KPMG

EU Audit Reform

Three observations about non-audit services

Audit Committee Institute

For accounting periods commencing on or after 17 June 2016 the prohibited services which auditors or members of their network cannot provide to their PIE audit clients are much more restrictive than existing non-audit services restrictions in the UK.

For most companies the most significant impact of these changes is likely to be for tax, corporate finance services and valuations which are largely prohibited. There are derogations (subject to the requirements that services 'have no direct or have a clearly inconsequential effect') for some tax and valuation services.

Furthermore, permitted services provided by the statutory audit firm and its network will be subject to cap of 70% of the average of the audit fees in the last three consecutive financial years for the statutory audit(s) of PIEs and their group entities.

1 The FRC's proposed *Guidance on Audit Committees* explicitly states that the audit committee is responsible for approving non-audit services and that it should set and apply a formal policy specifying the types of non-audit service for which use of the external auditor is pre-approved; and that such approval should only be in place for matters that are 'clearly trivial'. The implication is that for all non-clearly trivial services, prior approval by the audit committee is required before the auditor can be engaged.

What constitutes 'clearly trivial' will need to be determined by the audit committee after due consideration of the inherent nature of the 'type' of non-audit service, the impact on the financial statements and the monetary value.

While a sense of proportion should be applied, the introduction of the term 'clearly trivial' appears to be designed to discourage pre-approval, or at least encourage audit committees to think carefully about whether too many non-audit services have been pre-approved in the past.

In any event, non-audit services will need reviewing in the light of the changes and, in many cases, need amending.

2 The *Guidance on Audit Committees* also notes that the audit committee should also issue guidelines for how it will assess whether non-audit services have a direct or material effect on the audited financial statements, how it will assess and explain the estimation of the effect on the financial statements and how it has considered the external auditors' independence. The FRC Guidance is silent on the matter, but presumably such guidelines are designed to be shared with the external auditor and the investment community.

3 The EU legislation is being implemented differently at Member State level. This has created cross-border differences in the definition of what non-audit services can be provided by the statutory auditor. To ensure both compliance with the various regulations and common best practice, most groups will wish to address this issue at group level. Consequently, when setting the non-audit services policy, the 'group' audit committee will need to factor into its deliberations any non-audit service prohibitions existing in countries in which any group undertakings operate as well as those determined by the FRC.

Further information about the impact of the EU Audit Reforms on the composition, role and responsibilities of audit committees can be found in the ACI Guide Audit Reform: The impact on the role and responsibilities of audit committees.

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