



## Governance *in brief* EU position on auditor rotation goes further than UK rules

### Headlines

- The EU proposals go further than the FRC's Code changes and Competition Commission proposed Orders which apply to FTSE 350 companies only.
- All EU public interest entities are required to rotate their auditors after ten years.
- However, Member States do have the option to extend this period to 20 years if there is a tender at the ten year point.
- The legislation will also introduce new restrictions around the provision of non-audit services.
- The EU requirements will apply to all public interest entities and will therefore apply to all listed companies on regulated stock exchanges as well as banks and insurance companies authorised by EU member state authorities. In the UK this means AIM is excluded.

### A reminder of the FRC and Competition Commission requirements

The 2012 edition of the UK Corporate Governance Code, applicable for all periods commencing on or after 1 October 2012, includes a provision stating that FTSE 350 companies should put the external audit contract out to tender at least every ten years (C.3.7). As with all provisions of the Code, this is on a "comply or explain" basis.

On 15 October 2013 the Competition Commission published its final report closing the chapter on its inquiry into the statutory audit market for FTSE 350 companies. The Commission intends to issue an Order to the effect that FTSE 350 companies must put their statutory audit engagement out to tender not less frequently than every ten years.

On 17 January, the Competition Commission announced that it was revising its administrative timetable to enable the Commission to consider the implications of the EU proposals. The Commission is keen to ensure that their Orders do not contradict or duplicate EU regulation. It is anticipated that there will be a further round of consultation on the revised Orders, including the related transitional arrangements, in Q3 2014 and a commencement date in Q4 2014.

Further details on these requirements and the transitional arrangements for each are set out in our '**Governance in brief – Summary of final FTSE 350 audit tendering requirements**' available from [www.deloitte.co.uk/gibftse350](http://www.deloitte.co.uk/gibftse350).

### Preliminary agreement now reached on new European Union audit legislation

A preliminary agreement on new European Union audit legislation was reached by the European Parliament, the Council of the European Union and the European Commission in December 2013. A summary of key points in the preliminary agreement, which remains subject to a vote in the plenary European Parliament, is provided below based on our current understanding. As the legal and language review is ongoing and a vote in the European Parliament and approval by the Council remain, the text may undergo changes and interpretation of the text may evolve.

In addition to new rules on audit firm rotation, the legislation will also introduce certain restrictions around the provision of non-audit services, a 70% non-audit services fee cap, together with proposals to enhance communications between audit committees and auditors. Further details on those points will be issued once the legislation has been finalised but, given that many companies are considering audit tendering policies in light of the new UK Corporate Governance Code requirement for this year end, we felt it was important to provide you with the clearest indication we can of where the EU will land on audit firm rotation.

**Mandatory audit firm rotation**

The draft regulation introduces a requirement that all EU public interest entities rotate their auditors every ten years (Member States can choose to require rotation after a shorter period). If Member States choose to allow it, this period can be extended to a maximum of 20 years if the appointment is tendered after 10 years (where there is a joint audit the maximum period is 24 years). An entity may, on an exceptional basis, request that an extension is granted to re-appoint the existing statutory auditor where certain conditions are met. Such an additional engagement shall not exceed two years.

The starting point for the maximum duration period is the date of the first financial year covered by the appointment (this is deemed to include other firms that the audit firm has acquired or that have merged with it). In the case of uncertainty, the auditor is required to notify the designated competent authority who will ultimately determine the relevant date of commencement of the relationship.

A four year cooling-off period applies to the audit firm and any members of the audit firm’s network prior to re-appointment as the statutory auditor.

It is important to note that this EU legislation will apply to *all* EU public interest entities, so all main market listed entities in the UK, not just the FTSE 350 addressed under the Competition Commission and FRC rules. In addition, the definition of public interest entities currently also includes banks and insurance companies authorised by EU member state authorities and certain subsidiaries of non EU parent companies.

The good news is that the transitional arrangements set out below do allow a reasonable period for companies to prepare to meet the new requirements.

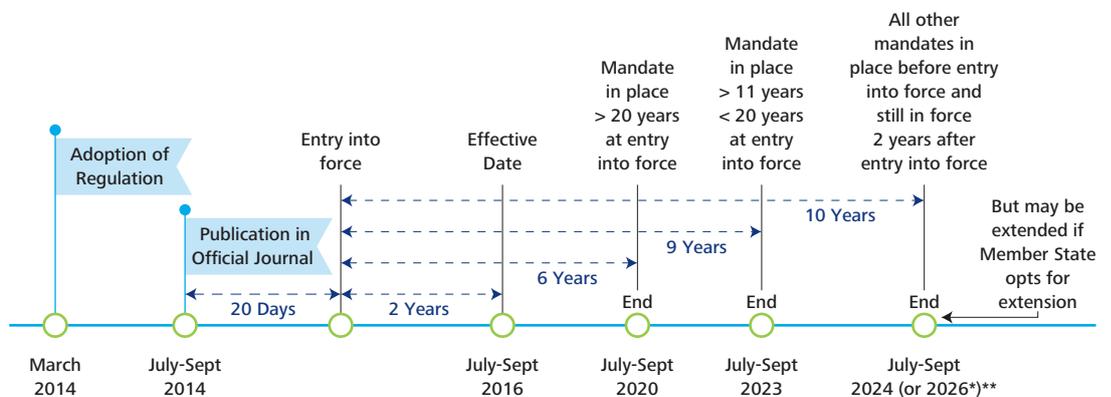
**Transitional arrangements**

The transitional arrangements for the new requirements are based around the duration of the audit appointment at the date of entry into force of the regulation (currently expected to be July-Oct 2014). If at that time the auditor has been in place for 20 years or more, the auditor may continue for up to six years from the date of entry into force of the regulation. If at that time the auditor has been in place for between 11 and 20 years, the auditor may continue for up to nine years. For all other situations, the engagement may continue until the end of the first maximum duration, i.e. ten years. If the Member State has implemented the maximum period allowed, the engagement may be extended up to a maximum of 20 years if a tender is undertaken or for 24 years if there is a joint audit. The restrictions on non-audit services and the communication requirements between auditor and the audit committee will become effective two years from the date of entry into force of the regulation (currently expected to be July-Oct 2014).

**What happens next?**

To become law, the text needs to go through a legal and language review by the Council and Commission legal services before being formally adopted by the plenary European Parliament (currently scheduled for 11 March 2014) and then the Council of the European Union, as co-legislators.

The Regulation will enter into force 20 days after its publication in the Official Journal of the European Union and will apply two years after its entry into force.



\*If 10-year period starts at effective date rather than entry into force – clarification being sought  
 \*\*Or less if Member State opts to reduce 10 year maximum

## Points for boards to consider for their disclosures this year end

Audit committees of FTSE 350 companies with December and March year ends will be in the process of drafting their disclosures on the new comply or explain Code provision on tendering every ten years. The EU announcement will influence the tendering policy and companies should not be afraid to discuss that within their disclosures. Examples from companies with a 30 September year end include Easyjet, Sage Group, Paragon, UDG Healthcare, Victrex and Aberdeen Asset Management.

### Deloitte view

- The EU position is now unlikely to change significantly subject to a few clarifications as the legislative process proceeds, but companies are now able to plan.
- Mandatory audit rotation across all public interest entities in the EU will have a very significant impact upon listed companies and the profession.
- The transitional rules on audit rotation provide enough time for companies to plan transition across the range of services provided by audit firms.
- Once the regulation has entered into force, companies will have a two year lead time before the proposed restrictions and 70% cap on non-audit services apply, enabling transition to be planned well ahead of the audit rotation requirement once the final wording is approved.

### Contacts – we value your feedback:

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### UK Centre for Corporate Governance

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