Audit for Growth and Prosperity in Europe: How Audit Regulation Helps Restore Public Trust

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Banking and finance

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The views expressed are those of the authors and do not necessarily reflect those of the European Commission

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A few words of introduction

- Part of 'Audit and Credit Rating Agencies' Unit
- Under the portfolio of DG FISMA within the Commission

BANKING AND FINANCE

DG Financial Stability, Financial Services and Capital Markets Union

Commissioner

Jonathan Hill

Commissioner in charge of Financial Stability, Financial Services and Capital Markets Union

Director General

Olivier Guersent

Director General of DG FISMA

In this presentation

PART I: Objective and structure of the EU audit reform

PART II: What's new?

PART III: Implementation challenges

PART IV: Questions from the audience

PART I: The EU Audit Reform

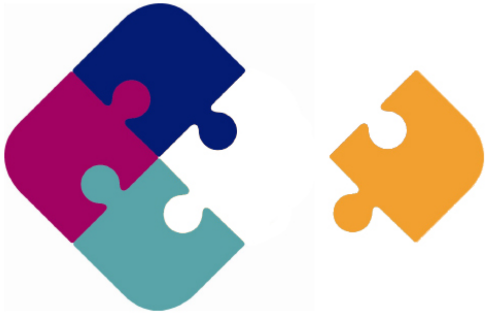
Objective of the EU Audit Reform

Robust audits → **Investor trust** → **Stronger capital markets**

The new EU audit rules

- **Horizontal rules** on statutory audits of annual financial statements and consolidated financial statements (Directive 2006/43 as amended by Directive 2014/56)

- **Specific requirements** for public-interest entities (PIEs) (Regulation 537/2014)



  - Listed companies
  - Credit institutions
  - Insurance undertakings
  - Other entities designated as such by Member States

- **Scope**: statutory auditors, audit firms & companies in the EU

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Key pillars

- **Enhancing transparency**
  - Enhanced information to investors
  - Greater accountability of auditors

- **Strengthening auditor independence**
  - Mandatory rotation of audit firms and statutory auditors
  - Prohibition on the provision of certain non-audit services
  - Cap on level of fees for the provision of non-audit services

- **Enhancing supervision**
  - More powers for national audit oversight authorities
  - Sanctioning regime further harmonised
  - 'Early warning mechanism'

- **Fostering market diversity**
  - Prohibition on 'Big Four-only third party' clauses
  - Proportionate approach to small undertakings

PART II: WHAT'S NEW?

Strengthening auditor independence

- **Applicable to all statutory audits**
  - New organisational requirements for statutory auditors and audit firms
- **Applicable to the audits of PIEs**
  - Mandatory rotation of audit firms and statutory auditors
  - Prohibition on the provision of certain non-audit services
  - Cap on level of fees for the provision of non-audit services

Mandatory audit firm rotation (PIEs)

- **10-year maximum** duration of the audit engagement
- Member States' options to extend:

  + 10 years upon tender
  or
  + 14 years in case of joint audit

- Transitional provisions for long-standing audit engagements

→ **Enhance Professional Scepticism**

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Black List of Non-Audit Services (PIEs)

- **Prohibition** on the provision of certain non-audit services (NAS)
  - Tax Services (Payroll Taxes, Customs Duties)
  - Services involving role in management or decision-making
  - Services relating to financing, capital structure, and investment strategy

- **Member State options**
  - Member States can add to the list of prohibited NAS
  - Certain black-listed NAS can be provided under strict criteria:
    - Certain Tax Services (e.g. Tax Forms, Tax Advice, Tax Inspections)
    - Valuation Services

➡ **Limit Risks of Conflicts of Interest**

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70% Cap on Non-Audit Services (PIEs)

- Cap on the fees charged for the provision of allowed non-audit services
- 70% of the average audit fees over the last three consecutive years
- Calculated at group level (audited PIE, parent undertaking, and controlled undertakings)
- Applies to audit firms operating in the EU only, not to the network

→ **Promote Independence**

Ensuring robust supervision (i)

- National audit oversight authorities strengthened:
  - **More independence from the audit profession**
  - **More powers**

- **One** competent authority responsible for audit oversight

- The competent authority shall be **governed by non-practitioners**, i.e., a natural person who has not, during the involvement in the governance of the public oversight body and in the preceding three years:
  - carried out statutory audits,
  - held voting rights in an audit firm,
  - been a member of the administrative, management or supervisory body of an audit firm, or
  - been employed by, or otherwise associated with, an audit firm

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Ensuring robust supervision (ii)

- The competent authority shall be organised in such a manner that **conflicts of interests** are avoided

- **Transparency**: including the publication of annual work programmes and activity reports

- **Adequate funding** and **adequate resources** to initiate and conduct investigations

- **Role of the professional body** and **delegation of tasks**
  However, no delegation of tasks with regard to:
  - Quality assurance system of PIE audits
  - Investigations for PIE audits
  - Sanctioning systems for PIE audits

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Ensuring robust supervision (iii)

- **Stronger sanctioning regime** with common minimum standards on:
  - The types and addressees of sanctions
  - The criteria to be taken into account by competent authorities when applying sanctions
  - The publication of sanctions
  - The mechanism to encourage reporting of potential violations

- **'Early warning mechanism'**

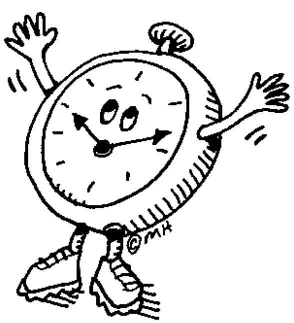
PART III: IMPLEMENTATION CHALLENGES

Less than 2 months before application

April 2014
Adoption by EU legislators

June 2014
Entry into force

17 June 2016
Applicability



Several national options

- **Definition of a PIE**
  - Covering only listed companies, credit institutions and insurance undertakings?
- **Rotation**
  - Duration of the maximum engagement period
  - Options to extend the maximum duration (public tendering; joint audit)
- **Black list**
  - Option to add prohibited non-audit services
  - Option to allow certain prohibited non-audit services

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Promoting a coherent application

- Transposition Workshops with Member States
- On-going dialogue with stakeholders
- Regular expert group meetings with national audit authorities
- Regular contacts with third country oversight authorities

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Facilitate a smooth transition

- Establishing tools to **monitor EU audit markets**

- Enhancing EU-wide supervision
(New Committee of European Auditing Oversight Bodies)

- Fostering **international cooperation** with non-EU audit oversight authorities

Fostering international cooperation

- **Unchanged framework** for third country cooperation
  - Adoption of equivalence decisions by the Commission
  - Adoption of adequacy decisions by the Commission

- **New role for the European Securities and Markets Authority (ESMA)** within the CEAOB
  - ESMA to chair subgroup on equivalence and adequacy

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International Standards on Auditing (ISAs)

- Possibility for the Commission to adopt the ISAs at EU level

- No specific deadline

- National auditing standards continue to apply

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Looking ahead

- Application and impact of the new EU rules (17 June 2016)
- Outcome of the Call for Evidence on the EU regulatory framework for financial services
- Global debate on audit quality

PART IV: ANY QUESTIONS?

FOR MORE INFORMATION:

http://ec.europa.eu/finance/auditing/