Guidebook
to the European Audit Reform

A new environment for PIEs and their auditors in Europe

MAZARS

DISCLAIMERS

This document primarily summarises the main changes the Reform will bring for **Public Interest Entities (PIEs)** and does not fully address the changes for non-PIEs.

For more information on the changes for non-PIEs, please refer to Appendix 6 – Factsheet on the Main Provisions Relevant for Small and Medium-Sized Undertakings[1].

Please also note that this document was prepared before any formal discussions in regard to interpretations on the transposition of the legislation at Member State level. Our interpretation could therefore be subject to some minor changes.

1. Prepared by the Federation of European Accountants (FEE)

MAZARS IS AN INTERNATIONAL, INTEGRATED AND INDEPENDENT ORGANISATION SPECIALISING IN AUDIT, ADVISORY, ACCOUNTING, TAX AND LEGAL SERVICES. THE GROUP OPERATES IN 72 COUNTRIES, AND DRAWS ON THE EXPERTISE OF 13,800 PROFESSIONALS TO ASSIST MAJOR INTERNATIONAL GROUPS, SMEs, PRIVATE INVESTORS AND PUBLIC BODIES, AT EVERY STAGE IN THEIR DEVELOPMENT.

FOREWORD

The Audit Reform adopted by the European Union in April 2014 finally lays down the foundations for a single market for the audit of European companies. It aims to rebuild confidence in the financial statements of European companies, and notably Public Interest Entities (PIEs), by reinforcing governance, auditor competence and audit quality, as well as increasing the independence of the key stakeholders involved in the audit process.

Mazars is an organisation that has developed and flourished within the European market. We have been an active contributor to the various debates initiated by the European Commission following its consultation in 2010 on the role of auditors in the 2008 financial crisis - a crisis which has had critical repercussions on European economies. Given the complexity of the subject matter and the efforts required to reconcile the various viewpoints and market practices, we congratulate the European Commission and the co-legislators on their ability to reach a balanced compromise that will serve as a stepping stone in creating a unique, harmonised, transparent and diversified European Audit Market.

This Reform is an important step because, in contrast to the long established US market or the developing Chinese market, we have lived in Europe with an audit market built upon a variety of national market practices, with no doubt well-meaning traditions, but that have done little to promote consistency of high quality practices or the emergence of strong integrated European led players able to serve the European domestic market and to contribute on the global scene. Moreover, in most countries there is an over-concentration of dominant global players which often hinders local relevance, independence and innovation.

We believe that this Reform is well balanced and has the potential to create a European system that promotes quality: improvement of audit reports, harmonisation of permitted and prohibited non-audit services, adoption of International Standards on Auditing, coordination of auditors' supervision, as well as harmonisation of audit practices.

Clearly a regulatory regime is necessary but not sufficient. It must be implemented with care, determination and collective intelligence to achieve the desired objectives. All players have to contribute. Member States will have to choose among various options, with the aim of promoting the most virtuous practices. To meet market expectations, PIEs will have to structure and further develop their own governance. Critically, PIEs will have to reconsider their external audit arrangements and choose the best audit practices and the most proactive audit firms to help them succeed in a complex, global and multicultural world undergoing profound change. The fundamental objective will be to ensure that this external control represents one of the pillars of an enhanced relationship of trust and confidence with their shareholders.

There is no doubt that this is an exciting long-term initiative. We are convinced that European businesses and the wider public interest in Europe will benefit from this reform if we are all firmly committed to rebuilding trust and confidence upon shared values of strong governance, transparency and competence.

Patrick de Cambourg,
Group Chairman, Chairman of the Governance Council

Philippe Castagnac,
Group CEO, Chairman of the Executive Board

TABLE OF CONTENTS

Guidebook to the European Audit Reform

EXECUTIVE SUMMARY 6

1 WHAT LED TO THE THE REFORM AND HOW TO PREPARE FOR ITS IMPLEMENTATION 9

1.1 The scope of the Directive on statutory audits of annual accounts and consolidated accounts 9
1.2 The scope of the Regulation on specific requirements regarding the statutory audit of PIEs 10
1.3 A reform with significant impacts for PIEs and their auditors 10
1.4 Implementation roadmap and potential barriers to success 11
1.5 Mazars' initial contribution 12

2 WHICH ENTITIES DOES THE REFORM PRIMARILY AFFECT? 14

2.1 Public Interest Entities (PIEs) 14
2.2 Statutory Auditors and Audit Firms 14

3 REINFORCING THE ROLE OF THE AUDIT COMMITTEE WITHIN PIEs 17

3.1 Composition and technical expertise of the Audit Committee 17
3.2 Increased responsibilities of the Audit Committee 17
3.3 Exemptions 17

4 PROMOTING ACCOUNTABILITY AND TRANSPARENCY THROUGH ADDITIONAL REPORTING 20

4.1 Content of audit reports for all entities subject to legal control 20
4.2 Changes to existing audit reports for PIEs 21
4.3 An additional report that serves to reinforce the role of the Audit Committee 22
4.4 Greater transparency requirements from Audit Firms 23
4.5 Other reporting requirements 24

10 POINT ACTION PLAN for PIEs and their Audit Committee 26

5 ENHANCED GOVERNANCE AND TRANSPARENCY: APPOINTMENT OF STATUTORY AUDITOR(S) OR AUDIT FIRM(S) 28

5.1 When a tender procedure applies 28
5.2 Inviting Statutory Auditors or Audit Firms to bid 28
5.3 Preparation of tender documents 29
5.4 Evaluation procedure 29
5.5 Selection procedure and appointment of the Statutory Auditor(s) or Audit Firm(s) 30

6 SAFEGUARDING THE INDEPENDENCE OF THE STATUTORY AUDITOR OR AUDIT FIRM 33
6.1 List of prohibited non-audit services 33
6.2 A period of prior restrictions for certain non-audit services 34
6.3 Introduction of a cap for non-audit services 35
6.4 Non-audit services provided to a subsidiary outside the EU 36
6.5 Cap on the total audit fees received by the Statutory Auditor or Audit Firm 38

10 POINT ACTION PLAN for investors 40

7 INTRODUCING MANDATORY ROTATION AND ENCOURAGING JOINT AUDIT 42
7.1 What the Regulation states about the mandatory rotation of Audit Firms 42
7.2 Recognising Joint Audit as a credible system 43
7.3 Rotation of key audit partners 44

8 WHAT ARE THE IMPLEMENTATION DEADLINES? 46
8.1 Transitional measures for ongoing audit mandates 46
8.2 How to calculate the tenure of audit engagements 47

10 POINT ACTION PLAN for Audit Firms 49

10 POINT ACTION PLAN for Member States, Competent Authorities and professional bodies at Member State level 50

9 PROMOTING A SECURE MARKET BY CREATING A EUROPEAN OVERSIGHT SYSTEM 52
9.1 Creating a Committee of European Auditing Oversight Bodies (CEAOB) 52
9.2 National Competent Authorities 53
9.3 Colleges of Competent Authorities 54
9.4 Cooperation between the various oversight bodies 54
9.5 Applicable International Standards on Auditing 56

10 APPENDICES 58
Appendix 1 - Key dates in the legislative process 59
Appendix 2 - Governance of Competent Authorities 59
Appendix 3 - College of Competent Authorities 60
Appendix 4 - Useful links 61
Appendix 5 - The Directive and Regulation 61
Appendix 6 - Factsheet on the main provisions relevant for SMEs 64
Appendix 7 - Abbreviations 66

EXECUTIVE SUMMARY

1. WHAT LED TO THE REFORM AND HOW TO PREPARE FOR ITS IMPLEMENTATION

The European Audit Reform arises from the 2008 Financial Crisis and has been the subject of intense discussions over the past four years. An amended **Directive 2006/43/EC** and a new **Regulation (EU) No 537/2014** have finally been published in the OJEU and will enter into force on 17 June 2014, allowing Member States a two-year period to transpose the new requirements at national level. This Guidebook aims to help key stakeholders understand the changes that lay ahead.

2. WHICH ENTITIES DOES THE REFORM PRIMARILY AFFECT?

The Directive sets out the requirements governing every statutory audit performed in the European Union by any **Statutory Auditor** or **Audit Firm.** The Regulation contains a series of additional requirements that relate only to the statutory audits of **Public Interest Entities - PIEs** (entities incorporated in an EU Member State with transferable securities on a regulated market of any Member State of the EU, Credit Institutions, Insurance Undertakings, or entities deemed by Member States to be PIEs).

3. REINFORCING THE ROLE OF THE AUDIT COMMITTEE WITHIN PIEs

The legislation **formalises a number of existing best practices for the Audit Committees** of PIEs by requiring a **majority of the Audit Committee members to be independent,** for the Audit Committee to have, as a whole, **competence relevant to the sector** in which the company operates, and with at least **one member having knowledge in auditing and/or accounting.** In addition, the legislation reinforces the responsibility of the Audit Committee in relation to monitoring all aspects of the statutory audit such as performance, independence and the provision of non-audit services as well as reappointment or retendering decisions.

4. PROMOTING ACCOUNTABILITY AND TRANSPARENCY THROUGH ADDITIONAL REPORTING

Confidence in auditing will be reinforced through enhanced reporting requirements by auditors. Principally the new legislation requires auditors to provide **more detailed audit reports to shareholders** and a **specific report to the Audit Committee** before issuing their audit report, as well as reporting on **"irregularities" to the Competent Authorities.** In addition, Audit Firms are required to be more transparent by publishing **transparency reports.**

5. ENHANCED GOVERNANCE AND TRANSPARENCY: APPOINTMENT OF STATUTORY AUDITOR(S) OR AUDIT FIRM(S)

The legislation specifies **a more prescriptive tendering process which will take place under the responsibility of the Audit Committee of PIEs** and will require the latter to recommend to the board at least two choices of Statutory Auditors or Audit Firms, with a justified preference for one of them. In addition to the tendering requirements, the legislation includes several measures to remove barriers to entry, including encouraging non dominant Audit Firms to participate in tenders and prohibiting so-called "Big 4 only" contractual clauses.

6. SAFEGUARDING THE INDEPENDENCE OF THE STATUTORY AUDITOR OR AUDIT FIRM

A list of prohibited non-audit services and a **threshold on fees for permitted non-audit services have been introduced.** The threshold is set at **70% of the average statutory audit fees for the previous three years.** Member States have the option of expanding the list of prohibited non-audit services or can permit certain tax and valuation services under specific circumstances. Audit Committees are required to approve all permissible non-audit services.

7. INTRODUCING MANDATORY ROTATION AND ENCOURAGING JOINT AUDIT

The legislation **introduces mandatory firm rotation for the Statutory Auditor of a PIE** after a maximum initial engagement period of **10 years,** although **Member States have the option of allowing PIEs to extend their auditor's engagement to 20 years** where an **audit tender** takes place or to **24 years** where there is a **Joint Audit.** Through a longer and automatic extension period without the need to tender, the Regulation recognises the merits of the **Joint Audit** system.

8. WHAT ARE THE IMPLEMENTATION DEADLINES?

Entry into Force of the legislation takes takes place on 17 June 2014, with a two year period for transposition. The legislation phases in requirements for mandatory firm rotation depending on the length of the existing audit relationship on the date the legislation enters into force. Where the existing audit tenure is equal to 20 years or more on 17 June 2014, the company cannot reappoint the incumbent Auditor after 17 June 2020. Where the existing audit tenure is between 11 and 20 years on 17 June 2014, the company cannot reappoint the incumbent Auditor after 17 June 2023. Where the existing audit tenure is 10 years or less, the Regulation applies in full.

9. PROMOTING A SECURE MARKET BY CREATING A EUROPEAN OVERSIGHT SYSTEM

Oversight of the audit profession in the EU will continue to be carried out at Member State level. The legislation requires **each Member State to designate a single Competent Authority to bear ultimate responsibility** for the audit oversight system. Coordination across national authorities will be supported by a new **Committee of European Auditing Oversight Bodies (CEAOB).** The CEAOB will be chaired by the Member States and not by the European Commission. **The European Securities and Markets Authority (ESMA)** will chair any subgroups created for the purpose of assessing public oversight systems of third countries or the international cooperation between Member States and third countries. The **European Competition Network (ECN)** will monitor market quality, concentration and competition in collaboration with the national Competent Authorities.

1. WHAT LED TO THE REFORM AND HOW TO PREPARE FOR ITS IMPLEMENTATION

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Upon his appointment as European Commissioner for DG Internal Market in February 2010, Michel Barnier made it an objective to pursue three major reforms[2], including a European Audit Market Reform. After the Financial Crisis of 2008, there was an **imminent necessity to restore investors' confidence in the financial statements of companies and therefore in their audits by eliminating conflicts of interest, guaranteeing independence, providing sound supervision capable of identifying early warning signs and encouraging more diversity in what is an overly concentrated market.**

The publication of a Green Paper in 2010 entitled **"Audit Policy: Lessons from the Crisis"** constituted a stepping stone which set off a three year legislative process *(see Appendix 1 for major legislative milestones)* that led to a final agreement put to vote by the European Parliament on 3 April 2014.

This Reform lays down the framework for the creation of a Single European Audit Market by **amending the Directive 2006/43/EC** which sets out the conditions for the audit of annual and consolidated financial statements and the adoption of a new **Regulation** for the statutory audit of PIEs *(see Chapter 2 for definition)*. Both the Directive and the Regulation have been published in the Official Journal of the European Union (OJEU) on 27 May 2014.

2 The other reforms include the Banking Reform and the Credit Rating Agencies Reform.
3 For more information on the impacts the Directive will have on SMEs, (*please see Appendix 6).*

1.1 THE SCOPE OF THE DIRECTIVE ON STATUTORY AUDITS OF ANNUAL ACCOUNTS AND CONSOLIDATED ACCOUNTS

The **Directive 2014/56/EU** of the European Parliament and of the Council of 16 April 2014 amending **Directive 2006/43/EC** on statutory audits of annual accounts and consolidated accounts applies to all statutory audits and now needs to be transposed into national law by each Member State.

The primary objective of the amendments is **to reinforce investor confidence in the truth and fairness of financial statements published by European companies.** Though much attention is given to the creation of a single market for audit and audit related governance in Europe and notably for PIEs where the public interest is greater, the Directive also promotes an approach that caters for the needs of **Small and Medium Enterprises (SMEs[3])** by promoting the principle of proportionality in applying the requirements of the Directive to smaller entities *(See Appendix 6).*

The Directive mainly covers:

- definitions of key stakeholders (i.e. PIEs, Audit Firms, Competent Authorities, etc.);
- European adoption (and process thereof) of International Standards on Auditing;
- European oversight system and responsibility of a single Competent Authority at Member State level;
- structure and role of the Audit Committees for PIEs;
- extension of the range of stakeholders able to call for the dismissal of auditors;

- mobility of audit professionals within the European Union;
- governance of Audit Firms;
- the overall organisation of auditors and their audit work;
- sanctions and whistleblowing;
- definition and rules over conflicts of interest;
- certain requirements relating to rotation of auditors, for example, in terms of information sharing.

1.2 THE SCOPE OF THE REGULATION ON SPECIFIC REQUIREMENTS REGARDING THE STATUTORY AUDIT OF PIEs

The **Regulation (EU) No 537/2014** on governing statutory audits of PIEs is directly applicable in all Member States[4] and will therefore apply throughout the EU without the need for it to be transposed into Member State law.

The primary objective of the Regulation is **to enhance public confidence in the annual and consolidated financial statements of PIEs, and hence contribute to the orderly functioning of markets through greater integrity and efficiency of financial statements.** The Regulation focuses exclusively on PIEs and mainly covers:

- the organisation and selection of Statutory Auditors and Audit Firms by PIEs;
- the independence of auditors;
- the supervision of compliance with the requirements of the Regulation.

1.3 A REFORM WITH SIGNIFICANT IMPACTS FOR PIEs AND THEIR AUDITORS

The Directive and Regulation, taken together, have significant impacts for PIEs and the auditors of PIEs. The key changes introduced include:

- a strong emphasis on a **reinforced governance by increasing the role of the Audit Committee** and introducing a fair and transparent tendering process for the selection of the Statutory Auditor(s) and Audit Firm(s);
- a system of **mandatory rotation of Audit Firms which encourages Joint Audit** and recognises it as a fully credible audit system with significant merits;
- **a list of prohibited non-audit services and a cap on permitted non-audit services** provided by the Audit Firm;
- **more detailed audit reports** to Audit Committees and to shareholders;
- a **broader reporting responsibility of auditors of PIEs towards Competent Authorities** in the context of irregularities;
- the **creation of a Committee of European Auditing Oversight Bodies (CEAOB)** to oversee the cooperation between Competent Authorities.

If implemented successfully by all stakeholders, the European Audit Reform provides Europe with an opportunity to distinguish itself firmly from other economic areas. The smooth transposition of the Directive and implementation of the Regulation at Member State level will be fundamental in building a secure environment in which:

- companies have the opportunity to improve their governance and the external control over their financial information;
- investors can regain confidence in financial

4. It is important to note that though the Regulation is directly binding, there are a number of options available to Member States which have to be determined at national level.

statements through expanded and more robust financial reporting and auditing;

- greater choice, innovation and easier market access will promote the emergence of a more competitive and dynamic European audit market reinforced by a supranational oversight system.

1.4 IMPLEMENTATION ROADMAP AND POTENTIAL BARRIERS TO SUCCESS

In order to secure the intended benefits of the Audit Reform and to create a new market environment, a large number of stakeholders impacted by the Reform will need to play their part in supporting and overseeing a harmonious implementation process. To ensure this, it is important to understand the major milestones and challenges on the horizon.

Some immediate key dates to consider:

17 June 2014	Entry into Force (EIF), 20 days after the Directive and the Regulation is published in the OJEU.
17 June 2016	Both the Directive and the Regulation become applicable on the Date of Application (2 years after EIF).
17 June 2016	Any transposition laws, decrees, regulations, norms at Member State level must be communicated before Date of Application.
Transitional Measures (see chapter 8)	Rotation obligations for ongoing audit engagements will benefit from a transitional period.

These milestones will introduce some challenges that will need to be overcome.

- Most Member States have different starting points across Europe. For example, the Netherlands and Italy already have mandatory rotation periods of 8 years and 9 years respectively. Some Member States already have a more restrictive regime applying to the separation of audit and non-audit services. Critically, there is a wide range of company law frameworks and auditor liability regimes across Europe.
- In order to reach a consensus, legislators introduced into the Directive and Regulation a significant number of "Member State options" (51 options in the Directive and 32 in the Regulation). Yet the success of the Reform will depend to a great extent on the ability of Member States to promote consistency across Europe.
- The enhanced requirements on Audit Committees and Regulators, in terms of both the need for resources and independence, will create a strain on the already limited pool of talent available to carry out these essential roles effectively.
- Expanding the societal role of auditors, for example in relation to the reporting of irregularities, will need to be organised and supervised with sound judgement and good practices.
- The legislators have considered the need for the smooth introduction of the new requirements through transitional provisions to allow for an "adjustment" period for PIEs, Audit Firms and Regulators. It will be important for stakeholders to fully use the time awarded for transition rather than rush things at the last minute.
- The success of effective supervision will depend on the ability and willingness of stakeholders to cooperate and start on new foundations, rather than tweak existing practices.
- All stakeholders will need to contribute and play their part. It is clear that, as the Reform is primarily intended for the benefit of shareholders and investors, they will need to connect actively with companies and their auditors.
- Joint Audit is encouraged within the legislation. All stakeholders will benefit from carefully considering the merits of this audit system on the basis of facts and existing good practices.

1.5 MAZARS' INITIAL CONTRIBUTION

The new legislation is detailed and complex. This Guidebook is intended to make the European Audit Reform more accessible to you. Considering the strong emphasis of the Reform on PIEs and their Auditors, this Guidebook focuses primarily on the key impacts for them. We hope it serves as a useful reference and that we have been successful in translating our experience as leading auditors of European PIEs into practical points that will help you play your part at implementing the Reform.

Key points to take away

- The Reform is made of amendments to the 2006 Directive on statutory audits of annual and consolidated accounts and a new Regulation. Both will be applicable in Member States by 17 June 2016. The Directive has to be transposed into Member State law and the Regulation applies directly with a number of options from which Member States could choose from.

- The most significant impact of the Reform will be for PIEs and their auditors, with key changes including regular audit tendering, mandatory rotation of Statutory Auditors and Audit Firms, enhanced reporting requirements for auditors, reinforced governance for PIEs on matters related to audit, a stricter approach to independence and conflicts of interest, and a European wide approach to supervision.

- The Reform provides exemptions for SMEs to the requirements otherwise set for PIEs, primarily on grounds of proportionality and relevance. For example, privately owned SMEs do not have to create Audit Committees and are exempt from all requirements set in the Regulation. A half-way house is defined for PIEs which are SMEs or which have market capitalisation of less than €100m.

- A lot of work is still required for the Audit Reform to deliver the intended benefits and all stakeholders will need to work together to facilitate an effective implementation.

2. WHICH ENTITIES DOES THE REFORM PRIMARILY AFFECT?

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2.1 PUBLIC INTEREST ENTITIES (PIEs)

The definition of PIE has not significantly changed when compared to the earlier 2006 Directive; however, the definition is now important to determine the entities that are in the scope of the Reform. ***(Directive, Article 2.13)***

PUBLIC INTEREST ENTITY (PIEs)		EXEMPTIONS
Listed entities and entities with listed debt	Entities incorporated in a EU Member State with transferable securities [shares or debt] on a regulated market of any Member State of the European Union.	Companies traded on alternative markets.
Credit Institutions	Undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits on its own account or electronic money institutions.	Member States may exempt cooperatives and savings banks with non-profit making purposes from the Regulation or from certain provisions of the Regulation.
Insurance Undertakings	Taking up and pursuit of the self-employed activity of direct insurance carried on by insurance undertakings which are: • Established in a Member State or; • Wish to become established there.	Mutual associations with • income lower than 1M€; • no offer for liability risks coverage; and • at least half of their income from persons who are members of the mutual association.

MS OPTION **In addition Member States may designate as PIEs any undertakings that are of significant public relevance because of the nature of their business, their size, or the number of their employees.**

2.2 STATUTORY AUDITORS AND AUDIT FIRMS

(Directive, Articles 2.2, 2.3, 2.5, 3.4,3a, 4)

Audit Firms	A legal person or any other entity, regardless of its legal form, that is approved by the Competent Authorities of an EU Member State to carry out statutory audits. A majority of the voting rights of the Audit Firm must be held by auditors, which are approved in any EU Member State, or by natural persons who have good repute and fulfill the educational requirements to work as an auditor.
Statutory Auditors	Any natural person who is approved by the Competent Authorities of an EU Member State to carry out statutory audits.
Third Country Auditor or Audit Entity	Non EU (not registered in any Member State) Auditors or Audit Entities providing audits on the annual or consolidated financial statements for an entity not registered in the EU.

Key points to take away

The Audit Reform covers a wide range of entities defined as PIEs. Member States have the option to broaden this definition in their jurisdiction by taking into account the public interest dimension of entities.

Audit firms will need to review their governance arrangements to ensure that the requirements of the Directive are met in terms of having a majority of suitably qualified individuals on their governance board and overall voting rights.

The Audit Reform applies to PIEs incorporated in any Member State and to European Audit Firms. Third Country Auditors are exempt from a majority of the requirements.

3. REINFORCING THE ROLE OF THE AUDIT COMMITTEE WITHIN PIEs

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The Directive and the Regulation reinforce the role of the Audit Committee[5] by expanding its responsibilities in ensuring the quality of the audit being performed. With this reform, the Audit Committee is significantly involved in the appointment process of the Statutory Auditor(s) or Audit Firm(s) *(see Chapter 5)*, is given greater accountability through enhanced reporting requirements by the Statutory Auditor(s) and Audit Firm(s) *(see Chapter 4, section 4.3)* and has a better defined role in order to ensure its independence and technical competence.

3.1 COMPOSITION AND TECHNICAL EXPERTISE OF THE AUDIT COMMITTEE

(Directive, Article 39.1)

1. The Audit Committee should be **composed of non-executive members** of the administrative or supervisory body and/or appointed by the general assembly.
2. At least one member needs to have **competence in accounting and auditing.**
3. The majority of members have to be **independent** of the audited entity.
4. The Chairman of the Audit Committee is **appointed by its members or by the supervisory body** of the audited entity.
5. The Audit Committee members as a whole must have **competence relevant to the sector in which the audited entity is operating.**

MS OPTION **Member States can require that the Chairman of the Audit Committee be elected on an annual basis by the general meeting of shareholders.**

5. Or any bodies performing an equivalent function within the audited PIE.
6. Please refer to the next page for the description of this footnote.

3.2 INCREASED RESPONSIBILITIES OF THE AUDIT COMMITTEE

(Directive, Article 39.6)

Additional responsibilities include:

1. informing the administrative or supervisory body of the PIE about the outcome of the statutory audit;
2. selecting the Statutory Auditor(s) or Audit Firm(s) following a tender process;
3. monitoring the financial reporting process and submitting recommendations or proposals to ensure its integrity;
4. monitoring the effectiveness of the internal quality control and risk management system. If applicable, the Audit Committee monitors the internal audit with regards to the financial reporting;
5. supervising the statutory audit of the annual and consolidated financial statements;
6. reviewing the independence of the Statutory Auditor(s) or Audit Firm(s) in accordance with the new Directive and Regulation *(see Chapter 6, Section 6.3 and 6.5).*

3.3 EXEMPTIONS

MS OPTION **Member States have the option of exempting the following entities from having an Audit Committee:**

- any subsidiary undertaking of an ultimate parent undertaking;
- any PIE which is an Undertaking for Collective Investment in Transferable Securities (UCITS)[6] or any Alternative Investment Fund (AIF);

3

- PIEs where the sole business is to act as an issuer of asset backed securities. These entities are required to explain to the public the reasons why they consider that it is not appropriate for them to have either an Audit Committee or an administrative or supervisory body entrusted to carry out the functions of an Audit Committee;
- any credit institution that takes deposits or other repayable funds from the public, that grants credits for its own account, whose shares are not admitted to trading on a regulated market of any Member State and which has, in a continuous or repeated manner, issued only debt securities admitted to trading in a regulated market, provided that the total nominal amount of all such debt securities remain below € 100,000,000.

(Directive, Article 39.3)

For SMEs with an average number of employees of less than 250 and a total balance sheet not exceeding €43,000,000 or an annual net turnover not exceeding €50,000,000, the functions assigned to the Audit Committee may be performed by the administrative or supervisory body as a whole, provided that where the Chairman of such a body is an executive member, he or she shall not act as Chairman when such a body is performing the functions of the Audit Committee.
(Directive, Article 39.2)

6. ***Article 1.2 of Directive 2009/65/EC*** - UCITS means an undertaking: (a) with the sole object of collective investment in transferable securities or in other liquid financial assets referred to in Article 50.1 of capital raised from the public and which operate on the principle of risk-spreading; and (b) with units which are, at the request of holders, repurchased or redeemed, directly or indirectly, out of those undertakings' assets. Action taken by a UCITS to ensure that the stock exchange value of its units does not significantly vary from their net asset value shall be regarded as equivalent to such repurchase or redemption. Member States may allow UCITS to consist of several investment compartments.

Key points to take away

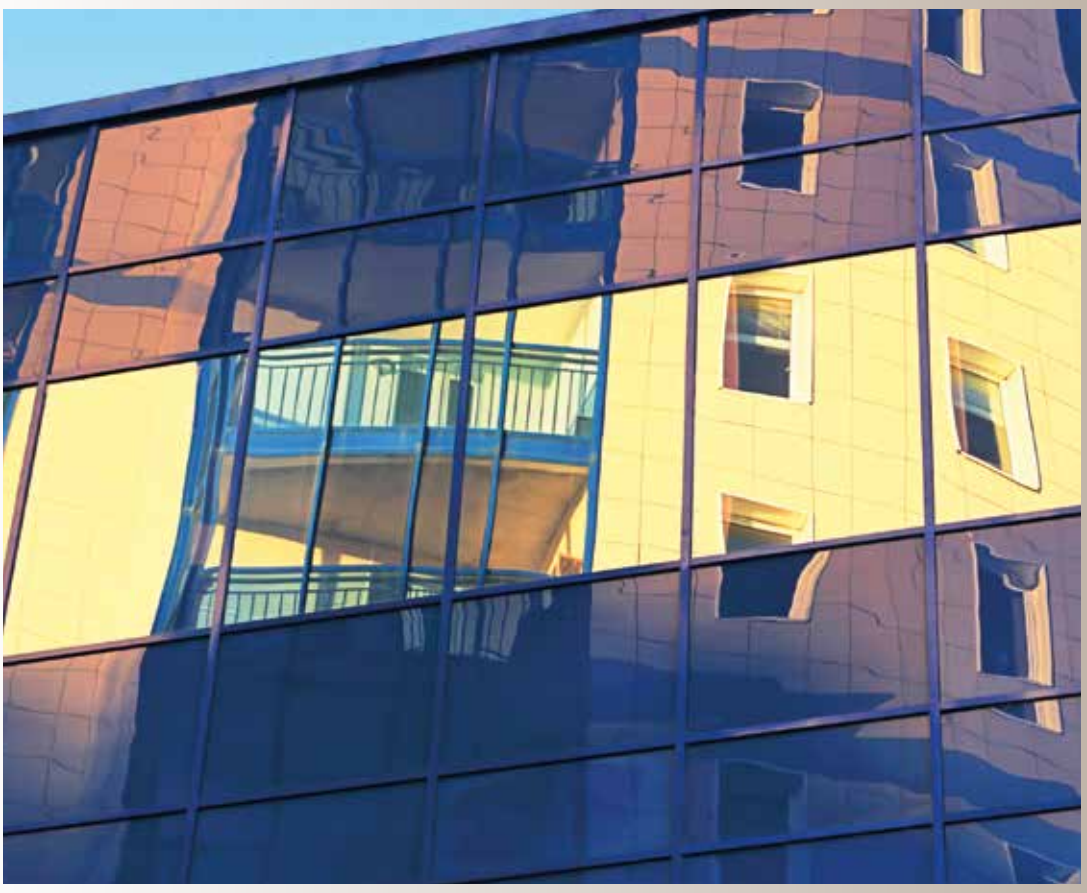
The role of Audit Committees and the competence and independence of their members is reinforced in the Regulation. Its leadership is established over all matters relating to the statutory audit.

Certain entities can be exempted by the Member States from setting up an Audit Committee.

Companies will need to define how they want to implement the Directive, review the terms of reference of their Audit Committee, the independence of its members and whether its Audit Committee has sufficient resources, time and skills available.

Audit Committees will need to develop and reinforce their working relationship with their auditors, and possibly shareholders and Regulators.

4. PROMOTING ACCOUNTABILITY AND TRANSPARENCY THROUGH ADDITIONAL REPORTING



4. PROMOTING ACCOUNTABILITY AND TRANSPARENCY THROUGH ADDITIONAL REPORTING

To increase the value of statutory audits, the Regulation and Directive aim to reinforce information communicated to shareholders and to the general public by requiring more thorough and detailed financial information. This information is required for all entities subject to legal control, with additional specific requirements for PIEs.

4.1 CONTENT OF AUDIT REPORTS FOR ALL ENTITIES SUBJECT TO LEGAL CONTROL

(Directive, Article 28)

4

Standard reporting requirements	a) Name the entity whose annual or consolidated financial statements are the subject of the statutory audit. b) Specify the annual or consolidated financial statements and the date and period covered. c) Identify the financial reporting framework that has been applied. d) Describe the scope of the statutory audit and identify the auditing standards used. e) Include an audit opinion (unqualified, qualified or an adverse opinion) which states clearly the opinion of the Statutory Auditor(s) or the Audit Firm(s) as to whether the annual financial statements give a true and fair view in accordance with the relevant financial reporting framework and whether the annual financial statements comply with statutory requirements. f) If the Statutory Auditor(s) or the Audit Firm(s) are unable to express an audit opinion, the report must contain a disclaimer of opinion. g) Refer to any other matters to which the Statutory Auditor(s) or the Audit Firm(s) draw attention by way of emphasis without qualifying the audit opinion. h) Include an opinion and statement, both of which are based on the work undertaken in the course of the audit. i) Provide a statement on any material uncertainty relating to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. j) Identify the place of establishment of the Statutory Auditor(s) or the Audit Firm(s).

MS OPTION **Member States may lay down additional requirements in relation to the content of the audit report.**

Reporting requirements for Joint Audits	a) **Where the audit was carried out by more than one Statutory Auditor or Audit Firm,** the Statutory Auditors or the Audit Firms must agree on the results of the statutory audit and submit a **joint report** and opinion. b) In the case of disagreement, each Statutory Auditor or Audit Firm must submit his/her or its opinion in a separate paragraph of the audit report and is required to state the reason for the disagreement.
Signatures	a) The audit report must be signed and dated by the Statutory Auditor(s). b) Where an Audit Firm carries out the audit, the audit report shall bear the signature of the Statutory Auditor(s) carrying out the audit on behalf of the Audit Firm. c) Where **more than one Statutory Auditor or Audit Firm** have been simultaneously engaged, the audit report must be signed by all Statutory Auditors or at least by the Statutory Auditors carrying out the statutory audit on behalf of each Audit Firm.

MS OPTION **In exceptional circumstances, Member States may provide that such signature(s) need not be disclosed to the public if such disclosure could lead to an imminent and significant threat to the personal security of any person. In any event, the name(s) of the person(s) involved shall be made known to the relevant Competent Authorities.**

4.2 CHANGES TO EXISTING AUDIT REPORTS FOR PIEs

In addition to the above, the Statutory Auditor(s) or the Audit Firm(s) of PIEs have to enclose the following additional information:

(Regulation, Article 10)

Additional information to provide for audit reports for PIEs

a) By whom or by which body the Statutory Auditor(s) or the Audit Firm(s) was /were appointed.

b) The date of the Auditor(s) or Audit Firm(s) appointment.

c) The period of total uninterrupted engagement (including previous renewals and reappointments of the Statutory Auditor(s) or the Audit Firm(s).

d) Provide, in support of the audit opinion, the following:

(i) a description of the most significant assessed risks of material misstatement, including assessed risks of material misstatement due to fraud,

(ii) a summary of the audit response to those risks; and where relevant,

(iii) key observations arising with respect to those risks.

e) Where relevant to the above information provided in the audit report concerning each significant assessed risk of material misstatement, the audit report shall include a clear reference to the relevant disclosures in the financial statements.

f) The extent to which the audit was considered capable of detecting irregularities, including fraud.

g) Any services, in addition to the audit, which have not been disclosed in the management report or financial statements (annual report).

h) Confirm that the audit opinion is consistent with the additional report to the Audit Committee referred to in Article 11 (see section 5.3).

i) Declare that the prohibited non-audit services referred to in Article 5(1) of the Regulation *(see section 7.2)* were not provided and that the Statutory Auditor(s) or the Audit Firm(s) remained independent of the audited entity in conducting the audit.

Other requirements include:

a) Except as required by point (f) above, the audit report should not contain any cross-references to the additional report to the Audit Committee referred to in Article 11 of the Regulation (see section 5.3).

b) The audit report shall be in clear and unambiguous language.

c) The Statutory Auditor(s) or the Audit Firm(s) shall not use the name of any Competent Authority in a way that would indicate or suggest endorsement or approval by that authority of the audit report.

MS OPTION **Member States may lay down additional requirements in relation to the content of the audit report for PIEs.**

4.3 AN ADDITIONAL REPORT THAT SERVES TO REINFORCE THE ROLE OF THE AUDIT COMMITTEE

The Statutory Auditor(s) or Audit Firm(s) shall submit to the Audit Committee of a PIE, before the audit report is submitted to the shareholders, a more detailed and extensive supplementary report. This additional report encourages a more direct relationship between the Audit Committee and the Statutory Auditor(s) or Audit Firm(s).

The report shall explain the results of the Statutory Audit carried out and shall include the following information:

(Regulation, Article 11)

4

Additional report to the Audit Committee

a) Include the declaration of independence stating that the Statutory Auditor(s), the Audit Firm(s) and partners, senior managers and managers conducting the audit are independent.

b) If the audit was carried out by an Audit Firm, the report must identify each key audit partner involved in the audit.

c) Where the Statutory Auditor(s) or the Audit Firm(s) has/have made arrangements for any of his, her or its activities to be conducted by another Statutory Auditor or Audit Firm that is not a member of the same network, or has used the work of external experts, the report shall indicate that fact and shall confirm that the Statutory Auditor or the Audit Firm received a confirmation from the other Statutory Auditor or Audit Firm and/or the external expert regarding their independence.

d) Describe the nature, frequency and extent of communication with the Audit Committee or the body performing equivalent functions, the management body and the administrative or supervisory body of the audited entity, including the dates of meetings with those bodies.

e) Include a description of the scope and timing of the audit.

f) Where more than one Statutory Auditor or Audit Firm have been appointed, describe the distribution of tasks among the Statutory Auditors and/or the Audit Firms.

g) Describe the methodology used, including which categories of the balance sheet have been directly verified and which categories have been verified based on systems and compliance testing, including an explanation of any substantial variation in the weighting of systems and compliance testing when compared to the previous year, even if the previous year's audit was carried out by other Statutory Auditor(s) or Audit Firm(s).

h) Disclose the quantitative level of materiality applied to perform the Statutory Audit ofthe financial statements as a whole and where applicable the materiality level or levels for particular classes of transactions, account balances or disclosures, and disclose the qualitative factors which were considered when setting the level of materiality.

i) Report and explain judgements about events or conditions identified in 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, and provide a summary of all guarantees, comfort letters, undertakings of public intervention and other support measures that have been taken into account when making a going concern assessment.

j) Report on any significant deficiencies in the audited entity or, in the case of consolidated financial statements, the parent undertaking's internal financial control system, and/or in the accounting system. For each such significant deficiency, the additional report shall state whether or not the deficiency in question has been resolved by the management.

k) Report any significant matters involving actual or suspected non-compliance with laws and regulations or articles of association which were identified in the course of the audit, in so far as they are considered to be relevant for the Audit Committee to fulfil its task.

l) Report and assess the valuation methods applied to the various items in the annual or consolidated financial statements including any impact of changes of such methods.

m) In the case of an audit of consolidated financial statements, explain the scope of consolidation and the exclusion criteria applied by the audited entity to the non-consolidated entities, if any, and whether those criteria applied are in accordance with the financial reporting framework.

n) Where applicable, identify any audit work performed by Third-Country Auditor(s), Statutory Auditor(s), Third-Country Audit Entity(ies) or Audit Firm(s) in relation to an audit of consolidated financial statements other than by members of the same network as to which the auditor of the consolidated financial statements belongs.

o) Indicate whether all requested explanations and documents were provided by the audited entity.

p) Report:

(i) any significant difficulties encountered in the course of the audit;

(ii) any significant matters arising from the audit that were discussed or were the subject of correspondence with management;

(iii) any other matters arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

Additional report to the Audit Committee

Other requirements include:

a) The Statutory Auditor(s), the Audit Firm(s) or the Audit Committee have the freedom to discuss key matters arising from the audit, referred to in the additional report to the Audit Committee, and in particular on any noted deficiencies, with the Audit Committee, administrative body or, where applicable, supervisory body of the PIE.

b) In the case of a **Joint Audit,** and where any disagreement has arisen on auditing procedures, accounting rules or any other issue regarding the conduct of the audit, the reasons for such disagreement shall be explained in the additional report to the Audit Committee.

c) The additional report to the Audit Committee shall be signed and dated. Where an Audit Firm carries out the audit, the report shall be signed by the Statutory Auditor(s) carrying out the audit on behalf of the audit firm.

d) Upon request, and in accordance with national law, the Statutory Auditor(s) or the Audit Firm(s) shall make available without delay the report to the Competent Authorities.

MS OPTION **Member States can set additional requirements in relation to the content of the additional report for the Audit Committee.**

4.4 GREATER TRANSPARENCY REQUIREMENTS FROM AUDIT FIRMS

To increase transparency within the audit market, Statutory Auditors and the Audit Firms that carry out the statutory audits of PIEs are required to publish an annual transparency report to the Audit Committee.

(Regulation, Article 13)

Transparency report from Statutory Auditors or Audit Firms auditing PIEs

a) A description of the legal structure and ownership of the Audit Firm.

b) If the Statutory Auditor or Audit Firm is a member of a network, they have to provide a description of the network, the countries in which each Statutory Auditor operates as a sole practitioner and the total turnover achieved as a sole practitioner.

c) A description of the governance structure of the Audit Firm.

d) A description of the internal quality control system.

e) An indication of when the last quality assurance review was performed.

f) A list of PIEs for which statutory audits were carried out.

g) Information concerning the basis for the partners' remuneration.

h) A description of the key audit partners' rotation plan.

i) Revenues from the statutory audit of annual and consolidated financial statements of PIEs and entities belonging to a group of undertakings whose parent undertaking is a PIE.

Transparency report from Statutory Auditors or Audit Firms auditing PIEs

j) Revenues from the statutory audit of annual and consolidated financial statements of other entities;

k) Revenues from permitted non-audit services to entities that are audited by the Statutory Auditor or the Audit Firm;

l) Revenues from non-audit services to other entities;

m) The transparency report shall be made public within four months of the end of each financial year on the website of the auditor and shall remain available on that website for at least 5 years.

OUR COMMITMENT TO TRANSPARENCY

At Mazars, we are committed to strengthening financial transparency. We have recently published our Group Annual Report for the ninth consecutive year, voluntarily offering transparency to our clients and to the market. This Annual Report includes our consolidated financial statements, prepared under IFRS and jointly audited by two Audit Firms. For more information, please visit our website: http://www.mazars.com/Home/News/Our-publications/Annual-reports/2012-2013-Annual-Report-Paving-new-ways-together.

4

4.5 OTHER REPORTING REQUIREMENTS

(Regulation, Article 7)

Reporting of irregularities

If the Statutory Auditor(s) or Audit Firm(s) suspects or have reasonable grounds to suspect that irregularities with regard to the financial statements are occuring or have occurred, the Regulation provides that the auditor has to inform the audited entity;

If the audited entity is unwilling to investigate the matter or does not take the appropriate measures to address the irregularities, the Statutory Auditor(s) or the Audit Firm(s) informs the Competent Authorities.

(Regulation, Article 12)

Report to the supervisors of PIEs

The Statutory Auditor(s) or the Audit Firm(s) has/have a duty to report promptly to the Competent Authorities supervising the audited PIE about any information concerning:

- a material breach of the laws, regulations or administrative provisions which specifically govern pursuit of the activities of the PIE;
- material threat or doubt concerning the continuity of the PIE;
- issuing of an adverse, qualified or refusal to issue an audit opinion on the financial statements.

An effective dialogue shall be established between the Competent Authorities supervising credit institutions and insurance undertakings, on the one hand, and the Statutory Auditor(s) and the Audit Firm(s) carrying out the statutory audit of those institutions and undertakings, on the other hand.

MS OPTION **Member States may require additional information from the Statutory Auditor(s) or the Audit Firm(s) provided it is necessary for effective financial market supervision as provided for in national law.**

Key points to take away

- Auditors are given new and extensive reporting responsibilities in order to promote accountability and transparency.
- With regard to shareholders, auditors will have to disclose information relating to their engagement and their independence, the scope and conduct of their audit, a commentary on key risks identified and how they have been addressed by the audit.
- With regard to the Audit Committee, auditors will have to provide a detailed and extensive supplementary report to support their audit opinion.
- With regard to wider society, auditors will have to publish a comprehensive Transparency Report on their activities in the PIE audit market.
- Auditors will have a broad duty to report irregularities, to the company and the relevant Competent Authorities, notably in relation to ongoing concern.

10 point ACTION PLAN for PIEs and their Audit Committee

1. Review the composition and functioning of their Audit Committee in line with the Directive notably in relation to competences, independence and terms of reference.
2. Determine if the Audit Committee has sufficient resources, and time in meeting, to deal fairly with the new expectations and obligations and, if not, make necessary adjustments.
3. Decide how the new requirements for regular audit tendering and auditor rotation should be implemented by the PIE.
4. Put in place a clear and efficient process for when an audit tender is launched, such as opening the process up to firms willing to participate and ensuring that all tenderers can participate on a level playing field.
5. Consider the instances where Joint Audit can add value to the audit of the entity.
6. Reconsider their policies in relation to auditors independence, including the provision of non-audit services and other areas where the independence of their auditors may be challenged by investors.
7. Define with relevant input from investors the key criteria to be considered when assessing the performance of their auditors or seeking to select new ones.
8. Get to know 'challenger firms' better either in the context of future audit tenders and/or to diversify the source of non-audit services.
9. Determine how the Audit Committee can provide concise and meaningful information in the annual report in a way that better assists shareholders in understanding their work.
10. Engage with their key institutional investors on an individual and collective basis.

5. ENHANCED GOVERNANCE AND TRANSPARENCY: APPOINTMENT OF STATUTORY AUDITOR(S) OR AUDIT FIRM(S)

5. ENHANCED GOVERNANCE AND TRANSPARENCY: APPOINTMENT OF STATUTORY AUDITOR(S) OR AUDIT FIRM(S)

The Regulation sets out requirements with regard to the PIE's appointment procedure in selecting its Statutory Auditor(s) or Audit Firm(s). These new requirements make the appointment procedures **more transparent** by introducing some new features and by continuing to **reinforce the role of the Audit Committee.** ***(Regulation, Article 16)***

It is assumed in this section that the Statutory Auditor(s) or Audit Firm(s) is/are appointed during the Annual General Assembly/Meeting, although Article 37 (2) of the Directive enables Member States to determine another mechanism for the appointment of Auditors.

The PIE defines the appointment procedure which will take place under the responsibility of the Audit Committee (or an ad-hoc nomination committee). ***(Regulation, Article 16.3, last paragraph).***

Undertakings with a market capitalisation of less than €100M or small and medium-sized PIEs are relieved from the requirement to organise a selection procedure as per the criteria laid down below in sections 5.2, 5.3, 5.4, 5.5, because of the disproportionate cost that it could generate.

5.1 WHEN A TENDER PROCEDURE APPLIES

This procedure takes place for the new appointment of any Statutory Auditor or Audit Firm. In particular this procedure applies in the case of:

- first time appointments;
- or for any re-appointments or new appointments when the current Auditor or Audit Firm has reached the **maximum duration** of their audit engagement *(more details on mandatory Rotation requirements are provided in Chapter 7).*

For any other audit engagements renewed before the maximum duration ***(Regulation, Article 17.1 and 17.2)*** the procedure outlined below in sections 5.2, 5.3, 5.4, 5.5 is not obligatory.

5.2 INVITING STATUTORY AUDITORS OR AUDIT FIRMS TO BID

The PIE is free to invite any Statutory Auditor(s) or Audit Firm(s) to bid and must ensure that the organisation of the **tender process does not exclude the participation of firms receiving less than 15% of the total audit fees from PIEs in the preceding calendar year** ***(Regulation, Article 16.3a).***

The list of such Auditors must be prepared by the Competent Authority on an annual basis and be made public. ***(Regulation, Article 16.3, last paragraph)***

Naturally the Statutory Auditors or Audit Firms invited to bid will need to be free of conflicts of interest and, in particular, should not be in a situation where they have provided specific prohibited non-audit services in the 12 months period preceding their appointment *(refer to Chapter 6, section 6.2).*

In addition, any clauses or restrictions on the choice of auditors will be null and void[7]. ***(Regulation, Article 16.6)***

7. The application of this requirement will become effective three years after the date of Entry into Force. (Regulation, Article 44)

5.3 PREPARATION OF TENDER DOCUMENTS

The PIE is required to prepare tender documents for the attention of the invited Statutory Auditors or Audit Firms. The tender documents prepared by the PIE should include at least the following:

a. Sufficient information on the business of the entity and the type of audit to be carried out; ***(Regulation, Article 16.3b)***

b. The selection criteria, which must be transparent and non-discriminatory, to be used during the evaluation of proposals received from the Statutory Auditors or Audit Firms; (***Regulation, Article 16.3b)***

c. Include, where applicable, the quality standards required by Member State Regulators. ***(Regulation, Article 16.3c)***

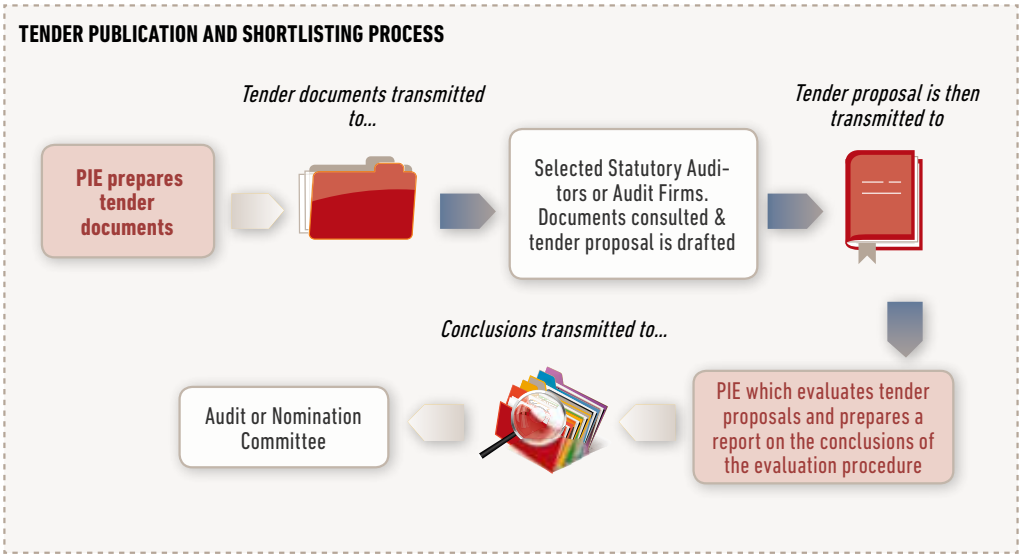
5.4 EVALUATION PROCEDURE

The PIE evaluates the tender proposals submitted based on predetermined criteria outlined in the tender documents prepared for the invited bidders and prepares a report on the outcome of the procedure which is then validated by the Audit Committee.

During the course of this procedure, the PIE is free to conduct direct negotiations with interested bidders. ***(Regulation, Article 16.3c)***

The PIE must be able to demonstrate to the regulator (upon request) that the selection procedure was conducted fairly and take into account inspection reports prepared by the Competent Authority on the Statutory Auditor(s) or Audit Firm(s) which has/have submitted proposals. ***(Regulation, Article 16.3e and f)***

FIGURE 5.3



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5.5 SELECTION PROCEDURE AND APPOINTMENT OF THE STATUTORY AUDITOR(S) OR AUDIT FIRM(S)

The Audit Committee submits a recommendation to the administrative or supervisory body of the PIE for the appointment of the Statutory Auditor(s) or Audit Firm(s). The recommendation must be justified and **present at least two choices** with a "duly justified preference" expressed for one of them. ***(Regulation, Article 16.2)***

The administrative or supervisory body discusses the recommendation and preferences presented by the Audit Committee and makes a proposal to the General Meeting of Shareholders for the appointment of the Statutory Auditor(s) or Audit Firm(s). If the proposal made does not follow the preference of the Audit Committee, a note should be provided explaining why the recommendation of the Audit Committee was not pursued.

The Auditor(s) or Audit Firm(s) appointed must have been involved in the selection process described above. ***(Regulation, Article 16.5)***

The Audit Committee must declare that it has not been influenced by third parties and has not been subject to a clause in the procedure such as to restrict the final choice of the General Meeting of shareholders. ***(Regulation, Article 16.6)***

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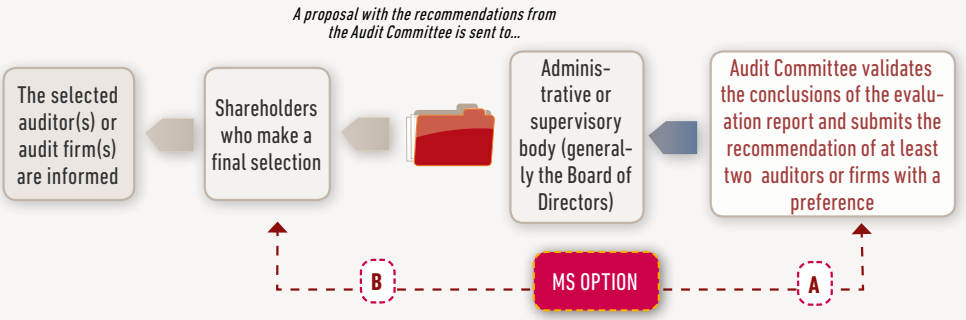
FIGURE 5.5

SELECTION PROCEDURE AND APPOINTMENT OF THE STATUTORY AUDITOR(S) OR AUDIT FIRM(S)



- A. Where the audited entity has a nomination committee where shareholders have a considerable influence and which has the task of making recommendations on the selection of auditors, Member State may allow a nomination committee to perform the functions of the Audit Committee.
- B. Member States decide the minimum number of Statutory Auditors or Audit Firms that shall be appointed by PIEs and establish the conditions governing the relations between the auditors or firms appointed.

Key points to take away

Audit tenders are made mandatory at the end of the "maximum duration", generally after10 years. An exceptions applies in the case of Joint Audit.

The Regulation provides for transparent and non-discriminatory selection criteria, opens all tenders to any non-dominant Audit Firm and forbids any clauses restricting the participation of any Statutory Auditor or Audit Firm.

The selection procedure takes place under the auspices of the Audit Committee which is required in the case of a sole audit to prepare a recommendation of two Statutory Auditors or Audit Firms expressing a preference for one.

The administrative or supervisory body needs to take this recommendation to the shareholders or duly explain why another choice is proposed to the shareholders.

6. SAFEGUARDING THE INDEPENDENCE OF THE STATUTORY AUDITOR OR AUDIT FIRM

6. SAFEGUARDING THE INDEPENDENCE OF THE STATUTORY AUDITOR OR AUDIT FIRM

To mitigate conflicts of interest and to preserve the independence of Statutory Auditor(s) or Audit Firm(s), the Regulation introduces provisions with regard to services provided to PIEs by their auditors. **A list of prohibited non-audit services and a cap on permitted non-audit services provided by auditors have been defined.**

Moreover, a limit has also been placed on the fees that a Statutory Auditor or Audit Firm can earn from the audit of a single PIE client.

6.1 LIST OF PROHIBITED NON-AUDIT SERVICES

The Statutory Auditor or Audit Firm (and any member of a network where the Statutory Auditor or Audit Firm belongs) carrying out the statutory audit of a PIE is not allowed to provide directly or indirectly to the audited entity, to its parent undertaking or to any of its controlled undertakings within the EU, any of the prohibited non-audit services listed below.

This restriction applies for the period between the start of the audited period and the issuing of the audit report *(See section 6.2).*

(Regulation, Article 5)

Prohibited non-audit services	
Tax services	Preparing tax forms, payroll tax, custom duties, identification of public subsidies and tax incentives, support regarding tax inspections, calculation of direct/indirect tax and deferred tax and provision of tax advice.
Projects related to management / decision making	Services that involve playing any part in the management or decision-making process of the audited entity.
Bookkeeping	Bookkeeping and preparing accounting records and financial statements.
Payroll services	Preparing the payroll and payroll processing.
Internal control, risk management, technology systems	Designing or implementing internal processes relating to the preparation or control of financial information or financial IT systems. It is prohibited to perform such a service in the period immediately preceding the audit of the financial year.
Valuation services	Evaluation of retirement benefits and valuations of litigation claims.

Prohibited non-audit services	
Legal services	Provision of general counsel, negotiating on behalf of the audit client, acting in advocacy role in the resolution of litigation.
Internal audit functions	Assisting the client in the performance of its internal audit activities.
Services linked to the financing, capital structure and allocation, and investment strategy of the audit client	**EXCEPT** providing assurance services in relation to the financial statements, including the provision of comfort letters in connection with prospectuses issued by the audit client.
Promoting, dealing in, or underwriting shares in the audited entity	Supporting the entity to price and sell its shares.
Human resources services	Searching for or seeking out candidates linked to the preparation of accounting records and financial statements, structuring the organisation's design and cost control, etc.

MS OPTION **Member States can add services to the list of prohibited non-audit services if threats to the auditor's independence are identified.**

In addition, Member States may decide to allow tax services (preparation of tax forms, identification of public subsidies and tax incentives, support regarding tax inspections, calculation of direct and indirect tax and deferred tax, provision of tax advice) if they satisfy the following requirements:

a) they have no direct or only an immaterial effect separately or in aggregate on the audited financial statements;

b) the estimation of the effect on the audited financial statements is comprehensively documented and explained in the additional report to the Audit Committee; and

c) the principles of independence are complied with by the Statutory Auditor or Audit Firm.

(Regulation, Article 5.3)

6.2 A PERIOD OF PRIOR RESTRICTIONS FOR CERTAIN NON-AUDIT SERVICES

To become an auditor of a PIE, the Statutory Auditor or the Audit Firm shall refrain, during the year preceding his/her/its appointment, from providing the following non-audit services:

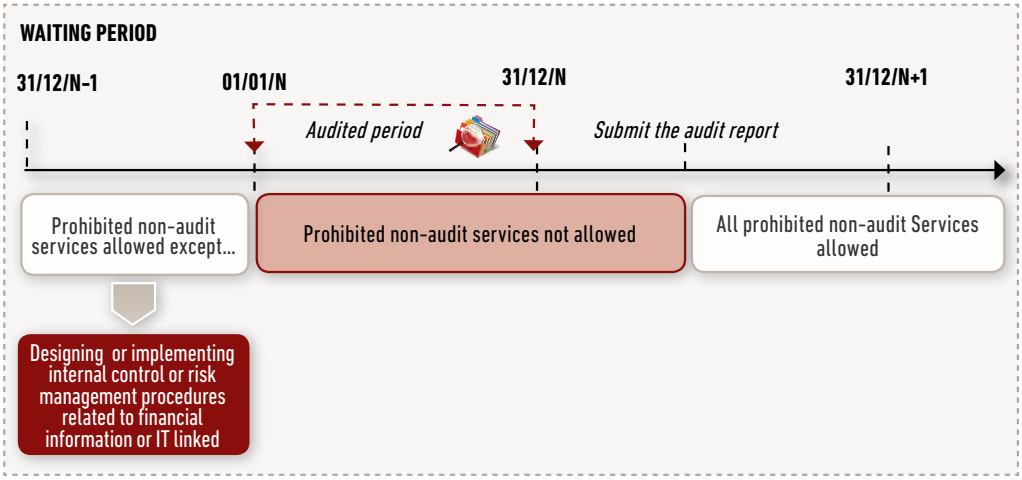
- design and implementation of internal control procedures and risk management in relation to the preparation and/or control of financial reporting;
- implementation of technical systems relating to financial reporting.

During the audit period, the Statutory Auditor or Audit Firm is not allowed to provide any of the prohibited non-audit services between the beginning of the period audited and the issuing of the audit report.

After the audited period, the departing Statutory Auditor or Audit Firm can provide any prohibited non-audit services to a PIE but only after submission of the audit report.

(Regulation, Article 5.1)

FIGURE 6.2



6.3 INTRODUCTION OF A CAP ON NON-AUDIT SERVICES

The Statutory Auditor or Audit Firm is allowed to provide non-audit services to the audited entity, its parent undertaking or its controlled undertakings so long as these non-audit services are restricted to services which are not cited in the prohibited non-audit services list *(see section 6.1)*.

The fees for providing non-audit services are limited **to a maximum of 70% of the average total statutory audit fees paid during the last three consecutive financial years** *(see figure 6.3)*.

(Regulation, Article 4.2)

FIGURE 6.3

The Regulation also requires the preliminary approval of the Audit Committee for any non-audit services rendered by the Statutory Auditor or Audit Firm.

MS OPTION **Member States can apply more stringent requirements to the thresholds mentioned above.**

6.4 NON-AUDIT SERVICES PROVIDED TO A SUBSIDIARY OUTSIDE OF THE EU

When a member of the network, to which the auditor carrying out a statutory audit belongs, provides any of the prohibited non-audit services outlined in section 6.1 to an undertaking incorporated in a non-EU country and controlled by or under the control of the audited entity, the auditor is required to assess whether their independence would be compromised by the provision of such services by the member of the network. The auditor may only continue to carry out the statutory audit if they can demonstrate that either their independence is not affected, or they can apply sufficient safeguards to mitigate threats affecting independence. ***(Regulation, Article 5.5)***

For further understanding, please refer to the examples below:

Scenario 1

Company Z, PIE, is registered in the UK and is audited by Mazars.

Company Z has 3 subsidiaries in various countries.

FIGURE 6.4-1

Chain of command	Country of incorporation	Audit Firm	Can prohibited non-audit services be provided by Mazars?
Z. Parent undertaking (PIE)	**UK**	**Mazars UK**	**No**
A. Subsidiary (can be either a PIE or not)	**France**	Mazars FR	No
B. Subsidiary (can be either a PIE or not)	**US**	Mazars US	Possible to provide non-audit services, if it is permitted according to national laws, because the entity is in a third country. Auditor of Z needs to assess if independence is compromised.
C. Subsidiary (can be either a PIE or not)	**South Africa (SA)**	Mazars SA	Possible to provide non-audit services, if it is permitted according to national laws, because entity is in a third country. Auditor of Z needs to assess if independence is compromised.

In this scenario, since Mazars is the legal auditor of the European PIE, Mazars and its network:

- cannot provide prohibited non-audit services to Z and A, located in the EU;
- will need to document an assessment of whether their independence is compromised before providing prohibited non-audit services for the subsidiaries in non EU countries or third countries (B and C);
- Mazars UK (auditor of Company Z) will need to report to the Audit Committee of company Z on any threats to its independence.

Scenario 2

Company Y is registered in the US and is not audited by Mazars.

Company Y has 6 subsidiaries split in two control chains:

- Y is the parent undertaking of A1 and A2;
- Chain 1 of subsidiaries: A1 controls B1 which controls C1;
- Chain 2 of subsidiaries: A2 controls B2 which controls C2.

FIGURE 6.4-2

Chain of Command	Country of incorporation	Audit Firm	Can prohibited non-audit services be provided by Mazars?
Y Parent Undertaking (can be either a PIE or not)	**US**	Audit Firm (X) US	Yes
A1. Subsidiary (can be either a PIE or not)	**France**	Audit Firm (X) FR	No
B1. Subsidiary (PIE)	**Spain**	Mazars Spain	No
C1. Subsidiary (can be either a PIE or not)	**China**	Mazars Cn	Possible to provide non-audit services, because entity is in a third country. Auditor of B1 needs to assess if independence is compromised.
A2. Subsidiary (not a PIE)	**Germany**	Mazars DE	Possible to provide non-audit services, if permitted by national law.
B2. Subsidiary (can be either a PIE or not)	**Italy**	Audit Firm (X) IT	Possible to provide non-audit services, if permitted by national law.
C2. Subsidiary (can be either a PIE or not)	**South Africa (SA)**	Mazars SA	Possible to provide non-audit services, if permitted by national law.

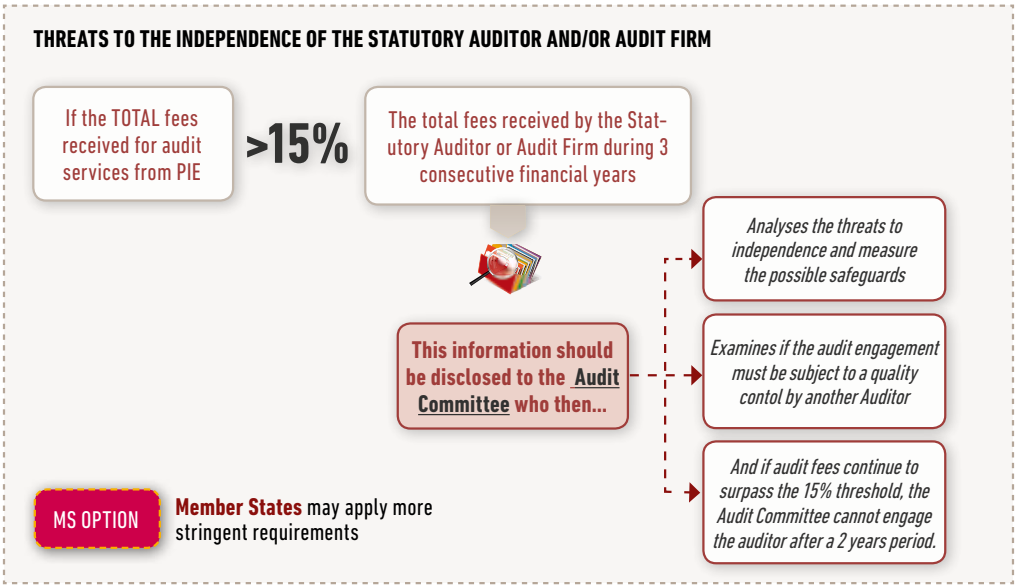
In this scenario, Mazars is the legal auditor of the European PIE B1. Mazars and its network:

- cannot provide prohibited services to A1 and B1, located in the EU;
- will need to document an assessment of whether their independence is compromised before providing prohibited non audit services for the subsidiaries controlled in third countries (C1);
- Mazars Spain will need to report to the Audit Committee of company B1 any threats to its independence;
- as A2, B2, C2 are only sister companies of B1 (not controlled), prohibited non-audit services can be provided, if allowed by national law.

6.5 CAP ON THE TOTAL AUDIT FEES RECEIVED BY THE STATUTORY AUDITOR OR AUDIT FIRM

In reviewing the independence of the Statutory Auditor or Audit Firm *(see figure 6.5 - cap on total audit fees received from PIE)*, the **Audit Committee** can activate a specific procedure when the dependence of the Statutory Auditor or Audit Firm with an audited PIE becomes excessive, specifically in terms of fees[8]. The Audit Committee may submit the appropriate audit engagement to a quality control review before the publication of the audit report and decide, on the basis of justified reasons, if the Statutory Auditor or Audit Firm can continue. If the decision is to continue, the Audit Committee can decide to keep the Statutory Auditor or Audit Firm in place for a period that should not, in any case, exceed two years, unless of course the independence threat disappears. ***(Regulation, Article 4.3)***

FIGURE 6.5



8. When the total fees received from a PIE in each of the last three consecutive financial years are more than 15 % of the total fees received by the Statutory Auditor or the Audit Firm or, where applicable, by the group auditor carrying out the statutory audit, in each of those financial years, such a Statutory Auditor or Audit Firm or, as the case may be, group auditor, shall disclose that fact to the Audit Committee and discuss with the Audit Committee the threats to their independence and the safeguards applied to mitigate those threats. The Audit Committee shall consider whether the audit engagement should be subject to an engagement quality control review by another Statutory Auditor or Audit Firm prior to the issuance of the audit report. (Regulation: Article 4.3)

Key points to take away

The Regulation introduces a strict approach to the independence of Statutory Auditors or Audit Firms with a "blacklist" of non-audit services and a financial cap of 70% on the audit fees for non-audit services.

The list of "blacklisted services" is wide ranging and only applies within the European Union. Subject to general principles of independence, an auditor will be able to provide any non-audit service that is not explicitly prohibited by the Regulation or any non-audit service outside of the European Union.

The provision of permissible non-audit services is subject to the approval of the Audit Committee following an assessment of the threats to independence and safeguards applied to mitigate or eliminate those threats.

The Audit Committee must monitor the independence of the Auditor and guarantee that the fees received by the Statutory Auditor or Audit Firm do not exceed a certain threshold.

Member States can decide to allow certain tax or valuation services if they are not material to the financial statements audited, and can also introduce more stringent threshold and independence requirements.

10 point ACTION PLAN for Investors

1. Ensure that their teams have sufficient resources and the necessary audit expertise to understand and engage with PIEs on audit related matters.
2. Develop clear policies in relation to:
   - the mandatory rotation of audit firms;
   - audit tendering including which firms should be considered and key criteria for the selection of auditors;
   - the provision of non-audit services;
   - the independence requirement of Audit Committee members;
   - regular assessments on the performance of auditors.
3. Engage with PIEs and their Audit Committees to ensure that the new requirements on Audit Committees, notably in relation to their responsibilities and reporting obligations, are implemented in a way that enhances investor confidence.
4. Organise appropriate communication with PIEs and their Auditors within the context of extended audit reports and enhanced reporting to Audit Committees.
5. Consider where Joint Audit could deliver value for investors.
6. Express support for the fair consideration of non-Big 4 auditors for appointment by PIEs and ensure that all tenderers have participated on a level playing field.
7. Ensure fund managers, proxy agencies and other representatives follow investors' declared policies.
8. Determine which issues covered in annual reports should be dealt with by way of a collective response of investor groups and which on a one to one basis between the investor and the PIE.
9. Actively enquire about auditors' selection process to ensure they are fair, transparent and robust, and that firms are demonstrably selected on the basis of merit.
10. Once the reform is fully implemented, maintain an open dialogue with professional and oversight bodies so as to give feedback on the pertinence of new measures and ideas on possible tweaks within the system.

7. INTRODUCING MANDATORY ROTATION AND ENCOURAGING JOINT AUDIT

7. INTRODUCING MANDATORY ROTATION AND ENCOURAGING JOINT AUDIT

One of the major changes introduced by this Reform is the **mandatory rotation of Audit Firm(s) by all PIEs after a set number of years *(Regulation, Article 17).*** The measures on rotation also recognise the merits of Joint Audit by allowing PIEs using this system to benefit from a longer rotation period without the need for a public tender.

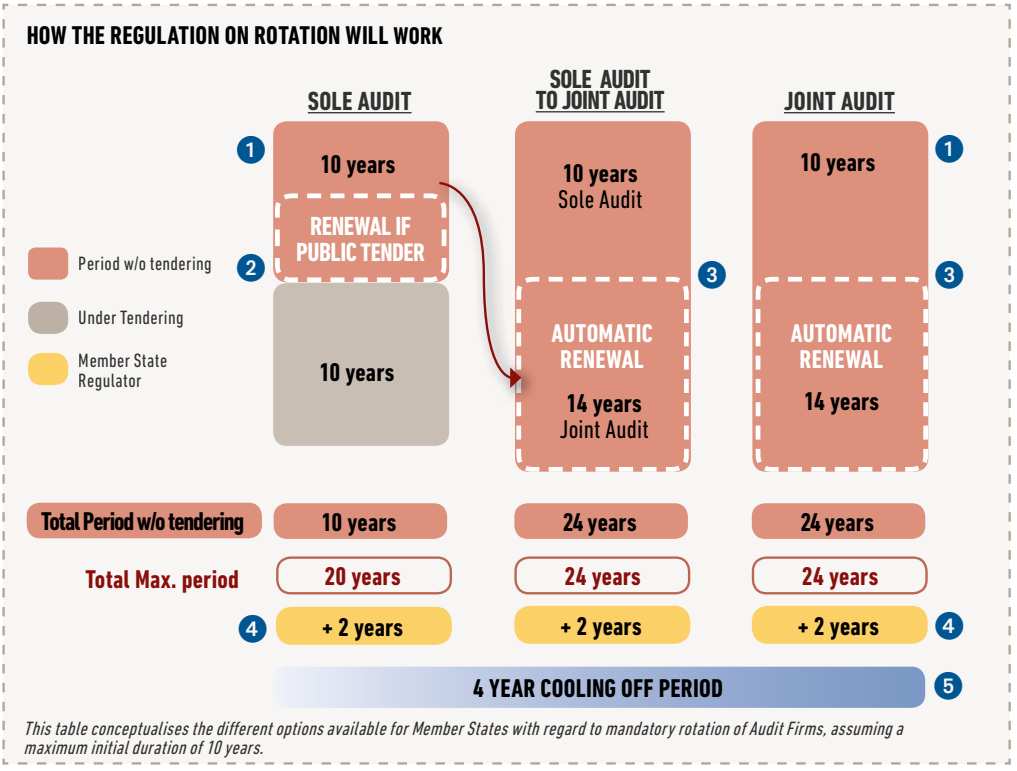
7.1 WHAT THE REGULATION STATES ABOUT THE MANDATORY ROTATION OF AUDIT FIRMS

The Regulation defines a 10-year maximum duration period of audit engagements with possible derogations in the following cases:

- for **Sole Audit engagements,** Member States may provide that the first 10-year period be extended to 20 years if a competitive tender is performed at the end of the first 10-year point (maximum duration);
- **Joint Audit engagements** can automatically be extended to 24 years at the first 10-year point (no tendering required);
- the Competent Authorities can also grant an additional 2-year extension after the second extension period, but only in rare circumstances.

(Regulation, Article 17)

FIGURE 8.1



This table conceptualises the different options available for Member States with regard to mandatory rotation of Audit Firms, assuming a maximum initial duration of 10 years.

7

1 Depending on the decision of Member States, PIEs can appoint an auditor for an initial minimum period of 1 year and for a maximum period of 10 years (including mandate renewals).

2 For Sole Audit engagements, after the end of a maximum duration of 10 years, the audit engagement can be extended to 20 years if there is a public tender or 24 years if there is a Joint Audit.

3 Sole Audit engagements can benefit from an automatic extention to 24 years, if the PIE switches to Joint Audit. For all Joint Audit engagements, after the end of the maximum duration, the audit engagement can be extended automatically to 24 years.

4 After the expiry of the maximum duration of the engagement, the PIE may, on an exceptional basis, request that the Competent Authority grant an extension to re-appoint the Statutory Auditor or the Audit Firm for a maximum period of 2 years.

5 Once the auditor is required to rotate off, the Audit Firm or any members of their network within the European Union shall not undertake the audit mandate for the audited entity for a minimum of 4 years.

MS OPTION **Member States have the following options:**

- **can set the maximum duration of the audit mandate as long as it does not go over the maximum total durations of 20 years (Sole Audit) or 24 years (Joint Audit),**
- **can set the minimum number of auditors required.**

7.2 RECOGNISING JOINT AUDIT AS A CREDIBLE SYSTEM

The Regulation recognises Joint Audit as a system with real merits in terms of audit quality, auditor independence and market diversity. These deep-rooted merits, which stem from the fundamental principle of the "four eyes system", are taken into account by allowing Joint Audit to benefit from an extended rotation period which helps improve good governance and organisation. Moreover, the Regulation recognises that Joint Audit promotes a multi-player market which encourages the development of smaller firms. ***(Regulation, Recital 20)***

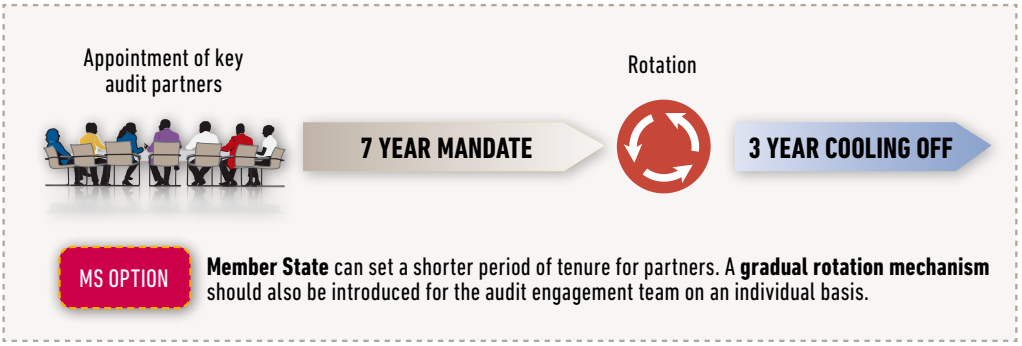
"The appointment of more than one Statutory Auditor or Audit Firm by PIEs would reinforce the professional skepticism and help to increase audit quality. Also, this measure, combined with the presence of smaller Audit Firms in the audit market would facilitate the development of the capacity of such firms, thus broadening the choice of Statutory Auditors and Audit Firms for PIEs. Therefore, the latter should be encouraged and incentivised to appoint more than one Statutory Auditor or Audit Firm to carry out the statutory audit."

This system is not prohibited in any Member State, but has often been misrepresented and misunderstood. However, Joint Audit has a history of success when operated by professionals with the right experience and attitude. Today, this system has received a stamp of approval at European level which highlights that it is encouraged and welcomed.

7.3 ROTATION OF KEY AUDIT PARTNERS

Rotation of audit partners every seven years already existed in the 2006 Directive; however, the Regulation has extended the cooling off period from 2 years to 3 years.

FIGURE 7.3



Key points to take away

As a general rule, all PIEs must rotate their auditor after a maximum period of ten years.

The option is given to Member States to allow a ten-year audit engagement to be extended up to 20 years if a public tender takes effect upon the expiry of the first ten-year period or up to 24 years without tendering, but only if two auditors or more were in place during the maximum initial duration or are simultaneously appointed after the maximum duration period. By allowing automatic renewal for Joint Audit, the legislation thus recognises the merit of this system which deserves to be encouraged.

Member States also have the option to apply a shorter maximum period than ten years, which would allow some countries to maintain their existing rotation requirements.

8. WHAT ARE THE IMPLEMENTATION DEADLINES ON ROTATION AND TENDERING?

8. WHAT ARE THE IMPLEMENTATION DEADLINES?

Both the Directive and Regulation will apply at the **Date of Application (17 June 2016).** However, due to the very large number of EU companies affected by the mandatory rotation of Audit Firms, this measure will be implemented progressively and will benefit from a **specific transitional period to ensure that the market can cope with the new regime.** The transitional arrangements will vary depending on the length of the audit appointment at the date of **Entry into Force (EIF): 17 June 2014.**

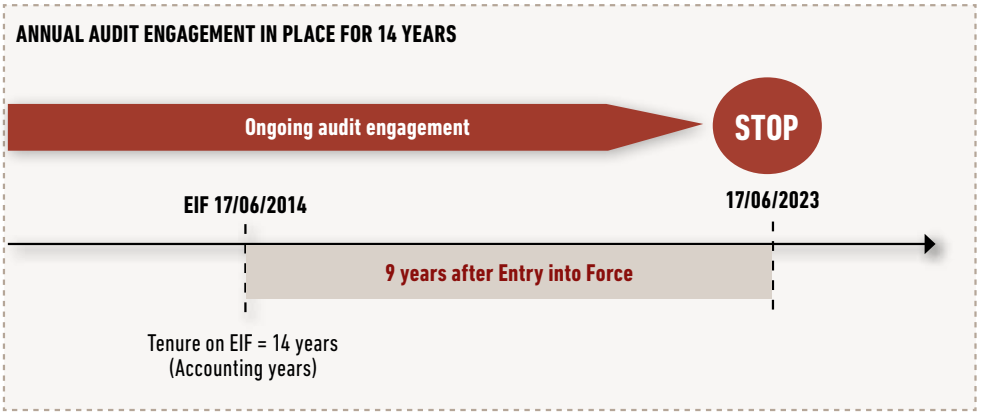
8.1 TRANSITIONAL MEASURES FOR ONGOING AUDIT MANDATES

For annual audit mandates (Regulation, Article 41)

1. Audit engagements in place for 20 years or more on EIF	May be renewed until June17, 2020. (6 years after EIF).	After this date, rotation applies.
2. Audit engagements in place for 11 years but less than 20 years on EIF	May be renewed until June 17, 2023. (9 years after EIF).	After this date, rotation applies.
3. Audit engagements in place for 10 years or less on EIF[9]	May continue without tendering until the end of the maximum duration (10 years for **Sole Audits** or 24 years for **Joint Audits).**	After, rotation applies. For **Sole Audits,** an extension to 20 years is possible in the case of public tendering or to 24 years if a switch is made to **Joint Audit.**

Example: annual audit engagement

FIGURE 8.1.A



9. This interpretation is somewhat inconsistent with the transitional arrangements applicable where the audit tenure is in excess of 11 years or 20 years. This section is still subject to review.

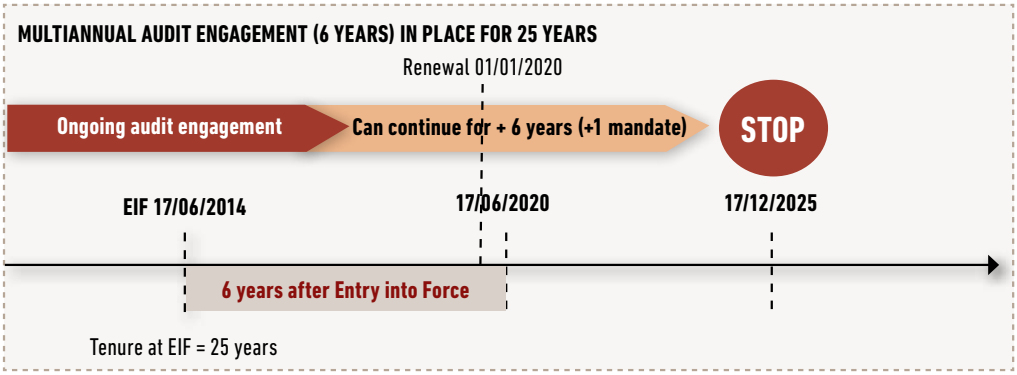
8

For multiannual engagements: 6 years (French example)

1. Audit engagements in place for 20 years or more on EIF	May continue for one or (in rare circumstances) two additional mandates if renewed during the 6-year period following EIF (until June 17, 2020).	If the end of the last 6-year mandate ends beyond June 17, 2020 –rotation applies.
2. Audit engagements in place for 11 years but less than 20 years on EIF	May continue for one or two additional mandates if renewed during the 9-year period following EIF (until June 17, 2023).	If the end of the last 6-year mandate ends beyond June 17, 2023 – rotation applies.
3. Audit engagements in place for 10 years or less on EIF[9]	May continue without tendering until the end of the maximum duration (10 years for **Sole Audits** = 1 mandate) or (24 years for **Joint Audits** = 2, 3 or 4 mandates).	For **Sole Audits**, 2 additional 6-year mandate are possible in the case of public tendering, and 3 additional 6-year mandates are possible if the switch is made to **Joint Audit.**

Example: multiannual audit engagement (6 years)

FIGURE 8.1.B



8.2 HOW TO CALCULATE THE TENURE OF AUDIT ENGAGEMENTS

- **The tenure of the engagement will be calculated on the date of EIF** to determine which transitional period applies.
- The **duration of the audit engagement will be calculated as from the first financial year covered in the audit engagement letter** in which the Statutory Auditor or the Audit Firm was for the first time appointed to carry out consecutive statutory audits for the PIE.
- This **calculation must take into account other firms that the Audit Firm has acquired or has merged with**, starting from the date the audited entity became a PIE.
- If there is uncertainty as to the date during which the Statutory Auditor or the Audit Firm began carrying out consecutive statutory audits for the PIEs, due to firm mergers, acquisitions, or changes in ownership structure, the Statutory Auditor or the Audit Firm is required to report **such uncertainties to the Competent Authority which shall ultimately determine the relevant date**.

Key points to take away

To enable a smooth implementation of the Regulation and reduce market disruption, transitional arrangement have been defined and which will vary depending on the length of the audit engagement at the date the new legislation comes into force: 17 June 2014.

If the auditor has been in place for 20 years or more at the date of EIF, the last renewal must take place before 17 June 2020; if the auditor has been in place for 11 years but less than 20 years at the date of EIF, the last renewal must take place before 17 June 2023; for all other engagements, the new regime will apply.

The tenure of the audit engagement will be counted from the day the entity became a PIE. Mergers between Audit Firms will not "reset" the duration of the engagement.

10 point ACTION PLAN

for Audit Firms

1. Review their governance arrangements to ensure the requirements of the Directive are met in terms of having a majority of auditors or similarly qualified individuals on their governance board and overall partner voting rights.
2. Prepare and publish more complete Transparency Reports.
3. Develop procedures with other firms to facilitate the handover of audit files upon rotation. For example could a "Permanent File" be handed over upon rotation?
4. Increase their emphasis on promoting high standards in relation to all aspects of audit quality including through a continuous learning and coaching culture in the audit practice.
5. Increase their investment in audit innovation in relation to audit services, notably in the way audits work and share, and communicate findings with Audit Committees and investors.
6. If a challenger firm, it should be willing to submit proposals for a significant number of PIE audits each year and to invest time and resources to develop relationships with PIEs.
7. Review their internal processes for conflict identification and whistleblowing management.
8. Ensure effective engagement with Regulators and investors on audit clients and on auditing issues generally.
9. Commit to working with other firms and other stakeholders with a view to enhancing audit quality across the market.
10. Seek to facilitate the emergence of a Single Audit Market across the European Union.

10 point ACTION PLAN

for Member States, Competent Authorities and Professional Bodies at Member States level

Member States need to transpose the European Directive and decide which options to take in relation to the Regulation:

1. Which non-audit services should be prohibited? Should a materiality threshold be defined?
2. What will be the maximum initial duration for auditors before rotation?
3. Should PIEs registered in Member State be allowed to renew their auditor(s) after 10 years if a public tender takes place? Allow a maximum duration of 24 years without tendering in the case of Joint Audits?
4. Which will be the designated "Competent Authority"?

Competent Authorities will need to:

5. Review their governance arrangements to ensure full independence from the Audit Firms.
6. Organise a system of delegation to other regulatory bodies, while retaining ultimate responsibility.
7. Put in place an inventory process of audit mandates, and establish clear policies on how the tenure of ongoing audit engagements will be calculated in order to define the application of the applicable transitional regime.
8. Organise regular communication with Audit Firms and PIEs to monitor the effective implementation of the European Audit Reform and request remedial actions where required.

Professional bodies should:

9. Consider training requirements and the scope of aptitude tests to facilitate the creation of the single market for auditors.
10. Assist in clarifying the requirements of new or amended practices and promote the development of features such as Joint Audit.

9. PROMOTING A SECURE MARKET BY CREATING A EUROPEAN OVERSIGHT SYSTEM

9. PROMOTING A SECURE MARKET BY CREATING A EUROPEAN OVERSIGHT SYSTEM

The world is changing fast and, of course, businesses of all sizes are becoming increasingly international. **Regulators are focused on ensuring greater levels of global consistency and effective competition, and there is also a natural wish to prevent any further economic meltdowns by improving early warning systems.** To promote such an environment, market supervision needs to be reinforced by creating **a sound oversight system capable of monitoring 1) coordination between Member State Regulators, 2) developments within the audit market, and 3) international best practices to guarantee a dynamic European market.**

9.1 CREATING A COMMITTEE OF EUROPEAN AUDITING OVERSIGHT BODIES (CEAOB)

The Regulation sets out the framework for the creation of a **Committee of European Auditing Oversight Bodies (CEAOB)** which will oversee cooperation between the Competent Authorities and will take over the existing role of the **European Group of Auditor Oversight Bodies (EGAOB).**

The Regulation allocates the following responsibilities to the CEAOB:

- facilitate the **exchange of information,** ensure expertise and promote best practices for the implementation of the Regulation and the corresponding Directive;
- provide expert **advice** to the Commission as well as to the Competent Authorities, at their request, on issues related to the implementation of the Regulation;
- contribute to the **technical assessment** of public oversight systems of third countries and to the international cooperation between Member States and third countries. The CEAOB can request assistance from the European Securities and Markets Authority (ESMA), European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA);
- contribute to the **technical examination of International Standards on Auditing,** including the processes for their development, with a view to their adoption at the EU level;
- contribute to **the improvement of the cooperation mechanisms** regarding oversight of PIE Audit Firms and the networks to which they belong;
- carry out other **coordinating tasks** in cases provided for in this Regulation.

The CEAOB will also publish information provided by Competent Authorities in an annual report.

The Composition of the CEAOB

(Regulation, Article 30)

The Chair	• Will be elected or removed by the 2/3 majority vote from applicants representing the Competent Authorities. • Will have a four-year term with re-election possible after a cooling-off period of four years. • If the Chair resigns or is removed before the end of the term, the Vice Chair will act as Chair until the next meeting of the CEAOB. The CEAOB will elect a new Chair for the remaining period of the term. • Has no voting rights.

9

The Vice Chair	• Is appointed or removed by the European Commission. • No voting rights.
Members	• Composed of high level representatives from the Competent Authorities. • One Member appointed by the European Securities and Market Authority (ESMA) with no voting rights but will chair Sub-Groups (see Sub-Group Creation below). • One vote for each member. • Decisions made through simple majority vote. • The Secretariat of the CEAOB is provided by the European Commission and the expenses of the CEAOB are included in the estimates of the Commission.
Observers	• The European Banking Authority (EBA). • The European Insurance and Occupational Pensions Authority (EIOPA).
Sub-group creation	• The CEAOB can establish Sub-Groups on a permanent or ad hoc basis. • The purpose of Sub-Groups is to assist the CEAOB in carrying out its tasks, primarily in the technical assessment of public oversight systems of third countries and relating to the international cooperation between Member States and third countries. • Any Sub-Groups created for the purpose of assessing public oversight systems of third countries or the international cooperation betwen Member States and third countries will be chaired by the Member appointed by ESMA. • Participation in the Sub-Group discussions may be extended to Competent Authorities from the countries of the European Economic Area (EEA) through invitation.
Meetings	• The CEAOB will meet on regular intervals and, where necessary, at the request of the Commission or a Member State. • The CEAOB, together with the European Systematic Risk Board (ESRB) will organise a meeting with the Statutory Auditors and any Audit Firms or networks carrying out the statutory audit of systematically important financial institutions in order to inform the ESRB of any significant developments. • The Chair will prepare the provisional agenda of each CEAOB meeting. • CEAOB's discussions are not public. The Chair or the Vice Chair must have the approval of its Members in order to communicate CEAOB's views or positions.

9.2 NATIONAL COMPETENT AUTHORITIES

Member States are required to organise an effective system of public oversight for Statutory Auditors and Audit Firms and must designate a Competent Authority responsible for such oversight. The Competent Authority verifies that the provisions of the Regulation and the Directive are applied ***(Regulation, Article 20).*** The Role of the Competent Authority includes:

- **approval and registration** of Statutory Auditors and Audit Firms;
- **adoption of standards** on professional ethics, internal quality control of Audit Firms and auditing, except where those standards are adopted or approved by other Member State Authorities;
- **quality assurance system and inspections** on the basis of an analysis of risk;
- **investigative and administrative disciplinary systems;**
- **monitor market concentration levels, market quality and competition** in collaboration with the European Competition Network (ECN).

(Directive 2006/43/EC, Article 32.4) *(See Appendix 2 for more information)*

9.3 COLLEGES OF COMPETENT AUTHORITIES

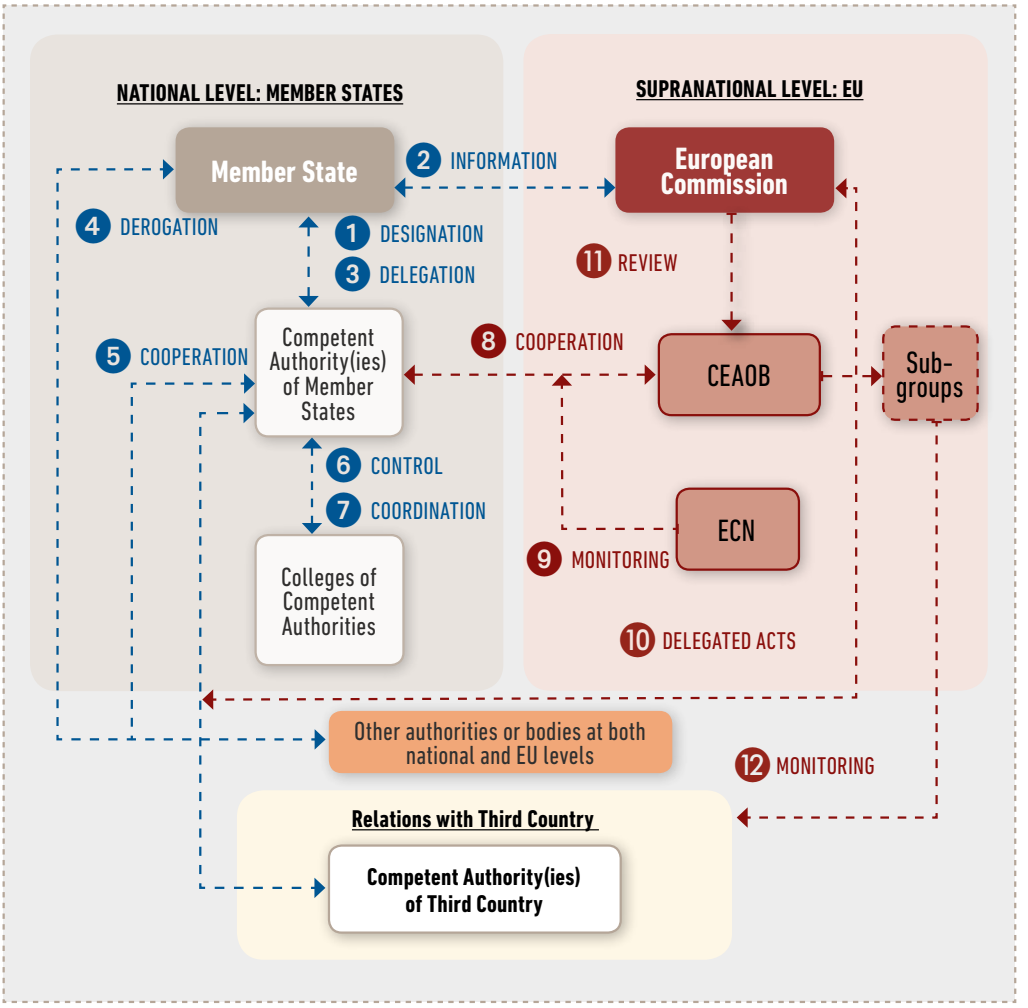
Given that the Regulation requires regular quality assurance inspections of Statutory Auditors and Audit Firms by the Competent Authority, the latter can establish Colleges with the participation of the home Member State and any other Competent Authority in order to facilitate the exercise of such inspections.

(Regulation, Article 32)

(See Appendix 3 for more information.)

9.4 COOPERATION BETWEEN THE VARIOUS OVERSIGHT BODIES

FIGURE 9.4



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1. **DESIGNATION** – Member State designates the Competent Authority.
2. **INFORMATION** – Member State informs the European Commission of the appointment of the Competent Authority. The European Commission consolidates the information coming from Member States and makes it public.
3. **DELEGATION** – Member States can delegate tasks to the Competent Authority and the Competent Authority can delegate tasks to other authorities except :
   - Quality Assurance System;
   - investigations;
   - imposition of penalties (sanctions and measures).
4. **DEROGATION** – Member State can delegate the imposition of penalties to another authority or body designated or otherwise authorised by national law.
5. **COOPERATION** – the Competent Authority and any authority with delegated tasks shall cooperate with :
   - Competent Authority (Article 32.4 of Directive 2006/43/EC);
   - other authorities such as CEAOB, ESMA, EBA, EIOPA (Regulation Article 35.2);
   - financial intelligence units and competent authorities (Article 21 & 37 of Directive 2005/60/EC).
6. **CONTROL** – The College of Competent Authorities ensures that the facilitator of Competent Authorities is appropriate.
7. **COORDINATION** – The facilitator coordinates with the College on rules established within the Competent Authorities.
8. **COOPERATION** – Competent Authorities of all the Member States cooperate with each other within the framework of the Committee of European Auditing Oversight Bodies (CEAOB).
9. **MONITORING** – Competent Authorities of each Member State and the European Competition Network (ECN) shall monitor the development in the market concerning statutory audit services to PIEs.
10. **DELEGATED ACTS** – The Commission adopts delegated acts in order to establish whether the two Competent Authorities (of third-countries and of Member States) are allowed to cooperate.
11. **REVIEW** – The Commission shall review and report on the operations and effectiveness of the system of cooperation between Competent Authorities within the CEAOB.
12. **MONITORING** – The CEAOB could establish sub-groups on a permanent or ad hoc basis to examine specific issues. Moreover the CEAOB should establish a sub-group for the purpose of carrying out the technical assessment of public oversight systems of third countries and relating to the international cooperation between Member States and third countries.

9.5 APPLICABLE INTERNATIONAL STANDARDS ON AUDITING

Statutory Auditors and Audit Firms are required to carry out statutory audits in compliance with international auditing standards, meaning International Standards on Auditing (ISAs), International Standard on Quality Control (ISQC1) and other related standards issued by the International Federation of Accountants (IFAC) through the International Auditing and Assurance Standards Board (IAASB), so long as they are relevant to the statutory audit.

The Commission, is allowed, by means of delegated acts, to adopt the International Standards on Auditing only if they:

- have been developed with proper due process, public oversight and transparency, and are generally accepted internationally;
- contribute a high level of credibility and quality to the annual or consolidated financial statements in conformity with the principles set out in Article 4.3 of Directive 2013/34/EC;
- are conducive to the Union's public good; and
- do not amend any of the requirements of the Directive or supplement any of its requirements apart from those set out in Articles 27 (Statutory audits of consolidated financial statements) and 28 (audit reporting).

MS OPTION **Member States may apply national auditing standards, procedures or requirements so long as the Commission has not adopted an international standard covering the same subject-matter.**

Notwithstanding the above, Member States may impose audit procedures or requirements in addition to the international auditing standards adopted by the Commission only:

- if those audit procedures or requirements are necessary in order to give effect to national legal requirements relating to the scope of statutory audits; or
- to the extent necessary to add to the credibility and quality of financial statements.

MS OPTION **Member States are required to communicate the additional audit procedures or requirements to the Commission at least three months before their entry into force or, in the case of requirements already existing at the time of adoption of an international auditing standard, at the latest within three months before the adoption of the relevant international standard.**

(Directive, Article 26)

9

Key points to take away

Though national oversight bodies still remain responsible for oversight at Member State level, a new European body is to be established, the Committee of European Audit Oversight Bodies (CEAOB), which will take over the existing role of the European Group of Auditor Oversight Bodies (EGAOB). The CEAOB will be chaired by a member of a Competant Authority from one of the Member States and not by the European Commission. The CEAOB will comprise the national authorities responsible for auditor oversight.

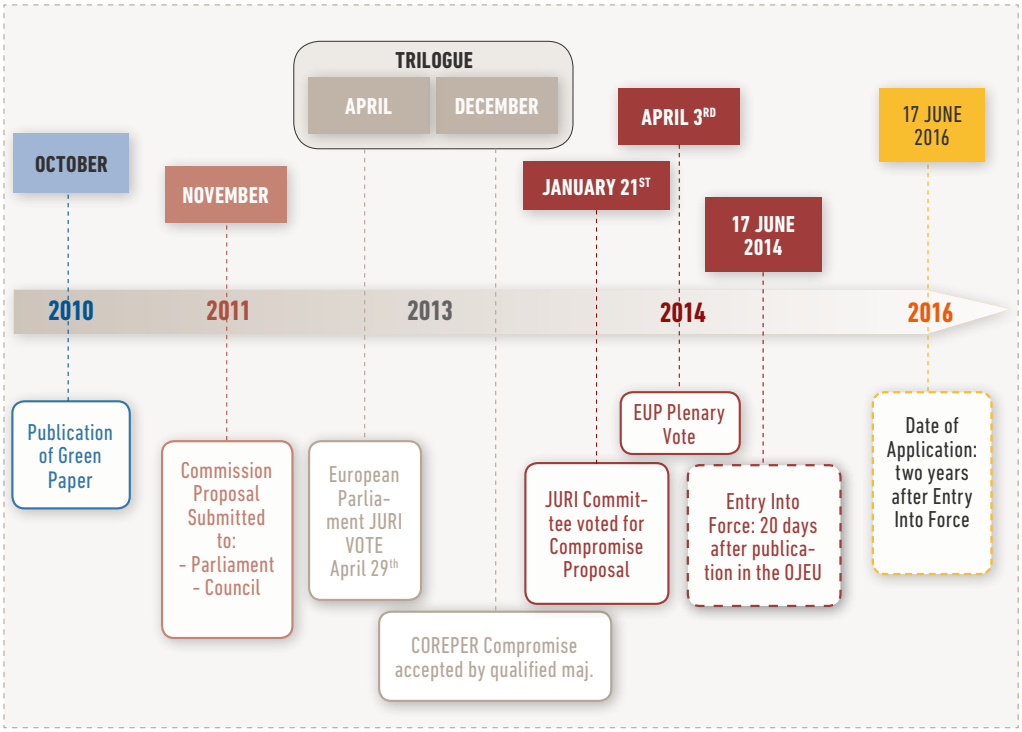
A member of ESMA will chair the subgroups primarily responsible for the technical assessment of public oversight systems of third countries and the international cooperation between Member States and third countries.

Cooperation will expand on a European level and various monitoring systems will be put in place to not only coordinate the work of Competent Authorities at national level within the framework of the CEAOB, but also to ensure a high level of market quality and competition.

The applicable international auditing standards are expected to be the International Standards on Auditing (ISAs), the International Standard on Quality Control (ISQC1) and other related Standards issued by the International Federation of Accountants (IFAC) through the International Auditing and Assurance Standards Board (IAASB), so long as the Commission has approved them for use in the European Union.

10. APPENDICES

APPENDIX 1 - KEY DATES IN THE LEGISLATIVE PROCESS



APPENDIX 2 - GOVERNANCE OF COMPETENT AUTHORITIES

Composition	• Non-practitioners who are knowledgeable in the areas relevant to statutory audit.
	• The National Competent Authority may consult experts or be assisted by experts for the purpose of carrying out specific tasks.
	• Member of the governing body who are responsible for decision-making are not allowed to have been involved during the past three years:
	  • in carrying out statutory audits;
	  • in holding voting rights in an Audit Firm;
	  • as a Member of the administrative, management or supervisory body of an Audit Firm;
	  • as a partner, employee or otherwise involved with an Audit Firm.

Powers	• Access data related to statutory audits. • Carry out on-site inspections of statutory Audit Firms. • Refer matters for criminal prosecution. • Request experts to carry out verification or investigation. • Take administrative measures and sanctions.

Cooperation	• Must cooperate with the CEAOB and the Competent Authorities of the European Parliament and the European Council.
Exchange of information	• Must provide the CEAOB on an annual basis with aggregated information regarding all administrative measures, sanctions and fines imposed.
Funding	• The national Competent Authorities should be adequately funded by the Member States. • Funding must be free from any undue influence by Statutory Auditors or Audit Firms.

(Regulation, Article 23)

APPENDIX 3 – COLLEGE OF COMPETENT AUTHORITIES

Requirements for the etablishment of colleges	• The Statutory Auditor or the Audit Firm must be providing audit services to PIEs within the jurisdiction of the Member States concerned. • A branch which is a part of the Audit Firm is established within the jurisdiction of the Member States concerned.
Facilitator of the college	• The Competent Authority of the home Member State shall act as facilitator. • Members of the college shall review the selection of the facilitator at least every 5 years. The facilitator will chair the meetings of the college, coordinate its actions and ensure efficient exchange of information among members of the college. • Within 15 working days of the establishment of the college, its members shall select a facilitator. In the absence of agreement, CEAOB must appoint a facilitator among the members of the college. • The facilitator shall, within 10 working days of his or her selection, establish written coordination arrangements within the framework of the college regarding the following matters: a. information to be exchanged between Competent Authorities; b. cases in which the Competent Authorities must consult each other; c. cases in which the Competent Authorities may delegate supervisory tasks. • In the absence of agreement, any member of the college may refer the matter to CEAOB. The facilitator shall give due consideration to any advice provided by CEAOB concerning the written coordination arrangements before agreeing their final text. • The written coordination arrangements shall be a single document containing full reasons for any significant deviation from the advice of CEAOB.

(Regulation, Article 32)

APPENDIX 4 – USEFUL LINKS

1. Useful References

The 2014 Directive and Regulation:
http://www.mazars.com/Home/Insights/Mazars-welcomes-European-audit-reform/The-EU-Audit-Reform-An-Encouraging-Step

2. Public and Professional Organisations :

European Commission
http://ec.europa.eu/internal_market/auditing/reform/index_en.htm

Federation of European Accountants (FEE)
http://www.fee.be/

Links to quick Facts about the Reform:
http://www.fee.be/index.php?option=com_content&view=article&id=1410&Itemid=396

3. Mazars Expertise

Mazars portal on the European Audit Reform:
http://www.mazars.com/Home/Insights/Mazars-welcomes-European-audit-reform

For useful tools prepared by Mazars (such as videos by in house and external experts on the reform, or more information on Joint Audit), please refer to the following page:

http://www.mazars.com/Home/Insights/Mazars-welcomes-European-audit-reform/The-EU-Audit-Reform-An-Encouraging-Step

APPENDIX 5 – THE DIRECTIVE AND REGULATION

Outline of the Directive 2014/56/EU - of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts

ARTICLE 1: AMENDMENTS TO THE DIRECTIVE 2006/43/EC

CHAPTER I: SUBJECT MATTER AND DEFINITIONS

- Article 1: Subject matter
- Article 2: Definitions

CHAPTER II: APPROVAL, CONTINUING EDUCATION AND MUTUAL RECOGNITION

- Article 3: Approval of Statutory auditors and audit firms
- Article 3a: Recognition of audit firms
- Article 4: Good repute
- Article 5: Withdrawal of approval
- Article 6: Educational qualifications
- Article 7: Examination of professional competence
- Article 8: Test of theoretical knowledge
- Article 9: Exemptions
- Article 10: Practical training
- Article 11: Qualification through long-term practical experience
- Article 12: Combination of practical training and theoretical instruction
- Article 13: Continuing education
- Article 14: Approval of statutory auditors from another Member State

CHAPTER III: REGISTRATION

- Article 15: Public register
- Article 16: Registration of statutory auditors
- Article 17: Registration of audit firms
- Article 18: Updating of registration information
- Article 19: Responsibility for registration information
- Article 20: Language

CHAPTER IV: PROFESSIONAL ETHICS, INDEPENDENCE, OBJECTIVITY, CONFIDENTIALITY AND PROFESSIONAL SECRECY

- Article 21: Professional ethics and scepticism
- Article 22: Independence and objectivity

- Article 22a: Employment by audited entities of former statutory auditors or of employees of statutory auditors or audit firms
- Article 22b: Preparation for the statutory audit and assessment of threats to independence
- Article 23: Confidentiality and professional secrecy
- Article 24: Independence and objectivity of the statutory auditors carrying out the statutory audit on behalf of audit firms
- Article 24a: Internal organisation of statutory auditors and audit firms
- Article 24b: Organisation of the work
- Article 25: Audit fees
- Article 25a: Scope of the statutory audit

CHAPTER V: AUDITING STANDARDS AND AUDIT REPORTING

- Article 26: Auditing standards
- Article 27: Statutory audits of consolidated financial statements
- Article 28: Audit reporting

CHAPTER VI: QUALITY ASSURANCE

- Article 29: Quality assurance systems

CHAPTER VII: INVESTIGATIONS AND SANCTIONS

- Article 30: Systems of investigations and sanctions
- Article 30a: Sanctioning powers
- Article 30b: Effective application of sanctions
- Article 30c: Publication of sanctions and measures
- Article 30d: Appeal
- Article 30e: Reporting of breaches
- Article 30f: Exchange of information
- Article 31: Auditors' liability

CHAPTER VIII: PUBLIC OVERSIGHT AND REGULATORY ARRANGEMENTS BETWEEN MEMBER STATES

- Article 32: Principles of public oversight
- Article 33: Cooperation between public oversight at Community level
- Article 34: Mutual recognition of regulatory arrangements between Member States
- Article 36: Professional secrecy and regulatory cooperation between Member States

CHAPTER IX: APPOINTMENT AND DISMISSAL

- Article 37: Appointment of statutory auditors or audit firms
- Article 38: Dismissal and resignation of statutory auditors or audit firms

CHAPTER X: AUDIT COMMITTEE

- Article 39: Audit committee

CHAPTER XI: INTERNATIONAL ASPECTS

- Article 44: Approval of auditors from third countries
- Article 45: Registration and oversight of third-country auditors and audit entities
- Article 46: Derogation in the case of equivalence
- Article 47: Cooperation with competent authorities from third countries

CHAPTER XII: TRANSITIONAL AND FINAL PROVISIONS

- Article 48: Committee procedure
- Article 48a: Exercise of the delegation

ARTICLE 2: TRANSPOSITION

ARTICLE 3: ENTRY INTO FORCE

ARTICLE 4: ADDRESSEES

Outline of the 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/EC

TITLE I: SUBJECT MATTER, SCOPE AND DEFINITIONS

- Article 1: Subject matter
- Article 2: Scope
- Article 3: Definitions

TITLE II: CONDITIONS FOR CARRYING-OUT STATUTORY AUDIT OF PUBLIC INTEREST ENTITIES

- Article 4: Audit fees
- Article 5: Prohibition of the provision of non-audit services
- Article 6: Preparation for the statutory audit and assessment of threats to independence

- Article 7: Irregularities
- Article 8: Engagement quality control review
- Article 9: International auditing standards
- Article 10: Audit report
- Article 11: Additional report to the audit committee
- Article 12: Report to supervisors of public-interest entities
- Article 13: Transparency report
- Article 14: Information for competent authorities
- Article 15: Record keeping

TITLE III: THE APPOINTMENT OF THE STATUTORY AUDITOR OR AUDIT FIRM BY PUBLIC INTEREST ENTITIES

- Article 16: Appointment of statutory auditors or audit firms
- Article 17: Duration of the audit engagement
- Article 18: Hand-over file
- Article 19: Dismissal and resignation of the statutory auditors or the audit firms

TITLE IV: SURVEILLENCE OF THE ACTIVITES OF STATUTORY AUDITORS AND AUDIT FIRMS CARRYING OUT STATUTORY AUDIT OF PUBLIC INTEREST ENTITIES

CHAPTER I: COMPETENT AUTHORITIES

- Article 20: Designation of competent authorities
- Article 21: Conditions of independence
- Article 22: Professional secrecy in relation to competent authorities
- Article 23: Powers of competent authorities
- Article 24: Delegation of tasks
- Article 25: Cooperation with other competent authorities at national level

CHAPTER II: QUALITY ASSURANCE, MARKET MONITORING, AND TRANSPARENCY OF COMPETENT AUTHORITIES

- Article 26: Quality assurance
- Article 27: Monitoring market quality and competition
- Article 28: Transparency of competent authorities

CHAPTER III: COOPERATION BETWEEN COMPETENT AUTHORITIES AND RELATIONS WITH THE EUROPEAN SUPERVISORY AUTHORITIES

- Article 29: Obligation to cooperate
- Article 30: Establishment of the CEAOB
- Article 31: Cooperation with regard to quality assurance reviews, investigations and on-site inspections
- Article 32: Colleges of competent authorities
- Article 33: Delegation of tasks
- Article 34: Confidentiality and professional secrecy in relation to cooperation among competent authorities
- Article35: Protection of personal data.

CHAPTER IV: COOPERATION WITH THIRD-COUNTRY AUTHORITIES AND WITH INTERNATIONAL ORGANISATIONS AND BODIES

- Article 36: Agreement on exchange of information
- Article 37: Disclosure of information received from third countries
- Article 38: Disclosure of information transferred to third countries
- Article 39: Exercise of the delegation
- Article 40: Review and reports
- Article 41: Transitional provisions
- Article 42: National provisions
- Article 43: Repeal of Commission Decision 2005/909/EC
- Article 44 : Entry into force

APPENDIX 6 - FACTSHEET ON THE MAIN PROVISIONS RELEVANT FOR SMES

FEE Factsheet on main provisions relevant for Small and Medium-sized Undertakings (SMEs)

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:

Main Provisions relevant for Small and Medium-sized Undertakings

Background

In April 2014, new legislation on audit policy reform was approved which consists of a Directive and a Regulation, namely:

- **A revision of the Statutory Audit Directive (SAD) (2006/43/EC)**[1] containing a series of amended and new requirements **applicable to all statutory audits within the European Union (EU)** (hereafter " **the 2014 Directive**"). This Directive will need to be transposed by Member States into their national law within **two years after its entry into force;** and
- **A Regulation**[2] **applicable only to statutory audit of Public Interest Entities (PIEs)** (hereafter " **the 2014 Regulation**"). This technically comes into effect 20 days after publication in the Official Journal. Nevertheless, mainly due to the fact that this **Regulation** refers to the **Directive**, there is also a **two-year delay** in the application of most provisions included in the Regulation.

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

Small- and Medium-sized Practices[3] **(SMPs) and Small- and Medium-sized Enterprises (SMEs) are key priorities for FEE and its Members. This Factsheet is focused on the provisions included in the Directive and Regulation that are most relevant for SMEs and SMPs. For general and other provisions, reference is made to the FEE Factsheet on the 2014 Directive and Regulation published on the FEE website**[4]**.**

The definition, size criteria and thresholds for small undertakings and medium-sized undertakings as well as their applicable auditing requirements are included in the 2013 Accounting Directive[5], for which reference is made to the FEE Factsheet on the June 2013 Accounting Directive.

Provisions of the 2014 Directive and Regulation relevant for SMEs and SMPs

Proportionate application

The **2014 Directive** promotes **proportionate application of its requirements to the scale and complexity of the operations of statutory auditor or audit firm and the audited entity.**

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1 http://www.europarl.europa.eu/sides/getDoc.do?type=AMD&reference=A7-2013-0171&format=PDF&language=EN&secondRef=066-066
2 http://www.europarl.europa.eu/sides/getDoc.do?type=AMD&reference=A7-2013-0177&format=PDF&language=EN&secondRef=259-259
3 Practices whose clients are mostly SMEs, which employ a limited number of professional staff
4 http://www.fee.be/images/publications/auditing/Factsheet_Audit_Policy_1404.pdf
5 Refer to pages 2 and 6 of this Factsheet accessible at: http://www.fee.be/images/Factsheet_New_Accounting_Directive_1401.pdf

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Association Internationale reconnue par Arrêté Royal en date du 30 décembre 1986

Simplified requirements optional to Member States

Member States have the option to simplify some requirements of the 2014 Directive for the audits of small undertakings. This 'simplification' can be applied in the following areas:

- **Independence** [2014 Directive, Article 22b (1)] – Every statutory auditor or audit firm needs to consider and document threats to independence before accepting or continuing audit engagement.
- **Internal organisation of statutory auditor or audit firm** [2014 Directive, Article 24a (1)] – Every statutory auditor or audit firm needs to meet a series of new requirements with regard to the internal organisation, including establishment of internal quality control system and a number of policies and procedures.
- **Records keeping** [2014 Directive. Article 24b (7)] – Every statutory auditor or audit firm needs to meet a series of new requirements with regard to the audit work, including requirements on independence, competence, resources, audit quality etc., but it also requires the statutory auditor or audit firm to keep records of all beaches of the provision of the 2014 Directive and 2014 Regulation and also of all complaints made about the performance of the auditor.

Specific provisions for small undertakings and SMEs

Application of ISAs

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 yet required). When a statutory audit for small undertakings is required, **Member states may take measures to ensure proportionate application to the audits of small undertakings** [2014 Directive, (Article 26 (5)].

Audit committee

The requirements related to the functioning of the audit committee are stated in the **2014 Directive**, but are applicable to PIEs only. However, with respect to PIEs that are SMEs, the function of the audit committee may be performed by an administrative or supervisory body [2014 Directive, Article 39 (2)]. A majority of the members of the audit committee have to be independent of the audited entity; where all members of the audit committee are members of the administrative or supervisory body, Member States may provide an exemption from this requirement [2014 Directive, Article 39 (5)].

Quality assurance

According to the **2014 Directive and Regulation**, every statutory auditor or audit firm shall undergo a quality assurance review (QAR) at least every six years for all entities and every three years for the statutory auditors or audit firms performing an audit of PIEs. It could be more often based on the risk analysis performed. The **2014 Regulation** excludes the auditors of PIEs from the stricter requirement in cases where the PIE audited is an SME, and thus the maximum period between QAR remains six years [2014 Regulation, Article 26 (2)].

Appointment of the auditor

According to the **2014 Regulation,** undertakings with reduced market capitalisation or small and medium-sized PIEs are relieved from the requirement to organise a selection procedure as per the criteria laid down in Article 16 (3) [2014 Regulation, Article 16 (4)].

* * *

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.

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APPENDIX 7 - ABBREVIATIONS

AIF: Alternative Investment Fund

Big 4: Deloitte, EY, KPMG and PWC

CEAOB: Committee of European Auditing Oversight Bodies

EBA: European Banking Authority

ECN: European Competition Network

EEA: European Economic Area

EGAOB: European Group of Auditor Oversight Bodies

EIF: Entry into Force

EIOPA: European Insurance and Occupational Pensions Authority

ESMA: European Securities and Markets Authority

ESRB: European Systematic Risk Board

EU: European Union

FEE: Federation of European Accountants

IAASB: International Auditing and Assurance Standards Board

IFAC: International Federation of Accountants

IFRS: International Financial Reporting Standards

ISAs: International Standards on Auditing

ISQC1: International Standard on Quality Control

MS: Member States

OJEU: Official Journal of the European Union

PIE: Public Interest Entity

QAR: Quality Assurance Review

SAD: Statutory Audit Directive

SMEs: Small and Medium Enterprises

SMPs: Small and Medium Practices

UCITS: Undertaking for Collective Investment in Transferable Securities

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