



EUROPEAN COMMISSION

MEMO

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Commissioner Michel Barnier welcomes provisional agreement in trilogue on the reform of the audit sector

I welcome the agreement reached this morning between the European Parliament and EU Member States on the reform of the audit sector. This is a first step towards increasing audit quality and re-establishing investor confidence in financial information, an essential ingredient for investment and economic growth in Europe.

Although less ambitious than initially proposed by the Commission, landmark measures to strengthen the independence of auditors have been endorsed, particularly in the auditing of financial institutions and listed companies. This will ensure that auditors will be key contributors to economic and financial stability.

With the agreement, audit firms will be required to rotate every 10 years. Public interest entities will only be able to extend the audit tenure once, upon tender. Under this measure, joint audit will also be encouraged. Despite the extension of the rotation period, this principle will have a major impact in reducing excessive familiarity between the auditors and their clients and in enhancing professional scepticism.

The new rules also provide innovative tools to limit the risk of conflict of interest. To avoid the risk of self-review, several non-audit services are prohibited under a strict 'black list', including stringent limits on tax advice and on services linked to the financial and investment strategy of the audit client. In addition, a cap on the provision of non-audit services is introduced.

Taken together, the agreed measures will considerably strengthen audit quality across the European Union. In this regard, I particularly welcome the agreement on the harmonisation of the international standards on auditing (ISAs).

On the cooperation between audit supervisory authorities, I regret that ESMA has not been endorsed as the core structure for coordination but I am pleased that it has been granted an initial mandate on international cooperation.

I congratulate the European Parliament, in particular the Rapporteurs Sajjad Karim and Kay Swinburne and the shadow Rapporteurs the Council, and successive EU Presidencies (Denmark, Cyprus, Ireland and Lithuania) for this major achievement.

It is now high time for auditors to meet the challenges of their role – a societal role.

I trust that once final details are reflected in the text and formally endorsed by the College, co-legislators will also approve the text in coming weeks.

Background

The financial crisis highlighted serious shortcomings in the stability of the EU economic and financial system. Auditors play an important societal role by providing stakeholders with an accurate reflection of the veracity of company's financial statements. However, a number of banks were given clean bills of health despite huge losses from 2007 onwards. In relation to the real economy, inspection reports from the Member States revealed lack of professional scepticism by auditors, misstatements and a lack of fresh thinking in the audits of major companies because of the average long-lasting relationship between the auditor and their clients.

Taken all together, the agreed measures ensure that auditors will be key contributors to economic and financial stability through increased audit quality, stronger independence requirements and more open and dynamic EU audit markets.

The key elements of the new rules include:

1. A clarified societal role for auditors

- **Increased audit quality:** In order to reduce the 'expectation gap' between what is expected from auditors and what they are bound to deliver, the new rules will require auditors to produce more detailed and informative audit reports, with a required focus on relevant information to investors.
- **Enhanced transparency:** Strict transparency requirements will be introduced for auditors with stronger reporting obligations vis-à-vis supervisors. Increased communication between auditors and the audit committee of an audited entity is requested.
- **Better accountability:** The work of auditors will be closely supervised by audit committees, whose competences are strengthened. In addition, the package introduces the possibility for 5% of the shareholders of the company to initiate actions to dismiss the auditors. A set of administrative sanctions that can be applied by the competent authorities is also foreseen for breaches of the new rules.

2. A strong independence regime

- **Mandatory rotation of audit firms:** Audit firms will be required to rotate after an engagement period of 10 years. After maximum 10 years, the period can be extended by up to 10 additional years if tenders are carried out, and by up to 14 additional years in case of joint audit, i.e. if the company being audited appoints more than one audit firm to carry out its audit. A calibrated transitional period taking into account the duration of the audit engagement is foreseen to avoid a cliff effect following the entry into force of the new rules.
- **Prohibition of certain non-audit services:** Audit firms will be strictly prohibited from providing non-audit services to their audit clients, including stringent limits on tax advice and services linked to the financial and investment strategy of the audit client. This aims to limit risk of conflicts of interest, when auditors are involved in decisions impacting the management of a company. This will also substantially limit the 'self-review' risks for auditors.
- **Cap on the provision of non-audit services:** To reduce the risks of conflicts of interest, the new rules will introduce a cap of 70% on the fees generated for non-audit services others than those prohibited based on a three-year average at the group level.

3. A more dynamic and competitive EU audit market

- **A Single Market for statutory audit:** The new rules will provide a level playing field for auditors at EU level through enhanced cross-border mobility and the harmonisation of International Standards on Auditing (ISAs).
- **More choice:** In order to promote competition, the new rules prohibit restrictive 'Big Four only' third party clauses imposed on companies. Incentives for joint audit and tendering will be introduced, and a proportionate application of the rules will be applied to avoid extra burden for small and mid-tier audit firms. Tools to monitor the concentration of the audit market will be reinforced.
- **Enhanced supervision of the audit sector:** Cooperation between national supervisors will be enhanced at EU level, with a specific role devoted to the European Markets and Securities Authority (ESMA) with regard to international cooperation on audit oversight.

The political agreement reached this morning is subject to technical finalisation and formal approval by the co-legislators.

For more information

http://ec.europa.eu/internal_market/auditing/reform/