to be independent<sup>12</sup>. This means that, as the statutory auditor has to be independent and is also subject to oversight, no other party would be better placed to perform these services from an independence perspective.

could be established that the auditor may not render other services to the PIE to be audited without audit committee involvement and/or approval. The audit committee should be able to predefine whether certain types and/or values of non-audit services can be awarded, or whether it wishes to award assignments individually, in particular in conjunction with its monitoring role.

The case by case analysis results in the auditor being prohibited or allowed to perform the service under consideration in that specific situation.

A prohibition for the auditor to provide these types of non-audit services to an audit client is not necessary to preserve auditor independence. A ban would also seriously undermine the ability of companies and stakeholders to timely and cost-effectively enter into transactions where currently the assurance provided by the auditor on any element of the transaction is considered to be relevant. It would also affect part of the supervisory system in certain key sectors of the economy. For these reasons, the IESBA Code of Ethics is consistent with the EC approach to permit this type of services within the overall requirement to address specific threats but without other limitations.

<sup>8</sup> It should be noted that a "fairness opinion" is not a defined term in EU legislation but would fall under assurance services under the IESBA Code of Ethics and therefore be subject to independence requirements.

<sup>9</sup> Certain types of "contribution-in-kind reports" are mandatory by EU law (2nd Company Law Directive) and are designed as assurance/attest services to protect minority shareholders and the public interest (i.e. squeeze out, merger situations, certain contractual relationships between companies, change of legal form). Though the EU legislation only requires these services to be performed by experts, many EU Member States require these services to be performed by the statutory auditor. Also, some EU Member States require the person providing such services to meet the same independence requirements as applicable for the statutory auditor.

<sup>10</sup> As per the European Commission Proposed Regulation on Audits of PIEs, these services may be provided by the statutory auditor or the audit firm subject to prior approval by the competent authority.

<sup>11</sup> Note that it is presumed that these expert services relate to services not covered elsewhere in this Policy Statement.

<sup>12</sup> See IESBA Code of Ethics Section 290 for Review Engagements and Section 291 for Other Assurance Engagements

<b>Generally permitted</b>	
<b>The EC Proposed Regulation intends to allow related financial audit services, but solely up to a limit of 10% of the fees paid for the statutory audit:</b>	<b>IESBA Code of Ethics</b> Does not explicitly define permitted services, but some typical examples of these services which are implicitly permitted are:
<ul style="list-style-type: none"> <li>• Audit or review of interim financial statements</li> </ul>	<ul style="list-style-type: none"> <li>• Review of interim financial statements</li> </ul>
	<ul style="list-style-type: none"> <li>• Assurance provided to lenders on compliance with certain contractual agreements of a loan</li> </ul>
<ul style="list-style-type: none"> <li>• Assurance on corporate governance statements</li> </ul>	<ul style="list-style-type: none"> <li>• Assurance on corporate governance statements</li> </ul>
<ul style="list-style-type: none"> <li>• Assurance on corporate social responsibility matters</li> </ul>	<ul style="list-style-type: none"> <li>• Assurance on Corporate Social Responsibility (CSR) matters</li> </ul>
<ul style="list-style-type: none"> <li>• Assurance on or attestation of regulatory reporting to regulators of financial institutions beyond the scope of the statutory audit and designed to assist regulators in fulfilling their role, such as on capital requirements or specific solvency ratios determining how likely an undertaking will be to continue meeting its debt obligations</li> </ul>	<ul style="list-style-type: none"> <li>• Assurance on or attestation of regulatory reporting provided to regulators in certain sectors (i.e. bank regulators) beyond the scope of the audit and designed to assist regulators in fulfilling their role, such as on capital requirements or specific solvency-related ratios determining how likely a company will be to continue meeting its debt obligations</li> </ul>
	<ul style="list-style-type: none"> <li>• Assurance on a company's pro-forma financial information, anticipating the result of a planned transaction as a merger, an acquisition or a disposal</li> </ul>
<ul style="list-style-type: none"> <li>• Certification on compliance with tax requirements where such attestation is required by national law</li> </ul>	<ul style="list-style-type: none"> <li>• Tax compliance work, such as assistance in preparing tax returns</li> </ul>
<ul style="list-style-type: none"> <li>• Any other statutory duty related to audit work imposed by [European] Union legislation to the statutory auditor or audit firm</li> </ul>	
<b>The EC Proposed Regulation would allow under certain circumstances</b>	
<ul style="list-style-type: none"> <li>• Due diligence services to the vendor or the buy side on potential mergers and acquisitions and providing assurance on the audited entity to other parties at a financial or corporate transaction<sup>13</sup></li> </ul>	<ul style="list-style-type: none"> <li>• Due diligence services on potential mergers and acquisitions</li> </ul>
<ul style="list-style-type: none"> <li>• Providing comfort letters for investors in the context of the issuance of an undertaking's securities<sup>14</sup></li> </ul>	<ul style="list-style-type: none"> <li>• Providing comfort letters for investors in the context of the issuance of a company's securities</li> </ul>
<b>The EC Proposed Regulation intends to prohibit without regard to materiality</b>	
<ul style="list-style-type: none"> <li>• Actuarial services</li> </ul>	<ul style="list-style-type: none"> <li>• Actuarial services which are not in effect valuation services</li> </ul>
<b>FEE Recommendation: The overall requirement to address specific threats shall apply without other limitations</b>	

## The way forward: harmonised European independence requirements

Non-audit services provided by auditors to their audit clients should not be treated as if every service endangers the auditor's independence in every circumstance. To prohibit provision as a whole would unnecessarily restrict the ability of business to choose the most appropriate adviser in circumstances when threats to independence would be absent or minimal or could be managed with safeguards. Certain services are not just permissible but are required to be performed by the auditor or can be best performed by the auditor. The provision of other services to audit and especially non-audit clients can enhance the quality of the audit as well as its effectiveness and efficiency. Indeed, in performing auditing, other assurance and even related

non-audit services, members of the audit profession obtain complementary and specialised knowledge and competence. Also, it is a reality that this variety of work attracts talented young graduates and other highly skilled resources which is crucial for the provision of high quality audit services.

Further harmonisation of these matters at European level could be achieved with the application of the principles and requirements of the relevant sections of the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board of Accountants (IESBA). Such common standards would also be a prerequisite for an EU passport for auditors.

### About FEE

FEE (Fédération des Experts-comptables Européens – Federation of European Accountants) represents 45 professional institutes of accountants and auditors from 33 European countries, including all of the 27 European Union (EU) Member States. In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 700.000 professional accountants, working in different capacities in public practice, small and big firms, government and education, who all contribute to a more efficient, transparent and sustainable European economy.

<sup>13</sup> As per the European Commission Proposed Regulation on Audits of PIEs, these services may be provided by the statutory auditor or the audit firm subject to prior approval by the competent authority.

<sup>14</sup> As per the European Commission Proposed Regulation on Audits of PIEs, these services may be provided by the statutory auditor or the audit firm subject to prior approval by the audit committee.