

Mandatory firm rotation: Tendering, joint audit, and transition



On June 16, 2014, after publication in the Official Journal, European Union (EU) audit legislation entered into force. For all provisions including those pertaining to nonaudit services (NAS), the effective date is June 17, 2016 (first financial year starting on or after June 17, 2016), except for mandatory firm rotation (MFR) requirement where specific transitional measures are provided. Certain member states have provided other start dates for the specific provisions of this legislation. The legislation is in the form of a [Directive](#) and a [Regulation](#). A number of options have been afforded to member states to be decided on at the local level. Member states are currently determining the implementation of various provisions as they have two years to transpose the EU audit legislation into their national law.

Many provisions in the legislation are intended to strengthen corporate governance and to enhance transparency of audits to investors and audit committees. The provisions that have received the most attention, such as MFR and prohibited NAS, are contained in the [Regulation](#) and only apply to public interest entities (PIEs) and their statutory auditors.

This legislation is complex, and the summary descriptions of legislative and implementation considerations outlined below do not constitute legal advice. Several areas of the legislation require interpretation and may evolve over time, and market participants may wish to seek legal advice before taking measures to comply with the legislation.

MFR general requirements

- The initial engagement period for a statutory auditor or audit firm should not be less than one year, but not exceed 10 years.¹ Tenure is counted from the start of the first accounting period audited, and only during the period when the entity was considered to be a PIE. In the case of a listing—where a company has had its auditor for a number of years before the listing date, the duration of the audit engagement should only be calculated from the beginning of the financial year in which the listing became effective. Member states may (1) adopt a rotation term of less than 10 years or (2) extend rotation period to:
 - Maximum 20 years in case of tendering, or
 - Maximum 24 years in case of joint audit.
- Competent member states' authority (e.g., audit oversight authority and/or securities regulator) may extend the auditor appointment for a further two-year term on an exceptional basis.
- Four-year cooling-off period is required.
- The requirement for 'key audit partners' to rotate after a maximum of seven years, followed by a three-year cooling-off period is retained under the new legislation; however, member states have an option to elect shorter partner rotation periods.

Tendering

A PIE is required to have a tender process with the close involvement of the audit committee when considering either the selection of a new auditor or the reappointment of an existing auditor at the end of the initial maximum duration period of 10 years if extension is allowed by a member state.² Audit committees are responsible for submitting a recommendation to the supervisory body of the audited entity for the appointment of the auditors. The recommendations should include at least two possible choices for the auditors and a justified preference for one of them.

Joint audit

A member state may adopt the option to allow extension to 24 years in the case of a joint audit. A PIE does not need to have a joint audit throughout the first 10-year period in order to qualify for an extension of that engagement for up to 24 years; however, the PIE would be required to have joint auditors for the entire extended period (i.e., up to 14 years).

¹ Described in the Article 17 of the Regulation http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.158.01.0077.01.ENG

² Described in the Article 16 of the Regulation http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.158.01.0077.01.ENG

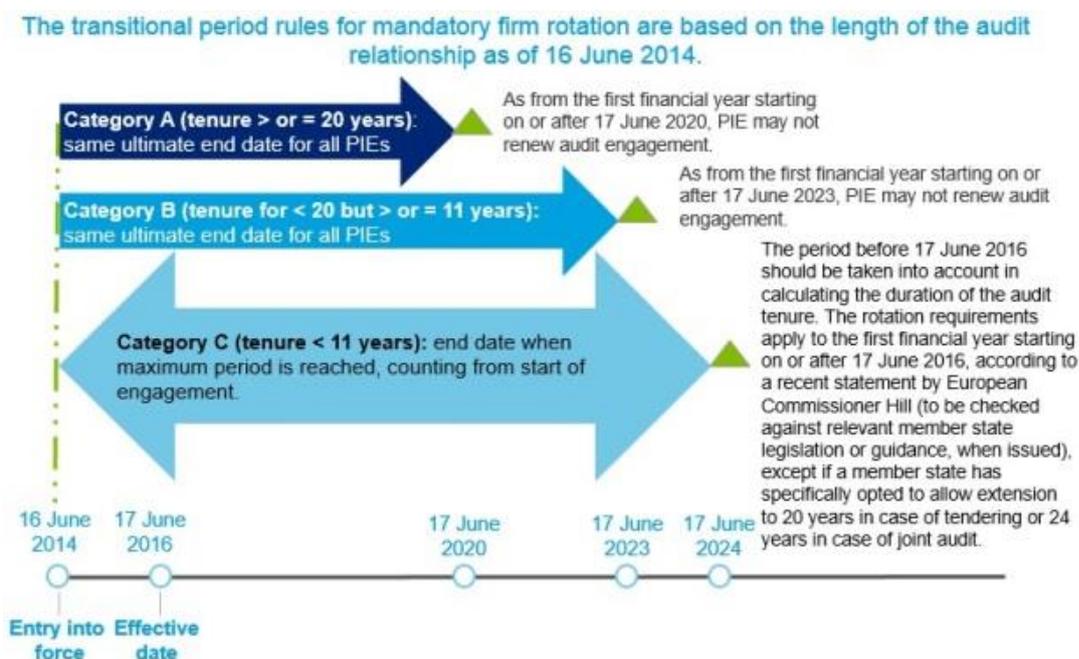
Timeline for transitional measures³

The transitional provisions depend on the length of the audit relationship at the date of entry into force of the Regulation on June 16, 2014. The fact that a tender may have been carried out recently, and the existing auditor having been reappointed, does not have an impact on the transitional measures described below:

Category A: PIE which has the same auditor for > or = 20 years on June 16, 2014 (i.e., audit relationships started in the financial year ended May 31, 1995, or earlier), may not enter into or renew the audit engagement with the incumbent auditor as of June 17, 2020.

Category B: PIE who has the same auditor for < 20 but > or = 11 years on June 16, 2014 (i.e., first year that was audited began after June 16, 1994 (i.e., July 1, 1994, to June 30, 1995), but not later than June 16, 2003 (i.e., June 1, 2003, to May 31, 2004)) may not enter or renew the audit engagement with the incumbent auditor as of June 17, 2023.

Category C: PIE who has the same auditor for < 11 years, on June 16, 2014, then the period before June 17, 2016, should be taken into account in calculating the duration of the audit tenure, according to the European Commission. The rotation requirements for this tranche of engagements would begin to apply to the first financial year starting on or after June 17, 2016, according to a recent statement by European Commissioner Hill (to be checked against relevant member state legislation or guidance, when issued), except if a member state has specifically opted to allow extension to 20 years in case of tendering or 24 years in case of joint audit.



³ Described in the Article 41 of the Regulation http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.158.01.0077.01.ENG Completed by EC reply to MEP question

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