

New EU audit legislation

Background to the new EU audit legislation

The new EU audit legislation (Regulation (EU) No 537/2014) sets out several measures to emphasize the importance of independence of auditors, including mandatory firm rotation and a list of prohibited non-audit services. The legislation also introduces new requirements on audit committees. On May 19, 2016, the Danish Parliament approved the bill on how the EU legislation should be implemented in Denmark applicable as from June 17, 2016.

Summary

In summary, the key areas are:

- The auditor's report will be more informative and tailored to the audited company
- Mandatory firm rotation for Public Interest Entities (PIE)
- The EU legislation introduces additional requirements specific to the role and responsibilities of audit committees
- The independence of auditors is strengthened by regulation of non-audit services performed by the statutory auditor and its network.

In the sections below, we describe key changes for each area in the new legislation.

In addition, the EU audit legislation also includes regulations regarding the Danish Disciplinary Board on Auditors' possibilities of intervening if the PIE's auditor, the PIEs or its member of the management body or audit committees overrides its audit obligations.

Auditor's report

For 2017, new auditor reporting requirements are implemented with the intention to provide greater transparency in the auditor's report about the audit (effective already 2016 for publicly listed companies according to ISA 701). The key change to the report is expanded information on key audit matters such as areas identified as significant risks, significant transactions or events or significant auditor judgment (including audit of accounting estimates).

Mandatory firm rotation

The EU audit legislation sets out a maximum audit firm engagement period of ten years. A tendering process can extend the engagement period by an additional ten years. Denmark has adopted these maximum audit firm engagement periods for all PIEs (e.g. listed companies, banks, mortgage credits and insurance companies) for which no option to extend the initial ten-year period exists. It is also possible to extend the engagement period by an additional 14 years, if two audit firms are elected for the remaining 14 years.

Certain transitional rules apply. Transitional periods for audit firms appointed before 17 June 2006:

- Appointed before 16 June 1994: No renewal after 17 June 2020
 - Appointed between 17 June 1994 to 16 June 2003: No renewal after 16 June 2023
 - Appointed between 17 June 2003 to 16 June 2006: Tender at first Annual General Meeting after 17 June 2016. No renewal 20 years after appointment.
 - Appointed between 17 June 2006 to 16 June 2014: Tender at first Annual General Meeting 10 years after appointment. No renewal 20 years after appointment.
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Auditor's report

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Role and responsibility of audit committees of PIEs

The EU audit legislation introduces additional requirements specific to the role and responsibilities of audit committees, as well as certain defined auditor oversight responsibilities. For some areas, the requirements are already commonly applied in Denmark but are now included in law. According to EU legislation, the audit committee is required to:

- Inform the entire board of directors of the outcome of the audit and explain the audit's contribution to the quality and integrity of the financial statements and the audit committee's role in this process
- Monitor the financial reporting process and submit recommendations to ensure its integrity
- Monitor the effectiveness of internal quality control and risk management systems
- Monitor the statutory auditor, taking into account inspection findings
- Review and monitor the independence of the statutory auditors
- Be responsible for the procedure for the selection of the statutory auditor.

The independence of auditors is strengthened by regulation of non-audit services performed by the statutory auditor and its network.

Two main areas are applicable to public interest entities (PIEs):

- The total fees for non-audit services, provided that such services are performed for three consecutive years, may not for the fourth financial year exceed 70 percent of the average of the fees paid for the statutory audit for a period of time (three consecutive years)
- Obligation to provide information to the audit committee if the fees that the auditor receives from the PIE amounts to more than 15 percent of the audit firm's or the signing auditor's total fees.

The EU audit legislation contains a list of services that cannot be provided ('prohibited services') by a statutory auditor and its network to an entity that is a PIE.

Non-audit services

With one important exception, Member States may not set a lower threshold in relation to non-audit services prohibition – the prohibited list is a minimum baseline. The exception allows a Member State an option relating to certain tax and valuation services. Denmark has opted to apply some of these exceptions, i.e. allowing certain valuation and tax services (preparation of tax forms, identification of public subsidies and tax incentives, support for tax inspections and tax advice), provided that these services have no direct effect, or have an immaterial effect either separately or in the aggregate, on the audited financial statements.

Services that are not on the list of prohibited services are permitted, subject to the general principles of independence. All permitted non-audit services provided by the audit firm will require audit committee approval. The Audit Committee may pre-approve selected non-audit services provided that independence is not impaired (typically below a capped amount). In addition, an overall cap on the fees from such permitted services will also apply to the statutory audit firm (fees for non-audit services may not exceed 70 percent of the audit fees).

The first fiscal year included in the calculation of the fee limit is the first year beginning after the EU audit regulation apply, i.e. fiscal years beginning on or after June 17, 2016. For a company with calendar year financial statements, the fee limit will take effect as from January 1, 2020 (based on the last three consecutive years after June 17, 2016, i.e. 2017, 2018 and 2019).

Denmark has opted to apply an exception allowing certain valuation and tax services, provided that these services have no direct effect, or have an immaterial effect either individually or in the aggregate, on the audited financial statements:

- Provision of tax services relating to:
 - Preparation of tax forms
 - Identification of public subsidies and tax incentives
 - Support regarding tax inspections by tax authorities
 - Provision of tax advice.
 - Valuation services, including valuations performed in connection with actuarial services or litigation support services.

List of services that cannot be provided ('prohibited services') by a statutory auditor and its network to an entity that is a PIE:

List of prohibited non-audit services

- Provision of tax services relating to:
 - Payroll tax
 - Customs duties
 - Computation of direct and indirect tax and deferred tax.
 - Services that involve playing any part in the management or decision-making of the audited entity
 - Bookkeeping and preparing accounting records and financial statements
 - Payroll services
 - Designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information or financial information technology systems (cooling-in period of one year when requested for audit proposal)
- Legal services with respect to:
 - Providing general counsel
 - Negotiating on behalf of the audit client
 - Acting in an advocacy role in the resolution of litigation.
 - Services related to the audit client's internal audit function
 - 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, such as the issuance of comfort letters in connection with prospectuses issued by the audit client
 - Promoting, dealing in, or underwriting shares in the audited entity
- Human resources services with respect to:
 - Management in a position to exert significant influence over the preparation of the accounting records or financial statements which are the subject of the statutory audit, where such services involve:
 - Searching for or seeking out candidates for such positions or
 - Undertaking reference checks of candidates for such positions
 - Structuring the organisation design and
 - Cost control.
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