



**ACCOUNTANCY  
EUROPE.**

# **NON-AUDIT SERVICES AND AUDITOR'S INDEPENDENCE**

Why do auditors provide other assurance services to their audit clients?

Briefing Paper

**VIEWS.**

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## **HIGHLIGHTS**

Stakeholders' increased expectations from companies for more transparency are accompanied by assurance needs on the information provided. Businesses count on auditors to deliver other assurance services and contribute to markets' sound functioning.

These assurance services are often closely linked to financial statements audit and third parties take comfort from auditor's involvement. This publication provides an overview of the measures that ensure auditors' independence while providing other assurance services to the companies they audit.

We detail how auditor's independence is maintained through:

- legal restrictions and ethical requirements
- public oversight and audit committee scrutiny
- transparency of fee-related information

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## INTRODUCTION

Financial statements audit contributes to markets sound functioning by increasing users' confidence and providing comfort on the reliability of companies' financial information. Companies publish financial statements to report primarily on their financial performance. Shareholders and other stakeholders such as investors, regulators, lenders, suppliers (hereafter: users) rely on the information provided in these financial statements when making their business decisions.

In this regard, the auditor is an independent third party between preparers and users of financial information. Users need to be assured about the auditor's independence to rely on the auditor's opinion on financial statements. Any concern about the auditor's (or the audit firm's) independence will discredit the audit results. These concerns may arise especially when the auditor or the audit firm provides other services to the audited company.

Some stakeholders consider auditors' providing any other service to an audit client as a significant threat to the auditor's independence. In reality, auditors provide only a limited number of permitted services that do not compromise their independence, to their audit clients.

This publication aims to contribute to the ongoing debate at both European and national levels. Specifically, it:

- communicates the strict measures already in place to ensure that auditors do not provide any service that compromise their independence
- describes the reasons why auditors are requested or required to provide other assurance services
- provides examples of services for which there is a public interest (i.e., benefits to shareholders and other stakeholders) in auditor's involvement

The paper focuses on European public interest entities (PIEs), however some of the considerations may also be relevant for non-PIEs and their auditors.

As the business environment is evolving constantly, it is not possible to draw up an exhaustive list of measures, reasons or examples. Therefore, this document can be used as a benchmark for future considerations related to non-audit services and auditor's independence.

## MEASURES IN PLACE TO ENSURE AUDITOR'S INDEPENDENCE

### AUDITORS ARE ALREADY PROHIBITED FROM PROVIDING MANY NON-AUDIT SERVICES

There are strict restrictions in laws and regulations, as well as in ethical standards, on what type of services auditors can provide to their audit clients.

The [EU Audit Regulation](#) prohibits the provision of a number of non-audit services to PIE audit clients, these comprise the so-called *blacklist*. As an additional measure, the Regulation establishes a cap for permitted services. Accordingly, the total fees that an audit firm can receive from a PIE for non-audit services are limited to 70% of the average of the audit fees received from that company in the last three years.

These measures came into effect in 2014. As noted by [the Audit Analytics report](#), the percentage of non-audit fees received from audit clients to total audit fees is around 25% (for 2019) and has been declining since 2014 across the EU.

Ethical standards for auditors establish further restrictions on non-audit services. [The International Code of Ethics](#), which forms the basis for many EU Member State professional codes of ethics, prohibits for instance any type of service that includes assuming a management responsibility for the company audited.

### INDEPENDENT PUBLIC AUTHORITIES OVERSEE THE AUDIT PROFESSION

The audit profession is regulated and auditor's independence is overseen by a public oversight authority in all EU member states. These authorities carry out quality assurance reviews (inspections) of the auditors. They take

administrative measures and impose sanctions in case of non-compliance with relevant legislation and ethical requirements including those related to independence.

### **AUDIT COMMITTEES SCRUTINISE AUDITOR'S INDEPENDENCE**

Boards and audit committees (or bodies performing equivalent functions) have certain responsibilities to ensure that the financial statements audit is conducted independently. The audit committee pre-approves all permitted service provided by the auditor. Before providing a non-audit service, auditors present audit committees an assessment about the threats to their independence. This includes explaining how any identified threat has been addressed by the auditor. Audit committees approve the service if they concur with the auditor's assessment and conclude that the auditor's independence will not be compromised.

### **AUDIT FIRMS HAVE COMPREHENSIVE POLICIES AROUND INDEPENDENCE**

Audit firms consider audit as the bedrock of their service offerings. They establish comprehensive policies to comply with independence requirements, including the ones related to non-audit services. These policies are designed and implemented as part of a firm's quality management system. They ensure that permitted services are provided to audit clients only if they do not compromise the auditor's independence.

For example, many firms keep a database that includes a list of 'restricted entities' to which certain services cannot be provided as per legal and ethical requirements. Furthermore, they perform a conflict-of-interest check before accepting a new client or a new engagement with a current client.

### **FEE-RELATED INFORMATION IS TRANSPARENTLY DISCLOSED**

The [EU Accounting Directive](#) requires PIEs (and large undertakings who are not PIEs) to disclose the total fees charged by each auditor or audit firm for the annual financial statements audit, other assurance services, tax advisory services and other non-audit services.

Moreover, PIE auditor firms prepare annual transparency reports and present a breakdown of their revenue from different types of activities, in accordance with the EU Audit Regulation.

Detailed disclosure of fee-related information in companies' financial statements and in firms' annual reports promotes transparency and enables scrutiny over the services provided by auditors and their independence.

## **AUDITORS AND OTHER ASSURANCE SERVICES**

Auditors may be required by legislation or requested by stakeholders to provide other assurance services, tax services and other non-audit services to their audit clients. When permitted to deliver these services under law or regulation, auditor's independence is safeguarded by specific measures as described in the previous section.

This section explains why auditors are requested or required to provide other assurance services to their audit clients. It provides various examples to demonstrate how such auditor's involvement has a public interest rationale. Broadly there are three main types of such services :

- services closely related to the audit itself and which may be considered as an extension of the financial statements audit
- services required by legislation as to be performed by an independent provider
- services demanded by third parties who need reliable information and receive comfort from the independent auditor's involvement

The distinction is not always clear, and an assurance service may exhibit more than one of the characteristics above. Hence this document does not make a categorical classification.

## WHY ARE AUDITORS THE ONES TO PROVIDE OTHER ASSURANCE SERVICES TO THEIR AUDIT CLIENTS?

### THE SERVICE IS CLOSELY LINKED TO THE FINANCIAL STATEMENTS AUDIT

Auditors perform audit procedures to understand the company and its financial reporting process during the financial statements audit. This understanding may be paramount to deliver a specific type of an assurance service. This is relevant when the service draws on information and systems with which the auditor would already be familiar. Therefore, another service provider would not be able to achieve similar efficiency and timeliness. Typically, there is a significant overlap between the work involved in such a service and the audit procedures.

#### EXAMPLES

##### Review of interim financial information

Interim financial information is presented in the form of financial statements or in a summarised form and is usually published as half-yearly reports. Users of these reports very often demand an independent review of reported information. This review prerequisites to have sufficient knowledge of the entity, its internal controls over financial reporting and its financial performance in previous periods. Consequently, it is the most cost-effective way when the auditor conducts the review.

##### Comfort letters

Comfort letters are written statements requested from listed companies for various capital market transactions. The comfort letter's provider must be independent from the issuer and be familiar with the company's financial reporting processes. Auditors already meet both criteria and usually provide comfort letters. In theory, it is possible for other service providers to perform the necessary procedures and to issue the comfort letter. However, it is impracticable for them to review and understand the accounting records solely for this purpose in a timely and cost-effective manner.

### AN INDEPENDENT SERVICE PROVIDER'S INVOLVEMENT IS REQUIRED BY LEGISLATION

Most PIEs are subject to reporting requirements established by laws and regulations. In some cases, the lawmaker expects the auditor (or another independent service provider) to be involved to enhance credibility in this reporting process. This expectation is not always stipulated explicitly in laws and regulations (*see point for consideration: importance of establishing a clear legal framework at EU level p.5*). In practice, auditors perform additional services, either in the context of the annual financial statements audit or as a separate assurance engagement.

#### EXAMPLES

##### Involving auditors in EU grants and government subsidies

EU funding programs and government subsidies usually require the audit of the beneficiaries' financial information. The most recent example is Covid-19-related subsidies and grants. Many governments have responded promptly to the crisis by introducing a wide range of support measures for companies. Along with these measures, additional regulatory and reporting requirements have also been established to ensure that taxpayers' money is not misused. Governments of many EU member states have assigned additional roles and responsibilities to auditors<sup>1</sup>. In most cases the role of the auditor is to provide assurance that the beneficiary companies meet the eligibility criteria determined by the respective government.

<sup>1</sup> For examples from various countries, see our publication available at <https://www.accountancyeurope.eu/publications/coronavirus-impact-on-ongoing-audits/>

## ESEF Assurance

Issuers in the EU regulated markets now prepare their annual financial reports in the European Single Electronic Format (ESEF)<sup>2</sup>. The European Commission (EC) and the Committee of European Audit Oversight Bodies (CEAOB) consider ESEF as a statutory requirement and concluded that ESEF filings should be subject to audit. Accordingly, auditors provide assurance on whether the annual financial reports are marked-up in compliance with the ESEF requirements. In jurisdictions where ESEF assurance is not mandatory, many issuers are voluntarily seeking assurance on their ESEF filings.

### Independent assurance on sustainability reporting

Reporting on environmental, social and governance (ESG) matters (sustainability reporting) contributes to having a more complete picture of the company. Increasingly, auditors are called on to provide assurance on certain elements of sustainability reporting<sup>3</sup>. The information's reliability is critical to assess the company's prospects. Recently, the EC [proposed](#) the introduction of mandatory assurance on sustainability reporting as a response to European Parliament's call. The proposal suggests that sustainability assurance by the auditor would help ensure connectivity between financial and sustainability information, which is particularly important for users of corporate information.

#### ***Point for consideration: importance of establishing a clear legal framework at EU level***

*ESEF and proposed Corporate Sustainability Reporting Directive (CSRD) are significant steps towards the transparency and digitisation of capital markets information. Harmonisation at EU level is a prerequisite for these initiatives to achieve intended objectives. In this regard, lessons learnt during ESEF implementation should guide establishing the framework about sustainability reporting and assurance.*

*The EC and the CEAOB statements that ESEF assurance should be regarded as part of annual audits, were both non-binding documents. Some EU member states have had different interpretations and did not mandate ESEF assurance in their national legislation. As a result, this important European initiative is being inconsistently implemented across EU.*

*The EU CSRD proposals suggest the auditor's providing sustainability assurance as the first option and allow Member States to deviate from this principle. As we have learned from the ESEF experience, leaving room for diverse interpretations by Member States can lead sustainability assurance to be considered as a non-audit service and thus be subject to the cap limitation. In such a case, auditors may have to reject sustainability assurance engagements while being able to perform the relevant procedures in the most effective and efficient manner.*

## **STAKEHOLDERS TAKE COMFORT IN AUDITOR'S INVOLVEMENT**

Auditors are viewed as trusted professionals by companies, public authorities, and other stakeholders. They need to meet strict conditions, including educational and experience qualifications to be recognised by national competent authorities. Furthermore, professional codes of ethics for auditors prescribe fundamental principles such as integrity, objectivity, professional competence and due care. Auditors operate quality management systems subject to regular public oversight to perform quality engagements. These measures allow third parties to take comfort from auditor's involvement related to company reporting.

<sup>2</sup> For more information on ESEF see our dedicated webpage available at <https://www.accountancyeurope.eu/publications/esef-guidance/>

<sup>3</sup> For more details on independent assurance on sustainability reporting see our publication available at: <https://www.accountancyeurope.eu/publications/setting-out-high-quality-non-financial-information-assurance-in-europe/>

## EXAMPLES

### Agreed upon procedures on compliance with contractual requirements

Companies may under contractual terms be required to obtain auditor's comfort with respect to compliance with contractual requirements, for instance on compliance with bank covenants. The other party of the contract, for example the bank, is considered as the engaging party. The auditor performs the procedures that have been agreed upon by the engaging party. The engaging party and other intended users draw their own conclusions from the work performed and findings reported by the auditor. A wide range of stakeholders demand agreed upon procedures for a variety of subject matters including due diligence in mergers and acquisitions, internal controls over financial reporting and corporate governance requirements.

### Assurance on reporting to the prudential regulatory authority

Credit institutions and banks are overseen by prudential regulatory authorities (PRA) and have to comply with supervisory requirements. They report relevant information to PRAs to demonstrate their compliance in different areas such as internal controls, anti-money laundering, capital maintenance and liquidity. Reported information needs to be checked within the audit or in a separate review, depending on national regulatory requirements. PRAs in many European countries frequently demand auditors to provide this type of assurance on a regular or an ad hoc basis<sup>4</sup>.

### Examination of targeted longer-term refinancing operations reporting

The European Central Bank (ECB) has conducted a series of targeted longer-term refinancing operations to enhance the functioning of the monetary policy transmission mechanism. The ECB also determined reporting requirements for the participating financial institutions and required an annual examination of the reported data's accuracy. The relevant ECB decision states that this exercise may be performed by the auditor in the context of the financial statements audit. This examination provides comfort to the ECB and efficiencies to participants since auditors already review how financial data is captured, utilised, and reported in a financial institution, as part of the audit procedures.

## CONCLUSION

Non-audit services are not a homogeneous group of services. The provision of non-audit services by auditors to PIE audit clients is firmly restricted. Before providing permitted non-audit services to audited companies, auditors assess the level of threats to their independence. This assessment is subject to audit committees' ex ante and public oversight bodies' ex post review.

As described in this paper, performing audit procedures and thereby understanding the company enable auditors to plan and conduct other assurance services in a more qualitative, efficient and effective manner. As trusted objective professionals, auditors provide these services to meet stakeholders' valid expectations and requirements. Their involvement improves reporting's reliability in an efficient way.

There is a clear trend in stakeholders' expectations from companies to report on a wider variety of matters, such as fraud, going concern, internal controls and corporate-societal impacts. In parallel, the scope of audit and other assurance services provided by the auditor are expected to keep evolving.

EU policymakers should support this evolution by establishing clear and timely frameworks that specify each party's responsibilities, for instance whether independent assurance is required and if so by whom it is to be provided. This would help achieve the EU policy objective to harmonise capital markets.

<sup>4</sup> For more information about the services provided by bank auditors see our publication available at <https://www.accountancyeurope.eu/publications/the-scope-of-bank-audits-in-europe/>

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