Overview of European Union Audit Legislation

In April 2014, the European Union formally approved significant legislation that will affect statutory audits of many EU companies. The legislation will be effective two years after it is published in the Official Journal of the European Union, which is expected in the near future. The legislation therefore is likely to be effective by the summer of 2016 (with additional transition periods for firm rotation, as described below).

Scope of Application

Key provisions of the legislation—including firm rotation requirements and non-audit services restrictions—will apply only to statutory audits of EU public interest entities, or PIEs, which are defined to include:[1]

1. EU-based (e.g., incorporated) companies that are listed on an EU regulated market (but not non-EU companies solely because they are dual listed in the EU); and
2. Certain credit institutions and insurance undertakings in the EU (whether or not listed).

Thus, the legislation will primarily affect non-EU companies only if they have operations in the EU that are considered PIEs in their own right, such as EU-based banking or insurance entities or EU-incorporated subsidiaries that are themselves listed on a regulated exchange in the EU.

Key Provisions

While there are areas of uncertainty that will remain until further interpretations are issued and EU member states implement the law, the key provisions of the legislation include:

Mandatory rotation of the statutory audit firm.

The legislation will require rotation of the statutory audit firm of a PIE after a maximum of 10 years.[2] However, individual EU member states can extend this term to:

- 20 years, if there is a competitive tender after the first 10 years; or
- 24 years, in the case of a joint audit regime (which currently is only required in France).

The legislation provides substantial transition periods for firm rotation, such that statutory audit engagements that have been in place for 20 years or more will have until 2020 to rotate, and statutory audit engagements that have been in place for 11 years or more (but less than 20 years) will be due to rotate in 2023. There is uncertainty around the rotation date for engagements of less than 11 years.

New prohibitions on non-audit services.

The legislation includes a detailed list of non-audit services that audit firms and members of their networks may not provide to PIE statutory audit clients.[3] These include prohibitions on tax services that are more restrictive than those required under U.S. auditor independence rules; individual EU member states may choose to allow certain tax services, provided they have no direct or material effect on the audited financial statements.

The legislation also contains an overall cap (at 70% of audit fees) on the amount of non-audit services a firm may provide to a PIE statutory audit client and certain of its EU affiliates.

Other provisions of note.

The provisions in the legislation requiring rotation of the statutory audit firm and limits on non-audit services have received the most attention. There are a number of other provisions in the legislation, however, which are likely to have an effect on statutory audits in the EU. These include provisions designed to:

- Strengthen audit committees,
- Provide more transparency into activities of the audit committee and the statutory audit,
- Enhance dialogue between auditors and regulators, and
- Void agreements that limit the choice of auditor.

Looking Forward

U.S. companies with EU operations that may be covered by the legislation should monitor developments as interpretive issues are clarified and individual EU member states implement the law.

The flexibility afforded individual member states could result in differing requirements across the EU, which in turn may increase compliance costs for effected companies. Effected companies should consider participating in the legislative process, especially over the next two years as individual EU member states consider the implementation options allowed by the legislation.

1 Individual EU member states may also choose to designate other entities as PIEs.
2 Individual EU member states may set shorter rotation periods.
3 Individual EU member states may prohibit additional non-audit services.