

Non-audit services

Accounting reform in the European Union (EU) will impact on the relationship between a public-interest entity and its auditor from 2016. How will these changes affect your business?

What is the European legislation?

There is a new EU regulation with specific requirements regarding the statutory audit of Public-Interest Entities (PIEs). A regulation has binding legal force throughout the EU, and will override national law where there is a conflict.

Who will be affected?

The Regulation applies to PIEs, and to audit firms only insofar as they carry out statutory audits of PIEs.

A PIE is defined as:

- entities governed by the law of an EU member state whose securities are admitted to trading on a regulated market of an EU member state;
- credit institutions (as defined);
- insurance undertakings (as defined); and
- other entities which are designated by member states as PIEs, for instance undertakings that are of significant public relevance because of the nature of their business, their size or the number of their employees.

When will the changes come into effect?

The regulation applies to PIEs for accounting periods commencing on or after July 2016.

What are the headlines?

The headlines of the legislation are as follows:

Headlines covered in this factsheet:

- the provision of certain non-audit services to a PIE by its auditor is prohibited; and
- there is a cap of 70% of the audit fee, averaged over three years, on the level of [allowable] non-audit services which a PIE's auditor is able to provide to the company.

Headlines covered in other factsheets:

- PIEs will be required to change their statutory auditor at least every ten years, although Member States can extend this up to 20 years where a company conducts a public tendering process for the audit, or up to 24 years if a company uses more than one auditor (joint audit);
- new reporting requirements by the auditor to shareholders and to the audit committee are introduced; and
- audit committee responsibilities are expanded, in particular relating to audit tendering procedures and auditor appointment requirements.



What will change in practice?

The audit committee may consider that the law is too complex, and risks an honest mistake that tarnishes their personal and corporate reputation. Instead they could design a simple policy which nevertheless complies with the minimum requirements of the law.

Appendix 2 describes an example policy, but such a policy might include:

1. a cap on the level of Non-Audit Services (NAS) which a PIE can allot to its auditor, and the auditor's network, at a maximum of 70% of the statutory audit fee for the group. Audit committees may wish to implement a cap lower than 70%. This is likely to require PIEs to build relationships with a greater range of accounting firms who it approves to carry out audit and non-audit services;
2. ban on specific non-audit services which an auditor and its network is able to provide to a PIE and its group undertakings. Audit committees will need to allow sufficient time to consider and monitor the practical implications of implementing these new rules.
In particular, it will be important for audit committees to plan ahead for the volume of non-audit services that are likely to be allotted to the auditor and other suppliers to avoid potential conflicts; and
3. the development and publication of a policy on a PIE's allotment of NAS assignments to its auditor, including specifying those services that must never be provided by the auditor, those which must always be provided by the auditor and those which can sometimes be provided by the auditor in particular circumstances (see possible policy in the appendix 2).

What are the rules on non-audit services provided by a company's auditor?

The provision of certain NAS such as specific tax, consultancy and advisory services to a PIE, to its parent undertaking and to its controlled undertakings within the EU are prohibited. The prohibition will apply both to the statutory auditor and to any member of the auditor's network.

The prohibition applies to the period between the beginning of the period audited and the issuing of the audit report. For example, for a company with a December year-end, whose 2018 annual financial statements are signed off by the auditor on 15 March 2019, the prohibition will extend to the period from 1 January 2018 to 15 March 2019.

The full list of prohibited NAS as described in the law is set out in appendix 1 to this factsheet. Certain of the prohibited NAS may be provided by the auditor if they have no direct or have immaterial effect, separately or in the aggregate on the audited financial statements (see appendix 1 for full details).

Services other than the prohibited NAS may be provided to a PIE by its auditor only where the provision is approved by the audit committee and any threats and potential safeguards to the auditor's independence are properly assessed and documented. Individual EU member states will be able to prohibit other services than those listed in appendix 1.

The provision of prohibited NAS by the auditor or a member of its network, to a company which is controlled by a PIE but is incorporated in a country outside of the EU, is allowed only where the auditor has assessed whether its independence would be compromised by the provision of such services (but see appendix 1: certain services always affect independence and are incapable of mitigation by any safeguards).

What are the rules regarding a cap on fees for non-audit services?

The volume of [allowable] non-audit services which a statutory auditor is able to provide to a PIE, its parent undertaking or its controlled undertakings will be limited to no more than 70% of the fee for the statutory audit, averaged over the prior three years.

Further, an auditor must disclose to and discuss with the audit committee the threats to their independence and the safeguards applied to mitigate those threats, when the total fees received from a PIE in each of the last three consecutive financial years are more than 15% of the total fees received by the audit firm.

Member states can apply lower caps than those described in the regulation.

Will there be any impact beyond the EU?

The law will impact predominantly on PIEs incorporated within the EU and non-EU PIEs with shares traded on an EU regulated market. However there are aspects of the legislation which could impact on non-EU elements of an EU-led group of companies, such as the restrictions on the type and volume of NAS which are able to be provided to those elements.

Any questions?

This factsheet serves as an introduction to some of the issues raised by the expected changes to EU accounting law. Further factsheets are available on other aspects of the law and can be obtained from your usual Grant Thornton representative, including:

- audit committee responsibilities;
- audit firm rotation and auditor selection; and
- auditor reporting to shareholders and the audit committee.

The impact of these changes will vary from entity to entity.

Appendix 1: Prohibited non-audit services by EU law

List of prohibited non-audit services

"Prohibited non-audit services" are defined in the regulation as follows:

- a. provision of tax services relating to:
 - i. preparation of tax forms;
 - ii. payroll tax;
 - iii. customs duties;
 - iv. 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;
 - v. 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;
 - vi. calculation of direct and indirect tax and deferred tax; and
 - vii. provision of tax advice.
- b. services that involve playing any part in the management or decision-making process of the audited entity¹;
- c. bookkeeping and preparing accounting records and financial statements;
- d. payroll services;
- e. designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information or financial information technology systems;
- f. valuation services, including valuations performed in connection with actuarial services or litigation support services;
- g. legal services, with respect to:
 - i. the provision of general counsel;
 - ii. negotiating on behalf of the audit client, or
 - iii. acting in an advocacy role in the resolution of litigation; and
- h. services related to the audit client's internal audit function;
- i. 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, including the provision of comfort letters in connection with prospectuses issued by the audit client;

- j. promoting, dealing in, or underwriting shares in the audited entity;
- k. human resources services with respect to:
 - i. 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;
 - ii. structuring the organisation design; and
 - iii. cost control.

"Materiality assessment" by the auditor

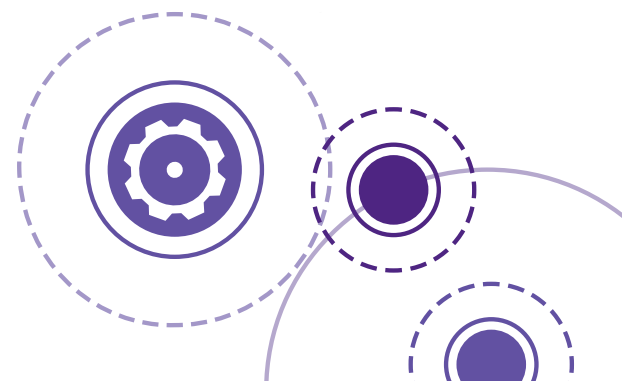
Member states may allow the services referred to in points (a) (i), (a) (iv) - (vii) and (f), provided that they satisfy the following requirements:

- i. they have no direct or have immaterial effect separately or in aggregate on the audited financial statements;
- ii. the estimation of the effect on the audited financial statements is comprehensively documented and explained in the additional report to the audit committee referred to in Article 11; and
- iii. the principles of independence laid down in Directive 2006/43/EC are complied with by the statutory auditor or audit firm.

Non audit services to non-EU members of the group

All services on the banned list are deemed to "affect independence", and "therefore require safeguards to mitigate the threats". However, being involved in the decision-taking of the audited entity and the provision of services [in b, c, e of the banned list] "shall be deemed to affect such independence in all cases and to be incapable of mitigation by any safeguards.

¹ Recital 8 to the regulation provides some guidance on what services could involve playing a part in the management or decision-making process of an audited entity as follows "The services that involve playing any part in the management or decision-making process of the audited entity might include working capital management, providing financial information, business process optimization, cash management, transfer pricing, creating supply chain efficiency and similar."



Appendix 2: Example policy for use by audit committees: allotment of non-audit services to the auditor

The following example policy on the allotment of non-audit services to the auditor is provided to assist an audit committee to draft a bespoke policy as it is relevant to the PIE it is serving. An audit committee may wish to include additional provisions and clauses to cater for specific scenarios or types of non-audit services which are significant.

Policy on the allotment of non-audit services to the company's auditor

The audit committee reviews the nature and extent of non-audit services supplied by the external auditors to the group, seeking to balance objectivity and value for money.

In determining the policy, the audit committee has taken into account the possible threats to auditor objectivity and independence, the Code of Ethics for Professional Accountants (the Code) issued by the International Ethics Standards Board for Accountants (IESBA) regarding the provision of non-audit services by the external audit firm and Articles 4 and 5 of the European Regulation 537/2014 regarding audit fees and the prohibition of the provision of certain non-audit services by the auditor.

The Code explains that threats to auditor objectivity and independence may arise from self-interest, self-review, management, advocacy, familiarity and intimidation. Consequently, the audit committee has categorized the work which could be carried out by external auditors into three categories:

1. services which the auditor is excluded from providing because the threat to their independence is considered to be too great to be mitigated by any safeguards. This includes all of the services listed in Article 5 of EU Regulation 537/2014 and, in particular prohibited services includes internal audit, systems design and implementation, accounting assistance, management functions (including working capital management, providing financial information, business process optimization, cash management, transfer pricing and creating supply chain efficiency), human resources, appraisal or valuation services, tax advisory work and services linked to the financing, capital structure and allocation and investment strategy of the company;

2. services which the auditor may be able to conduct, subject to a case-by-case consideration and approval by the audit committee. Approval by the audit committee is given in these cases if the threats to auditor independence are considered low, for example if the engagement is routine in nature and the fee is not significant in the context of the audit fee [consider providing a monetary value]. Such services include reporting on regulatory returns which it is certain will not lead to a material impact on the audited financial statements; and
3. services which the auditor should conduct in most circumstances. This category includes assignments such as reviews of interim financial statements and reporting obligations from regulators which require approval by the auditor.

In most cases and, in particular for assignments which are considered to be material in nature, the audit committee expects the assignment to be competitively tendered, unless for reasons of timing or confidentiality it is considered to be in its best interests to appoint on a single tender basis.

In the rare instances where it is not possible to give approval in advance, the audit committee may provide a general pre-approval for the performance of certain classes of work by certain professional services providers, subject to a fee limit of [£x]. The subsequent provision of the service is then ratified at the next meeting of the audit committee.

In any case, the audit committee only approves services other than the statutory audit, to be provided by the auditor, up to a level of [70%] of the statutory audit fee. This is the level at which the audit committee considers a self-interest threat to the auditor's independence may arise. The audit committee applies this cap across the group to all services provided by the auditor and other members of its network.

Fees paid to the auditor for audit services, audit-related services and other non-audit services are set out in note [x] to the financial statements.

Contact

If you wish to discuss this further, please contact a member of our team to discuss how we can help you assess the implications of this legislation.

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