

Nonaudit services: Restrictions and fee cap



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 a detailed list of NAS that audit firms and members of their networks may not provide to a PIE statutory audit client, its EU parent, or its EU controlled undertakings (subsidiaries)¹:

- NAS permitted to be provided to the audited PIE is subject to audit committee approval (and application of general principles of independence).
- Member states may prohibit additional NAS and establish stricter rules for NAS which are nonprohibited.
- Member states may adopt legislation allowing valuation services and certain tax services (i.e., preparation tax forms; identification subsidies and tax incentives; calculation of direct and indirect tax and deferred tax and tax advice) providing that these services have no direct effect, or have an immaterial effect on the audited financial statements.

NAS fee cap²

Fees for permissible NAS should not exceed 70% of the average audit fees paid in the last three consecutive financial years:

- The cap restricts permitted NAS in the fourth year (i.e., if in years one, two, and three, total statutory audit fees are €100, €120, and €170, respectively, then permitted NAS in fourth year are capped at 70% of the average of €130 (i.e., €91)).

- Services required by EU or national legislation are excluded.
- Competent authorities may exempt audit firm from the cap “on an exceptional basis” for a maximum of two financial years.
- Member states may further restrict NAS by adjusting the 70% cap.
- NAS restrictions apply for the first financial year after the date of application of the legislation (i.e., entities with a fiscal year ending December 31 would need to comply starting January 1, 2017).
- However, cooling-in period is required during the fiscal year prior to the period covered by the audited financial statements for some NAS (designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information or designing and implementing financial information technology systems).

In order to be able to carry out a statutory audit for a fiscal year starting on or after June 17, 2016 (when the Regulation starts applying), according to the European Commission, the cooling-in prohibition starts as from the fiscal year beginning on or after June 17, 2015. For example, for a PIE with June 30 year-end, the cooling-in period would have started to apply as of July 1, 2015. For a calendar year company, the cooling-in period would apply as of January 1, 2016.

¹ Described in the Article 5 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 4 of the Regulation http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.158.01.0077.01.ENG

Restrictions:

These include the following prohibitions:

- Provision of tax services relating to:
 - Preparation of tax forms
 - Payroll tax
 - Customs duties
 - Identification of public subsidies and tax incentives, unless support from the statutory auditor or audit firm in respect of such services is required by law
 - Support regarding tax inspections by tax authorities, unless support from the statutory auditor or audit firm in respect of such inspections is required by law
 - Calculation of direct and indirect tax and deferred tax
 - Provision of tax advice
- 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
- Valuation services, including valuations performed in connection with actuarial services or litigation support services
- Legal services, with respect to:
 - Provision of 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 issuing 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 organization design and
 - Cost control

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