European Union

EU audit reform – agreement on draft legislation

European Commission, Parliament and Council of Ministers have reached agreement on draft legislation to reform the audit market in the EU. A number of approvals remain outstanding, but it is now likely that the new legislation will be introduced this year.

If approved, this legislation - composed of a regulation and a directive - would mean that mandatory rotation of statutory auditors and audit firms will be introduced in the EU on a 10-yearly basis for all public interest entities (PIEs). There will also be additional restrictions on the non-audit services that audit firms can provide to audit clients.

These proposed reforms would have a profound impact as they apply to all public interest entities, whatever their size. PIEs are broadly defined as all EU companies with listed securities and all banks and insurers, whether listed or not.

Options for member states

There are some options in the proposals for member states to consider whether they want to make the national application less onerous or more stringent. For example, they may allow the auditor or audit firm to continue to audit the same company for up to 20 years (rather than 10) where there's a public tendering, and up to 24 years in case of joint audit. Transitional arrangements will depend on the length of tenure.

Does mandatory rotation improve audit quality?

"The proposals, if enacted, will increase cost and complexity for business just as the fragile European economy is recovering," said Richard Sexton, PwC Global Assurance leader. "It is hard to see how forcing companies to change auditors periodically does anything to improve audit quality…By definition mandatory audit firm rotation reduces competition and choice which is an odd outcome given the European Commission's stated desire to increase competition."

Restrictions on non-audit services

An annual cap on non-audit services of 70% is also planned. The test is likely to apply to the average of fees over the last three years. There is also a list of non-audit services that cannot be provided by the auditor of a PIE to that entity, or to its parent or subsidiaries within the EU.

Mr Sexton added: "This package of regulatory interventions is in danger of undermining the importance of good governance by imposing rules which restrict the ability of shareholders and investors to choose what is best for the companies they own. The role of audit committees, which is at the heart of the EU corporate governance system, has been seriously curtailed."

Next steps

The draft text now goes to vote at the JURI (Legal Services) Committee of the EU Parliament before proceeding to a plenary vote of the EU Parliament. Following formal approval from the Council of Ministers, the legislation can become law.