

Hilde Blomme*

Audit reform implementation in the EU: Where do we stand?

Izvajanje revizijske reforme v EU: Kje smo?

SUMMARY ● *The article gives an overview of the current state of play of the audit reform implementation across Member States, focusing on some of the key areas such as (1) provision of non-audit services, (2) mandatory audit firm rotation, (3) public oversight, as well as a short summary of FEE's work regarding this matter.*

Key words ● *audit reform, non-audit services, mandatory rotation, public oversight*

POVZETEK ● *Članek predstavlja pregled sedanjega stanja, povezanega z izvajanjem revizijske reforme v državah članicah Evropske unije. Osredotočen je na tri ključna področja, in sicer: (1) izvajanje nerevizijskih storitev, (2) obvezna rotacija revizijskih družb, (3) javni nadzor ter kratek povzetek dela, ki ga je na teh področjih opravil FEE.*

Ključne besede ● *revizijska reforma, nerevizijske storitve, obvezna rotacija, javni nadzor*

JEL: G 28, M 42

1. INTRODUCTION

The European audit reform package, comprising the Directive 2014/56/EU on statutory audits of annual accounts and consolidated accounts, amending the Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts¹ (hereafter referred to as "the Directive") and Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC² (hereafter referred to as "the Regulation"), has finally become applicable across the European Union.

* Hilde Blomme, namestnica izvršilnega direktorja Zveze evropskih računovodskih strokovnjakov (FEE), Reviseur d'Entreprises MBA FCCA CPA.

¹ <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0056&from=EN>.

² <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0537&from=EN>.

At this stage, it is important to understand where do we stand in the audit reform implementation process and what will be the legal framework at national level, as the Directive and the Regulation include a plethora of options.

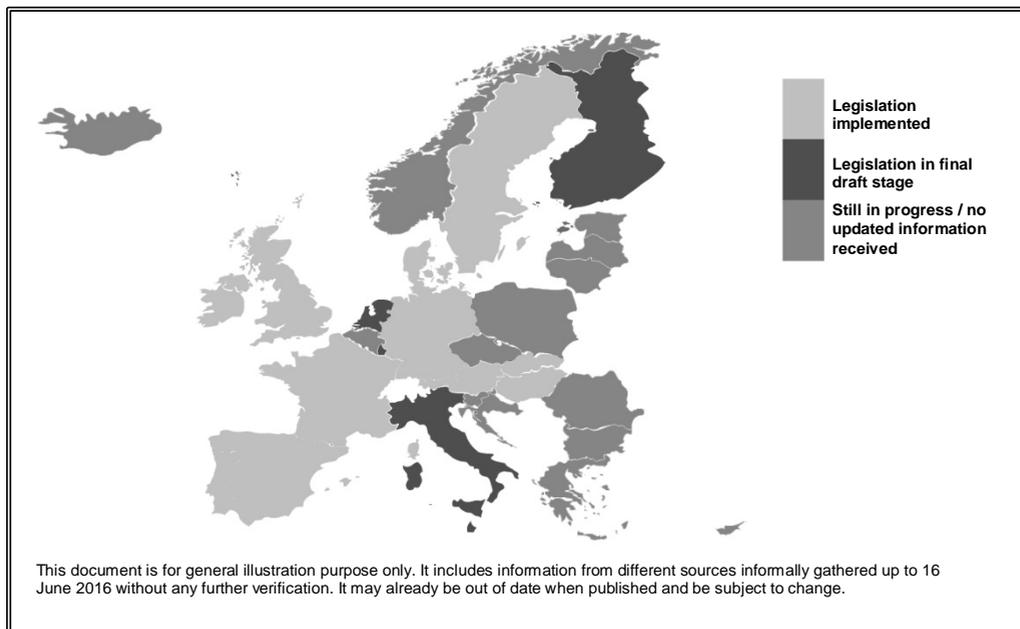
2. AUDIT REFORM IMPLEMENTATION – STATE OF PLAY

Member States had until 17th June 2016 to transpose the Directive into their national legislation and the Regulation became directly applicable across the European Union after this date.

Both the Directive and Regulation grant a number of options whereby Member States have to choose the way in which they want to transpose and implement the legislation. In the case of the Regulation, as long as the options granted are not implemented, the default framework is applicable.

According to the information gathered by the Federation of European Accountants, by 17th June 2016, only 11 Member States³ had implemented the European audit package, as shown in figure 1.

Figure 1: National developments



³ Austria, Denmark, France, Germany, Hungary, Ireland, Portugal, Slovakia, Spain, the United Kingdom and Sweden.

This information has to be interpreted with a caveat: in some of these Member States, the implementation process is not yet finalized, as national legislation will be supplemented by additional regulation dealing with specific matters.

On the other hand, one can see that there are some Members States where the audit legislation is in the final draft stage and it is expected to be adopted soon, meaning that the new provisions will be in place in more than half of the countries in the short term.

Nevertheless, there are Member States where the implementation process is further delayed, in some cases due to national specificities, such as general elections, what will lead, for a certain period of time, to a discrepant legal framework across the European Union.

Therefore, we urge Member States to complete the implementation process in order to provide legal certainty to all stakeholders and to contribute to the level playing field in the European audit market.

Harmonisation is key to avoid the unintended impact that divergence in national legislations can have on European Union businesses operating beyond their national borders. At a time when growth should be a priority, a complex regulatory environment will only translate into additional costs and inefficiencies for businesses and will not contribute to enhancing confidence in doing business in the European Union.

The next sections of this article will be focused on the analysis of the audit reform implementation in some of the key areas.

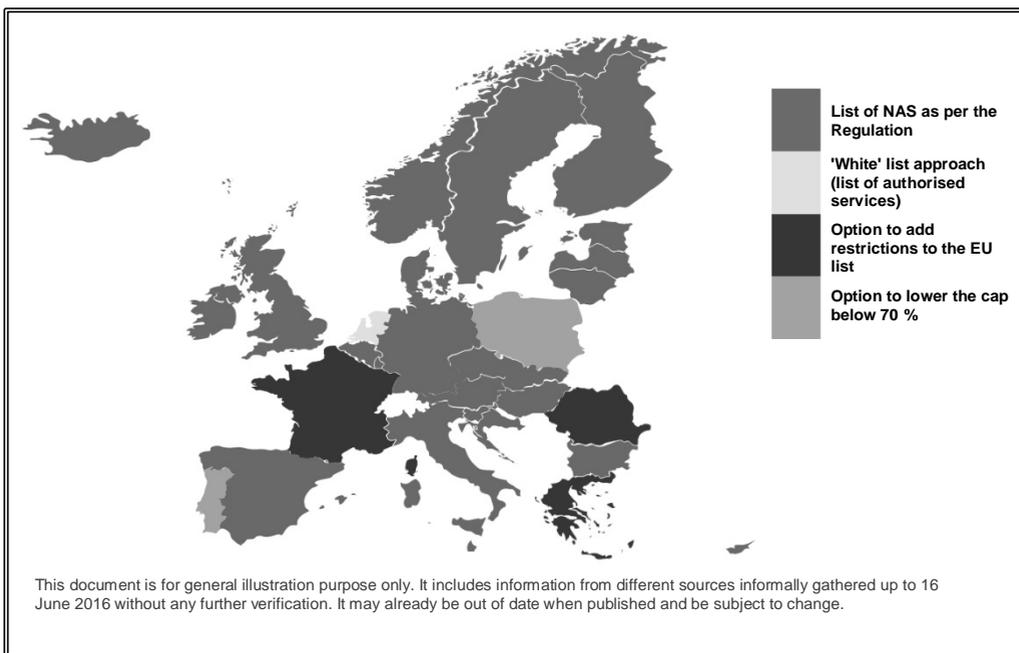
3. PROVISION OF NON-AUDIT SERVICES

The Regulation includes some important new requirements related to the provision of non-audit services (NAS) to Public interest entities (PIEs), such as a list of prohibited NAS (the so called "black list")⁴ and a cap on the provision of these services (the so called "70 % cap")⁵.

Additionally, various options are available to Member States to apply stricter conditions on and to add to the list of prohibited non-audit services.

⁴ Article 5(1) of the Regulation that introduces a list of prohibited NAS that the audit firm and any member of its network are not allowed to provide to any statutory audit client which is a PIE, to its parent undertaking in the European Union or to its controlled undertakings within the European Union.

⁵ Article 4(2) of the Regulation includes a limitation of the amount of allowed non-audit services provided to an audit client.

Figure 2: Provision of non-audit services

Regarding these options, figure 2 shows a clear trend amongst Member States to opt for the list of prohibited NAS included in the Regulation, revealing a very harmonised approach in this matter.

According to the information gathered, a small number of countries opted for or are considering to add other non-audit services to this list and only one⁶ opted to lower the non-audit services cap below 70 %.

The Federation of European Accountants welcomes this approach and encourages Member States that are still implementing the audit legislation to take into consideration the potential negative effects of deviating from this trend, such as regulatory divergence and fragmentation across the European Union Single Market, which might heavily bear on PIEs operating across the European Union.

Additionally, a consistent interpretation of the Regulation, both related to the scope and related to the meaning of the provisions concerning the provision of non-audit services, will be crucial to achieve a level playing field in the European

⁶ So far, Portugal was the only country to lower this cap to 30 %. The information regarding Poland is still provisional.

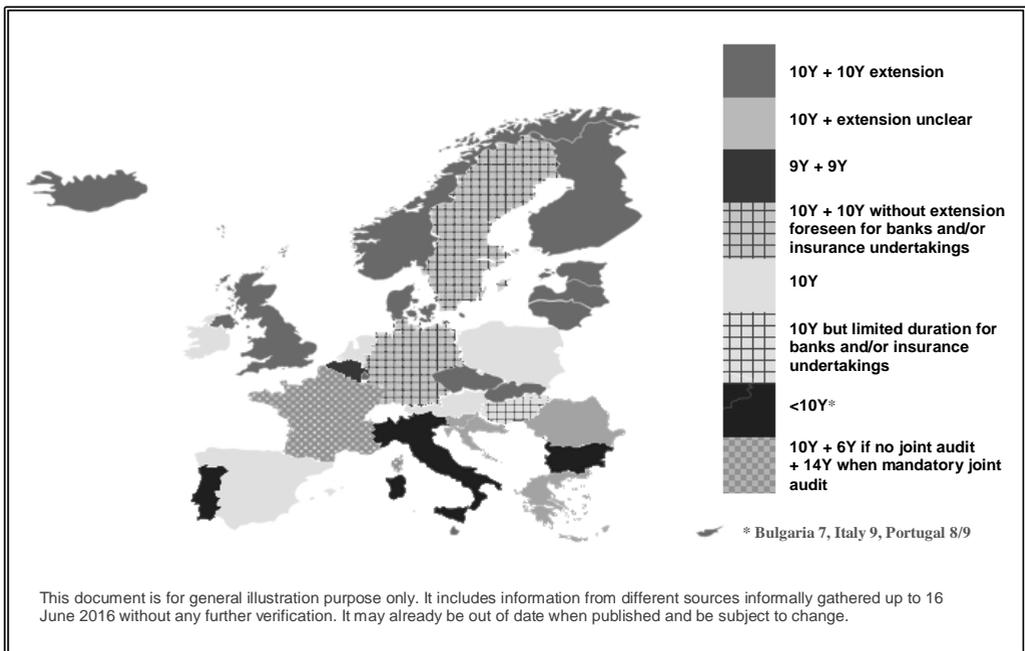
audit market. Where existing, the relevant guidance for equivalent provisions provided by the IESBA Code of Ethics or the European Commission (EC) Recommendation 2002/590/EC should be used⁷.

4. MANDATORY AUDIT FIRM ROTATION

One of the major changes introduced by the audit reform regards mandatory audit firm rotation.

The Regulation defines a ten-year maximum duration for audit engagements with options to extend this under certain conditions. Member States are given two options with which they may allow companies to prolong the initial maximum duration of an audit engagement, via "tendering" or "joint audit" up to 20 or 24 years respectively.

Figure 3: Mandatory Audit Firm Rotation



⁷ For further information, please refer to the FEE Briefing Paper on the provision of non-audit services: [http://www.fee.be/images/BP_140825 - Provision of NAS.pdf](http://www.fee.be/images/BP_140825_-_Provision_of_NAS.pdf).

As displayed in figure 3, despite damageable divergences on the duration and the use of the options to allow an extension, we see a welcomed trend towards consistency in setting the initial duration period at ten years.

Regarding the options to allow an extension, one can also see that some Member States opted to differently treat a sub-set of PIEs, namely the financial sector entities, by excluding this extension.

We strongly encourage Member States to take up these duration extension options in a harmonised way, in order to not limit flexibility for businesses, their audit committees, boards and shareholders, as demonstrated in the FEE Briefing Paper on the appointment of the auditor and the duration of the audit engagement⁸.

Although the Federation of European Accountants understands the contribution of mandatory rotation to independence and objectivity, the effect of disruption for PIEs operating cross border due to different rotation timeframes and deadlines across the EU should not be underestimated.

5. PUBLIC OVERSIGHT

Public oversight was one of the areas most impacted by the European audit reform.

The fundamentals for oversight of the audit profession at national level are carried forward from the 2006 Statutory Audit Directive. It required every Member State of the EU to organise a public audit oversight system and to designate a competent authority to be responsible for the execution of oversight. The new EU legislation brings the organisation of public oversight a step further.

As stressed in the FEE Briefing Paper: Public Oversight of the Audit Profession: Enhancing Credibility and Supporting Cooperation (June 2014)⁹, the Federation of European Accountants supports and acknowledges the need to enhance independent national public oversight within each Member State. Nevertheless, the involvement of all relevant stakeholders, especially experts, is paramount to ensure meaningful oversight that incorporates up-to-date knowledge, expertise and practice.

⁸ For further information: [http://www.fee.be/images/BP_140825 - Appointment of the Auditor.pdf](http://www.fee.be/images/BP_140825_-_Appointment_of_the_Auditor.pdf).

⁹ For more information regarding the implications of the audit reform on public oversight, please refer to: [http://www.fee.be/images/BP_140825 - Public Oversight of Audit.pdf](http://www.fee.be/images/BP_140825_-_Public_Oversight_of_Audit.pdf).

The new legislative framework provides the possibility for the delegation of certain oversight tasks from the competent authority to professional bodies. However, quality assurance reviews, investigations and disciplinary matters can no longer be delegated to professional bodies for PIE audits.

The Federation of European Accountants supports the provisions on public oversight and possible delegation to professional bodies as it allows for practical solutions focused on operational effectiveness and cost efficiency, whilst leveraging of the experience of the professional bodies and enabling proper separation of powers.

As far as sanctioning is concerned, the powers provided to national competent authorities should be separated according to the 'trias politica' principle, meaning the separation of legislation, execution and sanctioning. There is also a need for a certain level of communication of sanctions, respecting privacy rules, as a contribution to enhancing audit quality.

In order to inform the implementation of the European Union audit legislation in relation to public oversight at the national level, the Federation of European Accountants has conducted a survey¹⁰ with its member bodies to determine:

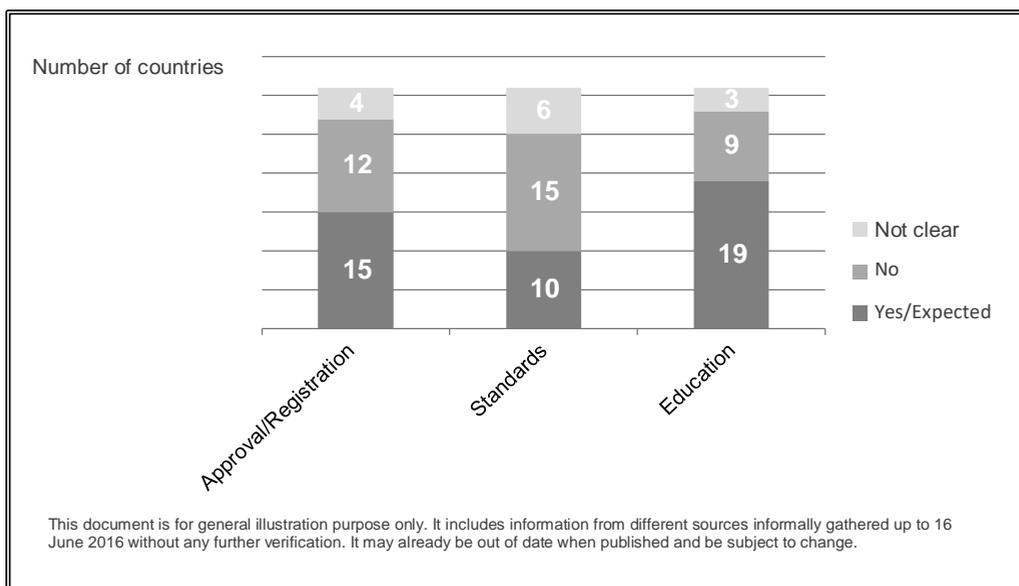
- (1) The current state of affairs regarding the organisation of public oversight of statutory auditors and audit firms in European countries; and
- (2) How the changes included in the new and amended EU provisions have impacted, or are expected to impact, the organisation of public oversight in European countries.

In the next sections, we intend to illustrate the potential use of delegation of tasks regarding public oversight of both PIE and non-PIE auditors across the European Union following the implementation of the audit reform.

a. Public oversight: delegation of tasks for auditors of PIEs

Figure 4 shows the potential outcome of the delegation of tasks by the public oversight body to the professional body for auditors of PIEs.

¹⁰ For more information: http://www.fee.be/images/1506_Public_Oversight_Survey_third_publication.pdf.

Figure 4: Public oversight: delegation of tasks for auditors of PIEs

The approval and registration of PIE auditors is expected to be delegated to the professional body in 15 countries, 12 countries will not delegate this and 4 countries are undecided.

For standard setting, delegation to the professional body is expected in 10 countries, not in 15 other countries and 6 countries do not yet know.

The education of auditors will be delegated to the professional body in a majority of 19 countries, 9 countries will not delegate it and 3 are unclear so far.

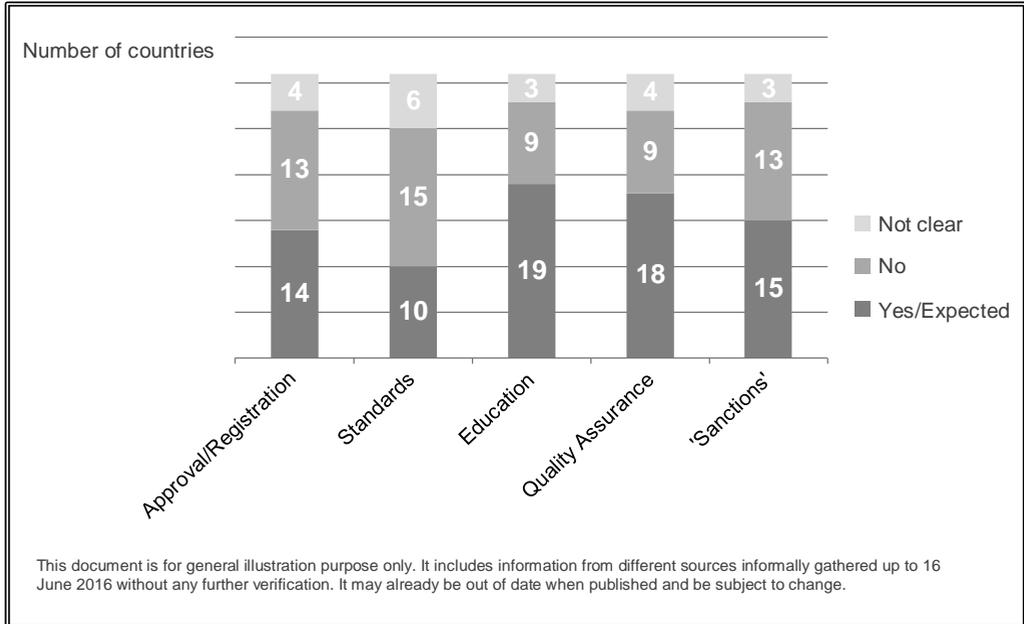
Although these data is still provisional in some cases, it gives already a good indication of the level of confidence in professional bodies and the profession at large in a significant number of European countries.

For the oversight of PIEs auditors, where delegation of tasks related to inspections of auditors is no longer possible, we strongly support that the national competent authority consults experts to carry out its specific tasks. This would secure an appropriate mechanism to identify, assess and use relevant up-to-date expertise and experience from practitioners regarding the work of the audit profession and the conduct of statutory audit.

b. Public oversight: delegation of tasks for auditors of non-PIEs

Regarding the delegation of tasks by the public oversight body to the professional body for auditors of non-PIEs, figure 5 shows that there is a varying but quite good level of delegation that can be expected.

Figure 5: Public oversight: delegation of tasks for auditors of non-PIEs



As can be seen, education and quality assurance of non-PIE auditors are the most common delegated tasks to professional bodies. The first task is expected to be delegated in a majority of 19 countries, 9 countries will not delegate it and 3 countries are undecided, while the latter task is expected to be delegated in 18 countries, 9 countries will not delegate it and 4 countries are undecided.

Professional bodies are also expected to keep playing an important role in investigative and administrative disciplinary systems (so called 'sanctions'), where a delegation of tasks is expected in more than half of the countries (15), while 13 countries will not delegate them and 3 countries are still considering.

The Federation of European Accountants is pleased to observe that public oversight of non-PIE auditors will rely to a great extent on the work of professional bodies and encourages Members States that are still in implementation phase to further consider the use of delegation in this area.

6. CONCLUSION

Although the implementation process is still underway, the Federation of European Accountants welcomes that, in some areas, Member States are following a harmonised approach on the use of the options foreseen in audit legislation, especially regarding the initial duration of the audit engagement and the list of prohibited NAS.

Regarding the organisation of public oversight, many Member States rely on a certain degree of delegation to professional accountancy bodies which are committed to continue playing an important role in this area, and working together with national competent authorities to enhance audit quality.

The Federation of European Accountants has been working very actively with its members and the entire profession in Europe, as well as with the European Commission, in order to promote as much as possible a level playing field. In this sense, we urge all stakeholders to further collaborate in a successful implementation of the new audit framework.

About FEE

FEE (Fédération des Experts-comptables Européens – Federation of European Accountants) is an international non-profit organisation based in Brussels that represents 50 institutes of professional accountants and auditors from 37 European countries, including all of the 28 EU member states.

FEE has a combined membership of more than 875,000 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.