

Audit committees' role

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.



Overview

The legislation includes several provisions¹ designed to strengthen audit committees of EU companies and to provide more transparency into the activities of the audit committee and the statutory audit. Most of the requirements for audit committees set out in the legislation are already being performed today and represent 'best practice.' These requirements are now being enshrined into the law.

Each PIE, subject to certain exceptions below, must have an audit committee composed of nonexecutive members:

- At least one member of the audit committee must have competence in accounting and/or auditing.
- The committee members as a whole should have competence relevant to the company's business sector.
- Exceptions to having a separate audit committee include (member state option):
 - PIE which is a subsidiary undertaking provided that there is an audit committee at the group level that complies with the requirements of this legislation.
 - PIEs which are Undertakings for Collective Investments in Transferable Securities or alternative investment fund.
 - PIE whose sole business is to act as an issuer of asset-backed securities.
 - Any credit institution that only has debt, not shares, listed on a regulated market where debt does not exceed €100 million in total, and the credit institution has not issued a prospectus marketing debt.

Audit committee responsibilities

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.² All permitted NAS provided by the audit firm or a member of the network to the PIE, its parent undertaking, or its controlled undertakings require audit committee approval. Audit committees are required to issue guidelines regarding the provision of tax and valuation services if a member state exercises its option to permit such.

Audit committees must monitor auditor independence and review a nonpublic report prepared by the auditors specifically for the audit committee that includes³:

- More detailed information on the results of the audit.
- Disclosure of quantitative level of materiality applied to perform the statutory audit, materiality level(s) for particular classes of transactions and account balances or disclosures, and qualitative factors used to determine materiality.
- Reporting and explaining judgments about events or conditions identified during 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 providing a summary of all measures that have been taken into account when making a going-concern assessment.

¹ See in particular Article 39 of the Directive http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.158.01.0196.01.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

³ Described in the Article 11 of the Regulation

http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.158.01.0077.01.ENG

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