

## FACT SHEET: AUDIT COMMITTEE ROLE AND RESPONSIBILITIES; AND AUDITOR OVERSIGHT



**The new EU legislation, in the form of a Directive and a Regulation, introduces additional requirements specific to the role and responsibilities of audit committees; as well as changes to auditor oversight.**

### What are the major changes to the role of the audit committee?

Provisions affecting audit committees are contained in both the [Directive<sup>1</sup>](#) and [Regulation<sup>2</sup>](#). The Directive states that 'Member States shall ensure that each public-interest entity (PIE) has an audit committee. The audit committee shall be either a stand-alone committee or a committee of the administrative body or supervisory body of the audited entity.' However, the functions assigned to the audit committee may be performed by the administrative or supervisory body as a whole.

In reality, most of the requirements for audit committees set out in the legislation are already being performed today and represent 'best practice'. So the only change of substance is the fact that these requirements are now being enshrined in law.

The table below outlines the requirements of all EU audit committees. However, Member States may decide that the certain PIEs are not required to have an audit committee and as such may opt to allow exemptions in certain scenarios as discussed further on page 2.

#### Article 39.6 of the Directive states that the audit committee shall:

- a. **inform** the administrative or supervisory body of the audited entity of the outcome of the statutory audit and **explain** the role of the audit committee in that process;
- b. **monitor** the financial reporting process and **submit recommendations** or proposals to ensure its integrity;
- c. **monitor** the effectiveness of the undertaking's internal quality control, risk management systems and internal audit (where applicable), regarding the financial reporting of the audited entity, without breaching its independence;
- d. **monitor** the performance of audits – taking into account the findings and conclusions of the audit reviews carried out by the competent authorities;
- e. **review** and **monitor** the independence of the statutory auditors<sup>3</sup>; and
- f. be **responsible** for the **procedure** for the selection of the statutory auditor.

1 [http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L\\_.2014.158.01.0196.01.ENG](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.158.01.0196.01.ENG).

2 [http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L\\_.2014.158.01.0077.01.ENG](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.158.01.0077.01.ENG).

3 The use of the word 'auditors(s)' in this document refers to auditor(s) and/or audit firms.

## The Regulation sets out specific activities required of a PIE's audit committee – what are these?

The Regulation implements a number of new monitoring, reporting and approval provisions that will require more oversight by audit committees of PIEs. These are summarised in the table below.

Activities	Key provisions affecting audit committee oversight of PIE statutory audits
<b>Monitoring the level of audit fees</b>	Monitor the percentage of fees received from a PIE by the statutory auditor – including oversight by the audit committee of the operation of the 70% fee cap for permitted non-audit services (Article 4).
<b>Assessment of compliance</b>	Oversee the process by which the statutory auditor assesses the provision of permitted services provided within the EU, ensuring that the following requirements are complied with: <ol style="list-style-type: none"><li>they have no direct or have immaterial effect, separately or in the aggregate, on the audited financial statements;</li><li>the estimation of the effect on the audited financial statements is comprehensively documented and explained; and</li><li>the process complies with the principles of independence (Article 5.3).</li></ol>
<b>Approval of permitted NAS</b>	Assess the threats to independence and the safeguards that the statutory auditor will apply to mitigate these threats, before approving permitted services within the EU. All permitted services within the EU require approval from the audit committee following this assessment (Article 5.4).
<b>Issuing guidelines and policy</b>	Issue guidelines and appropriate policy in relation to services that may be permitted subject to Member State derogation in relation to certain tax services and valuation services, provided that they are immaterial, comprehensively documented and independent – i.e. in line with the requirements of Article 5.3 above (Article 5.4).
<b>Appointment of statutory auditors</b>	Assess and recommend potential statutory auditors. The audit committee is responsible for the procedure and recommendation for the selection of the statutory auditors. The recommendation should consist of two choices for the audit engagement and the justified preference for one of them (Article 16.2).
<b>Extension of audit tenure</b>	Recommend extension of audit tenure only if appropriate. The maximum initial period (of up to 10 years) may be extended (for Member States that opt to permit extension) only if the audit committee recommends at the general meeting of shareholders that the engagement be renewed, and the proposal is approved (Article 17).
<b>Monitoring auditor independence</b>	Monitor auditor independence. The statutory auditor should confirm its independence annually to the audit committee of the audited entity and discuss any threat to its independence as well as the safeguards applied to mitigate those threats (Article 6.2).

## What is the audit committee's role in the audit tender process?

Audit committees are responsible for submitting a recommendation to the administrative or supervisory body of the audited entity for the appointment of the auditor. The recommendation should include at least two possible choices for the audit engagement and a justified preference for one of them.

Tender documents should contain transparent and non-discriminatory selection criteria to be used for the evaluation of proposals.

The audited entity has to prepare a report on the conclusions of the selection procedure, which is validated by the audit committee, to demonstrate that the selection procedure was conducted in a fair manner.

For further guidance on the role of the audit committee and tendering, see the [KPMG Audit Committee Institute's handbook](https://www.kpmg.com/Ca/en/services/Audit/AuditCommittee/Documents/ACI-Audit-Committee-Handbook.pdf).<sup>4</sup>

## Can audit committees of multiple PIEs in a group defer to the group audit committee outside the EU to make NAS approvals?

No. Approval by an EU-based audit committee (or equivalent) is required for all NAS provided to EU PIE subsidiaries. An audit committee based outside the EU cannot give this approval.

<sup>4</sup> <https://www.kpmg.com/Ca/en/services/Audit/AuditCommittee/Documents/ACI-Audit-Committee-Handbook.pdf>

## When is such a tender process required?

This procedure takes place for the new appointments of any statutory auditor and in particular applies to:

- first time appointments; and
- any reappointment when the audit reaches the initial maximum duration of the audit engagement.

## Who can be on an audit committee?

Provisions covering the make-up of the audit committee are set out in Article 39.1 of the Directive and are summarised in the table below.

<input checked="" type="checkbox"/>	The audit committee should be <b>composed of independent non-executive members</b> of either the administrative body or the supervisory body.
<input checked="" type="checkbox"/>	Audit committee members can be directly appointed at the annual general meeting. However, a majority of the members of the audit committee have to be <b>independent of the audited entity</b> .
<input checked="" type="checkbox"/>	At least one member of the audit committee has to have <b>competence in accounting and/or auditing</b> .
<input checked="" type="checkbox"/>	The committee members as a whole should have <b>competence relevant to the sector</b> in which the company has its business.
<input checked="" type="checkbox"/>	The Chair of the audit committee is <b>appointed by its members</b> or by the supervisory body of the audited entity. Note – Member States can opt to require the Chairman be elected annually by the shareholders general meeting.

## Are there any exemptions from the requirement to have an audit committee?

Article 39.1 of the Directive states that 'Member States shall ensure that each public-interest entity has an audit committee.' However, Member States may opt to exempt certain PIEs as summarised in the table below.

Member State option <sup>5</sup>
Where all members of the audit committee are <b>members of the administrative or supervisory body</b> of the audited entity, Member States may provide that the audit committee is to be exempt from the independence requirements.
Member States may decide that <b>certain subsidiary undertakings, credit institutions, undertakings for collective investment in transferable securities (UCITS) and issuers of asset-backed securities</b> are not required to have an audit committee.
Member States may require or allow a PIE not to have an audit committee provided that it has a <b>body or bodies performing equivalent functions to an audit committee</b> , established and functioning in accordance with provisions in place in the Member State in which the entity to be audited is registered.
In such a case, the entity has to disclose which body carries out those functions and how that body is composed.

## Who will be responsible for auditor oversight in the EU and what is their remit?

National oversight bodies still remain responsible for oversight at a Member State level. However, a new body is to be established, a Committee of European Audit Oversight Bodies (CEAOB), which will take over the existing role of the European Group of Auditor Oversight Bodies (EGAOB) and will oversee cooperation between Competent Authorities.

The CEAOB will be chaired by and comprise of the national authorities responsible for auditor oversight and will have the following responsibilities:

- facilitate the exchange of information, expertise and best practices for the implementation of this legislation;
- provide expert advice to the Commission as well as to the competent authorities, at their request, on issues related to the implementation of this legislation;
- contribute to the technical assessment of public oversight systems of third countries and to the international cooperation between Member States and third countries;
- contribute to the technical examination of international auditing standards, including the processes for their elaboration, with a view to their adoption at EU level;
- contribute to the improvement of cooperation mechanisms for the oversight of public-interest entities' statutory auditors, audit firms or their networks;
- carry out other coordinating tasks in the cases provided for in this legislation.

5 See summary of all Member State options at: [http://www.ffe.be/index.php?option=com\\_content&view=article&id=1412&Itemid=106&lang=en](http://www.ffe.be/index.php?option=com_content&view=article&id=1412&Itemid=106&lang=en).

## What are the practical considerations for audit committees in light of this regulatory change?

All EU statutory audits will be affected by the EU audit reform legislation. How and when they are affected will differ from company to company, depending on a number of variables and the views of investors. The chart below identifies a number of initial considerations in relation to the role and responsibility of audit committees.

### Immediacy and depth of the impact of the new rules



#### Ask yourself ...

#### Considerations

<b>Does our entity have/require an audit committee? Should I establish one?</b>	No	?	Yes	Member State options may allow certain entities to be exempt from requiring an audit committee based on size and complexity.
<b>Do I have adequate resources on the audit committee?</b>	Insufficient	?	Sufficient	Review the terms of reference of an audit committee. Assess the independence, competence and capacity of its members.
<b>Will the requirements be significantly different from how we operate today?</b>	No	?	Yes	The legislation may require a change of approach to governance, structure and even culture in some operations as the new legislation becomes applicable throughout the EU. The impact will be more significant in markets with less mature corporate governance regimes.
<b>How formalised is our approach to independence – e.g. is our NAS policy fit for purpose?</b>	No policies	?	Formalised approach	There should be clarity around what non-audit services are permissible and what are prohibited. Permissible services require audit committee approval.
<b>Do we have established procedures for carrying out an audit tender?</b>	No procedures	?	Well established	The audit committee now has explicit responsibility for audit tenders and should ensure transparent, non-discriminatory selection criteria are used; including an assessment of the performance of auditors.

For further information please speak to your usual KPMG contact.

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