

Guidance on non-audit services and fee cap

The EU audit legislation introduces restrictions on the range of non-audit services that public interest entities (PIEs) in the EU can obtain from the statutory audit firm and its network. The legislation became applicable on 17 June 2016 and will apply to financial years starting on or after this date.

In this document you can find a summary of the measures regarding the introduction of prohibitions on the provision of certain NAS by a statutory audit firm to their PIE audit clients. There are also some frequently asked questions and answers.

Prohibition of certain non-audit services (NAS) to PIEs (Article 5.1 of the Regulation)*

Prohibited non-audit services (the blacklist)				
a. Tax and tax compliance services:	i.	Preparation of tax forms	Member states can allow the provision of tax services relating to i), iv), v), vi) and vii) as long as:	<ul style="list-style-type: none"> they have no direct or have immaterial effect on the audited financial statements, estimation of the effect on the audited financial statements is comprehensively documented and explained in the additional report to the audit committee, and principles of independence are complied with.
	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 in respect of such inspections is required by law		
	vi.	Calculation of direct and indirect tax and deferred tax	Audit committee to set guidelines with regard to provision of such services	
	vii.	Provision of tax advice		
b. 'Services that involve playing any part in the management or decision-making of the audited entity'. <i>This definition is open to interpretation; it could include such things as "working capital management, providing financial information, business process optimization, cash management, transfer pricing and creating supply chain efficiency and the like"</i>				
c. 'Services linked to the financing, capital structure and allocation, and investment strategy of the audit client'. <i>These are also not clearly defined. Due diligence services and issuing of comfort letters would be allowed unless they fall under another restriction of the blacklist (e.g. tax)</i>				
d. Promoting, dealing in, or under-writing shares in the audited entity				

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e. Legal services with respect to:	i. The provision of general counsel	
	ii. Negotiating on behalf of the audit client	
	iii. Acting in an advocacy role in the resolution of litigation	
f. Book-keeping and preparing accounting records and financial statement		
g. Payroll services		
h. Designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information or designing and implementing financial information technology systems (subject to a one year cooling-in period, see below)		
i. Valuation services	<ul style="list-style-type: none"> Member states can allow the provision of valuation services as long as: 	<ul style="list-style-type: none"> they have no direct or have immaterial effect separately or in aggregate on the audited financial statements, estimation of the effect on the audited financial statements is comprehensively documented and explained in the additional report to the audit committee, and principles of independence are complied with <p>audit committee to set guidelines with regard to provision of such services</p>
j. Services related to the audit client's internal audit function		
k. Human resources services relating to:	i. Management in a position to exert significant influence over the preparation of the accounting records or financial statements subject to statutory audit, where such services for such positions involve:	<ul style="list-style-type: none"> searching for or seeking out candidates undertaking reference checks on candidates
	ii. Structuring the organisation design	
	iii. Cost control	

* Requirements in this table are based on the EU Regulation and may vary locally due to member state implementation.

The statutory audit firm cannot provide the services listed above during the period between the beginning of the period audited and the issuing of the audit report. For services covered by (h) above, there is also a restriction on the provision of such services during the financial year immediately preceding the beginning of the period audited. Each PIE in a group will have to comply with the NAS rules applicable to the EU member state in which it is based. Non-PIE EU parent and controlled entities of an EU PIE will have to follow the NAS rules applicable to PIEs in the EU member state in which they are based.

Additionally services covered by (b), (f) and (h) may not be provided by the statutory audit firm or its network to controlled entities, outside the EU, of an EU PIE.

All other services are allowed, subject to the approval of the audit committee following an assessment of the threats to independence and the safeguards in place to mitigate or eliminate those threats.

Member States have certain options in implementing the legislation

a. Add services to the list of prohibited services
b. Establish stricter rules setting out the conditions under which an audit firm may provide NAS
c. Allow specified tax and valuation services subject to conditions (see table above)

Fee cap for permissible non-audit services (NAS)

Permissible non-audit services and fee-cap	
<p>A cap on permissible NAS of maximum 70% of the average of the fees paid in the last three consecutive financial years for the statutory audit(s) of the audited entity and, where applicable, of its parent undertaking, its controlled undertakings and of the consolidated financial statements of that group of undertakings. Regarding application of the cap:</p>	<ul style="list-style-type: none">• The cap will only apply in the fourth consecutive year; the clock will be reset if in one year no NAS were provided. During the first three consecutive years under the legislation, no cap applies.• The cap applies to a given statutory auditor/audit firm only. The fees generated by the services provided by members of network firms are not relevant for the purposes of the calculation of the cap.• Services required by national or EU legislation are exempted from the calculation of the cap• Member state have the option to make the cap more stringent• Member state may allow their competent authorities to exempt audit firms from this requirement upon request and on an exceptional basis for a period not exceeding two years

Q&As on non-audit services and fee cap:

Q: Audit firm A is the statutory auditor of a non-PIE. The statutory auditor of the PIE parent (or subsidiary) is a different network. Is audit firm A subject to Art. 5 of the Regulation on NAS restrictions for the non-PIE subsidiary?

A: No. The restrictions apply to the statutory auditor of the PIE and its network. However the normal threats and safeguards evaluation process resulting from the application of the IESBA Code of Ethics should be applied, together with compliance with any local independence requirements.

Q: Audit firm A is the statutory auditor of an EU PIE. The parent company of the PIE, which is also incorporated in the EU, is audited by another network. Audit firm A has been invited to participate in a tender to provide payroll services to the parent company. Is audit firm A permitted to provide payroll services to the parent company in 2017?

A: No. The prohibitions on non-audit services, as set out in Article 5.1, apply to the audited PIE and to its parent(s) and controlled undertaking(s) in the EU. There is no exception to the prohibitions on the grounds that the service is to the EU parent entity, even if that entity is not an audit client of audit firm A's network.

Q: A PIE audit client has a non-PIE subsidiary both of which are audited by audit firm A. Would audit firm A be allowed to provide payroll services to the non-PIE subsidiary?

A: No, the prohibitions on non-audit services, as set out in Article 5.1, apply to the PIE audited entity and to its PIE and non-PIE parent(s) and controlled undertaking(s) in the EU. For non-EU controlled undertakings a threats and safeguards approach applies but some services are always deemed to affect independence (ie services involving 'playing any part in the management or decision making of the entity', bookkeeping and preparing accounting records/financial statements, designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information or financial information technology systems). Payroll services would be caught on the restriction on bookkeeping/preparing accounting records.

Q: Spain has not taken up the member state option with respect to tax services but Malta has. Would audit firm A based in Malta be allowed to provide tax services to the Maltese (PIE or non-PIE) subsidiary, if these are not allowed in the country of the PIE parent?

A: Yes, audit firm A based in Malta would be allowed to provide permissible tax services to the subsidiary in Malta. The principle of local law applies; derogations taken by a member state will only apply within that member state. However, there are a few member states which are considering to apply an 'extraterritorial' effect to the audit firm in their jurisdiction, so it is important to check with the local audit firm of the PIE.

The audit committee of the Spanish PIE would need to pre-approve the tax services in Malta, as would the audit committee of the Maltese subsidiary if itself a PIE.

Q: Is audit committee approval needed for any non-audit service?

A: Yes. The Regulation requires the audit committee (or the body performing equivalent functions) of an EU PIE to approve the provision of all permissible NAS by the statutory auditor or by a member of the audit firm's network to the PIE itself and to its EU parent and controlled undertakings. We understand that approval of permissible NAS is only required from audit committees of entities that are located within the EU and in relation to services that will be provided within the EU.

Q: Can the audit committee pre-approve a list of permissible non-audit services which an audit firm can provide to an audited entity?

A: Yes. There does not seem to be anything preventing audit committees giving approval for certain types of services in advance. However, member states may decide differently (e.g. in the UK such "blanket" approval is only permitted for services that are clearly trivial). Of course, parent entities of groups may decide that the audit committees at each level in the group need to assess the threats to independence and safeguards on a case-by-case basis.

Q: If a PIE is a subsidiary of another PIE, should the NAS rendered by the statutory auditor to the parent company also have to be approved by the audit committee of the subsidiary (i.e. a double approval by both audit committees)?

A: No. The services are being provided to the parent company in the EU, which is PIE and has a PIE subsidiary. So if the parent is PIE, the audit committee of this parent is the only approver.

Q: Can audit committees of multiple PIEs in a group defer to the Audit Committee of the EU parent PIE for this approval?

A: The audit committee of the ultimate PIE parent undertaking in the EU should approve non-audit services to be provided to the PIE and non-PIE parent and controlled undertakings in the EU. If any controlled undertaking is itself a PIE and is a direct recipient of these non-audit services (i.e. the service is being provided directly to the subsidiary), those services should also be approved by the audit committee of the controlled undertaking (to the extent that an audit committee is required by local law). In any case it is recommended to liaise with the audit committee in the respective territories, since they will know the local requirements best.

Q: Audit firm A is the statutory auditor of EU PIE subsidiaries of a large US IT company. Is it sufficient that the audit committee of the US parent approves permissible non-audit services by the audit firm to the group?

A: No, each PIE in the EU must set up an audit committee. As a minimum the audit committee of the EU PIE parent entity should approve the services to this EU PIE and its controlled entities in the EU.

Q: What happens to the fee cap requirements if an EU PIE is going through a major capital market transaction and needs its statutory audit firm to perform certain non-audit services?

A: First, only permissible non-audit services can be provided, subject to the fee cap. However, services that are required by EU or national law, are exempted from the cap calculation. In addition, under the EU rules, there is an option for member states to allow the statutory auditor, at the entity's request, an exemption from the requirements of the cap for up to two financial years in exceptional circumstances. It is our understanding that services needed for a capital market transaction may fall under these exceptional circumstances.

Q: Am I correct in saying that neither the outgoing audit firm (2017 audit) nor the incoming audit firm (2018 audit) can provide non-audit services prohibited by the Regulation between 1 January 2018 and the issuance of the audit report for 2017 in May 2018?

A: That is correct - the outgoing audit firm cannot provide prohibited non-audit services to the audited entity until the issuing of their final audit report. Prohibitions will of course continue for the incoming audit firm.

Q: I understand that audit firm A cannot provide prohibited services during the audit period to my company. However, would it be possible for audit firm A to participate in a tender process for non-audit services in the months leading up to rotation?

A: Yes, in the months prior to rotation, audit firm A would be allowed to participate in a tender for non-audit services on condition that they do not start providing such services prior to the issuing of the final audit report.

Q: Audit firm A rotated off as statutory auditor of an EU PIE but continues to audit the client's subsidiary in China. Are there still restrictions for the clients to receive non-audit services from audit firm A?

A: No, there has to be an audit relationship with an EU PIE for the EU NAS restrictions to apply to subsidiaries outside the EU. IESBA and Chinese independence restrictions will apply.

Q: I have heard that for certain non-audit services, a cooling-in period applies. Can you explain which services will be caught?

A: A one year cooling-in period applies to one type of service only: 'designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information or designing and implementing financial information technology systems'. For financial years beginning on or after 17 June 2016, statutory auditors and audit firms who had provided these services to a PIE in the previous financial year will not be able to carry out the statutory audit of that PIE.

Q: Article 5.1 of the Regulation stipulates that a cooling-in period applies to the services listed under point (g) which are legal services. Above you say that the cooling-in period applies to designing internal control systems which are listed under point (h) of the article. Which is correct?

A: The answer above is correct. The EC published a Corrigendum in May 2014 rectifying its mistake. The cooling-in period applies to the following service: ‘designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information or designing and implementing financial information technology systems’.

Q: Can you give an example of when the cooling-in period will apply?

A: The cooling in period applies to the financial year preceding the first financial year beginning on or after 17 June 2016 and thereafter. For example, if a PIE intends to appoint new statutory auditors in December 2016 for the period commencing 1 July 2017, the incoming audit firm is not permitted to provide the prohibited service with effect from 30 June 2016 and can only accept the appointment if they comply with this requirement.