



EU audit reform – What you need to know

Fact sheet: The impact of the European Union (EU) audit legislation beyond the EU

The EU Audit legislation does not directly apply to entities outside of the EU – but certain European subsidiaries of non-EU parents could be scoped in to the requirements.

The rules became effective from 17 June 2016, and multi-nationals will be working through the implications of the legislation and how it affects their EU subsidiaries, particularly as the patchwork of rules continues to emerge across the EU.

What are the key requirements that could have some impact for entities outside of the EU?

The two key provisions which could have some impact are mandatory firm rotation (MFR) and the restrictions around Non-Audit Services (NAS). The MFR and NAS Fact Sheets should be read in conjunction with this Fact Sheet as they contain background details that support the concepts outlined below:

	MFR	NAS
EU baseline measure:	<ul style="list-style-type: none"> – 10-year mandatory audit firm rotation for all EU Public-Interest Entities (PIEs) (maximum duration period). 	<ul style="list-style-type: none"> – Expands the list of NAS the statutory auditor, and certain of its network firms, cannot provide. – A fee cap of 70% on permitted NAS performed by the statutory auditor.
Member State options available to:	<ul style="list-style-type: none"> – Extend the maximum duration period once up to a maximum of 20 years (in the event of a public tender) or 24 years (for a joint audit). – Implement a shorter maximum duration period of less than 10 years. 	<ul style="list-style-type: none"> – Prohibit additional NAS. – Permit certain tax and valuation services. – Set the NAS fee cap lower than 70%. – Establish stricter rules around permitted NAS.
Effective date:	<ul style="list-style-type: none"> – Transition period depends on the length of the audit firm’s tenure as at 16 June 2014. 	<ul style="list-style-type: none"> – NAS prohibitions apply to the first financial year end commencing after 17 June 2016.

MFR – How do the rotation rules apply to EU subsidiaries of a non-EU parent?

If a non-EU parent has subsidiaries in the EU, and any of these subsidiaries are EU PIEs in their own right – then irrespective of size, these PIE subsidiaries will have to rotate in line with the national law of the Member State where they are incorporated.

As a number of Member States have adopted different rotation rules locally, it is entirely possible that EU PIEs within a multi-national group will need to rotate at different times and according to different rules.

MFR – Do the MFR rules apply to non-EU subsidiaries of an EU parent?

If a PIE parent company in the EU has subsidiaries outside of the EU, then these subsidiaries are not covered by the PIE definition, because they are not '*governed by*' the law of an EU Member State. As such non-EU subsidiaries would not be impacted by the MFR rules.

If an EU PIE subsidiary within a multi-national group is required to rotate/ tender will that trigger the need for the whole group to tender/to rotate auditors?

No – there is no requirement for the whole multi-national group to tender or rotate. However, for purely practical reasons the EU parent may choose to rotate auditors of the entire group, including non-EU subsidiaries, in line with the law prevailing in the parent company's country of incorporation.

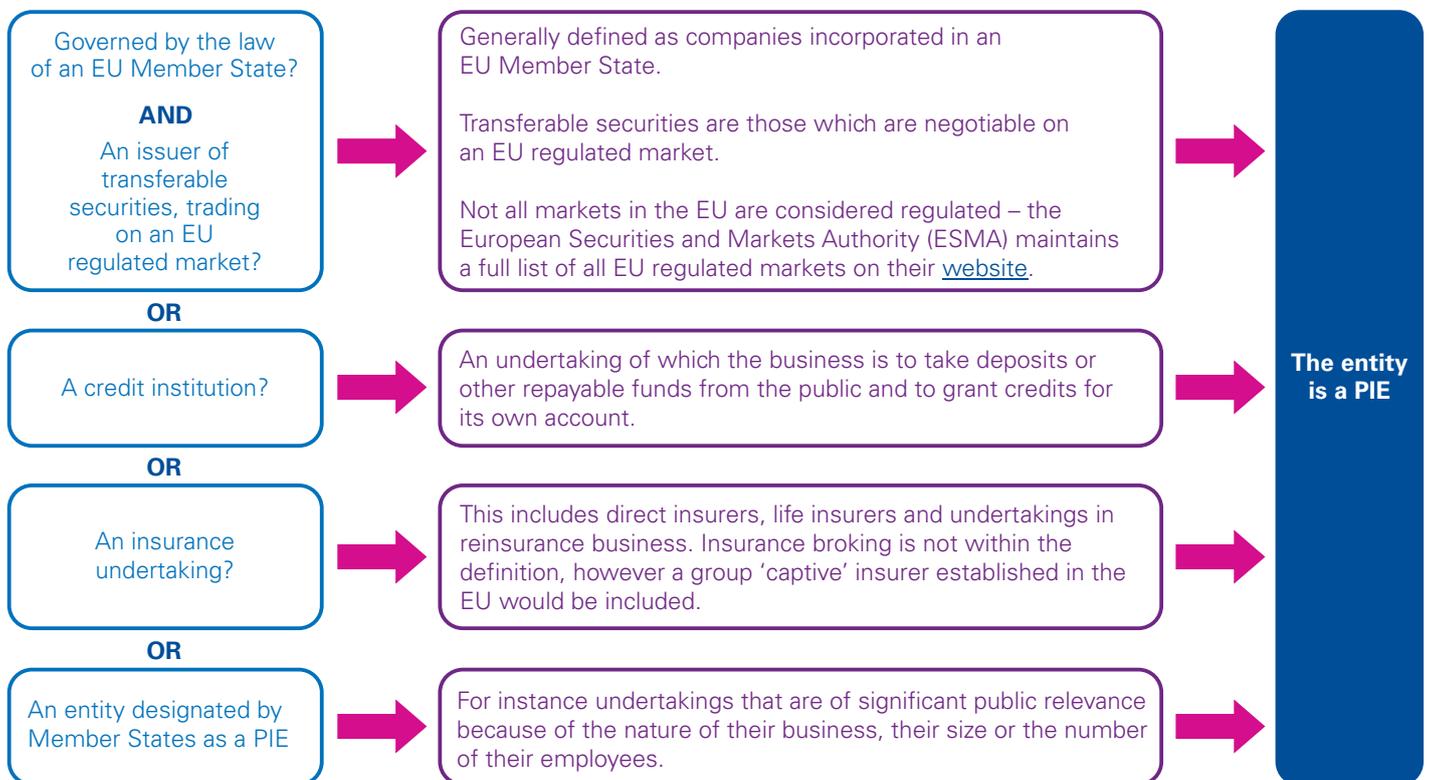
A dual listing within the EU and outside of the EU – is this an EU PIE?

Non-EU governed companies that are also listed on a regulated market¹ in the EU would not fall within the

1. https://registers.esma.europa.eu/publication/searchRegister?core=esma_registers_mifid_rma

Ask yourself ...

Is the entity a public interest entity (PIE²)?



2. See Article 2(13) of the Directive http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.158.01.0196.01.ENG

PIE definition and would not be required to rotate their statutory auditors.

For example a Jersey or Guernsey incorporated company with debt listed on a regulated market in the EU will not be a PIE as the Channel Islands are not a part of the EU.

Who do the NAS restrictions apply to?

The Regulation contains a list of prohibited NAS (see NAS Fact Sheet) that cannot be provided by the statutory auditor or its network, to a company that is an EU PIE, to the PIE's EU parent company(ies) or to the PIE's EU controlled undertakings. However, there are additional considerations for services provided by the network to controlled undertakings outside the EU as outlined on the next page.

How do the NAS restrictions apply to controlled undertakings incorporated outside the EU?

Another member firm of the statutory auditor's network (other than the auditor of the EU PIE itself), can potentially provide NAS included on the list of prohibited NAS to a controlled undertaking outside of the EU but only if the statutory auditor of the EU PIE can justify that the independence of their audit is unaffected.

However, there are still three types of services that are always deemed to affect independence of the statutory auditor of the EU PIE regardless of the nature of possible safeguards put in place. As such these three services are always 'absolute prohibitions' and can never be provided by members of the statutory auditor's network to controlled undertakings incorporated outside of the EU, regardless of where these services are provided.

The absolute prohibitions are as follows:

- Services that involve playing any part in the management or decision making of the audited entity (Article 5.1(b));
- Bookkeeping and preparing accounting records and financial statements (Article 5.1(c)); and
- 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 (Article 5.1(e)).

Further guidance is available in the [KPMG EU Audit Legislation FAQs](#). See the example Non-EU group structure chart on page 4.

Consider a non-EU bank or insurer with banking/insurance controlled undertakings in several EU countries. How do the EU NAS rules apply?

As each EU banking/insurance controlled undertaking will be an EU PIE, no member of the audit firm's network may provide prohibited NAS to each PIE nor any company in the direct ownership chain of that PIE (either upwards or downwards) if they are governed by EU law. The rules regarding 'absolute prohibitions' relating to controlled undertakings of the PIE outside the EU will also apply.

The EU prohibitions on NAS **do not** apply:

- To non-EU parent companies/group companies upstream from the EU PIE; nor
- To sisters of the EU PIE regardless of whether formed in the EU if they are not in the direct ownership chain of the EU PIE.

See the example Non-EU group structure chart.

How does the Regulation apply to branch offices?

EU branches of non-EU based credit institutions or insurance undertakings do not fall within the PIE definition.

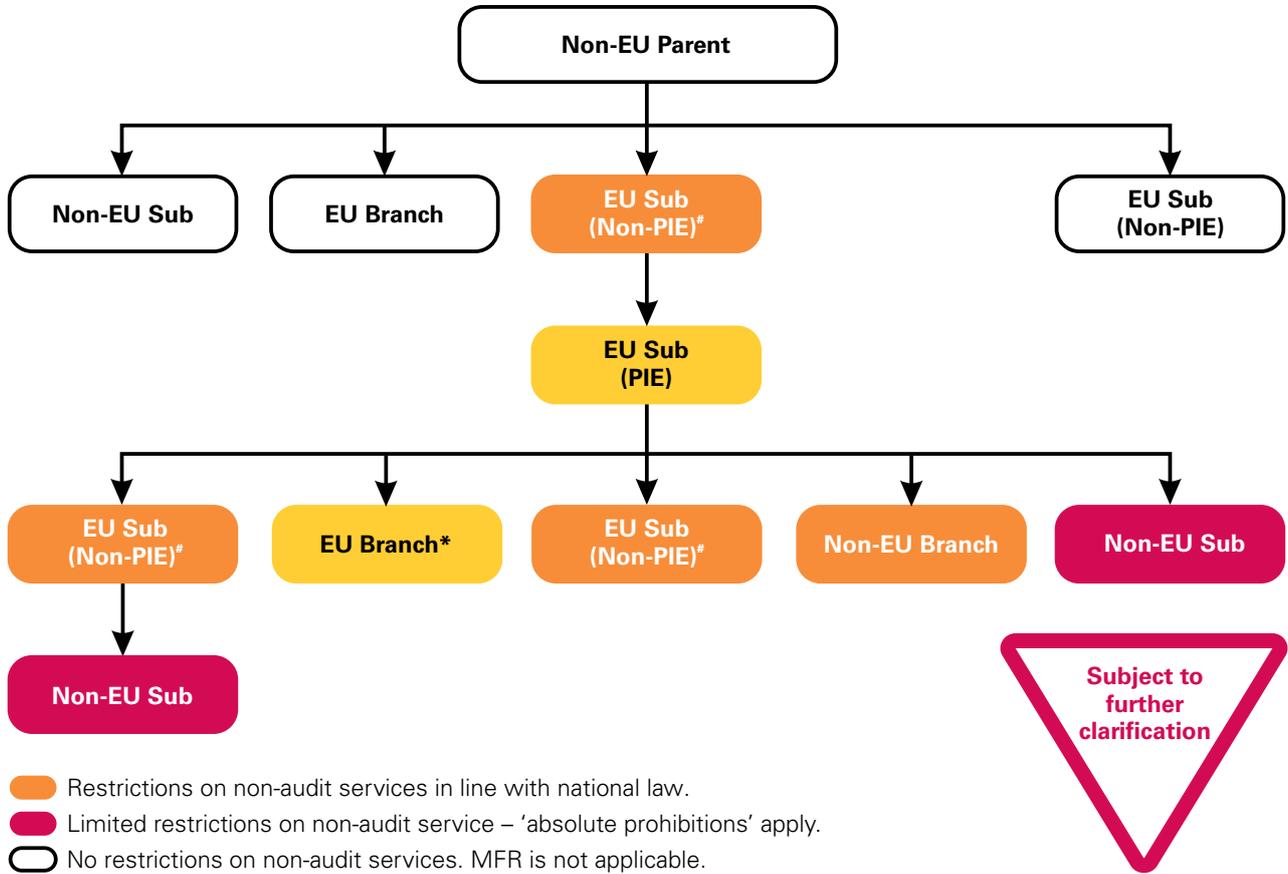
EU branches of an EU PIE are subject to all aspects of the Regulation as they form part of an EU PIE. The branch is required to follow the local requirements of the EU PIE as they form part of the PIE and are not separate legal entities.

Non-EU branches of an EU PIE would be caught in that the NAS prohibitions would apply equally to the branch inside/outside the EU as to the rest of the legal entity inside the EU.

Note there is still scope for Member States to designate additional PIEs which could bring branches within the national definition.

See the example Non-EU group structure chart on page 4.

Example non-EU group structure: For illustrative purposes only



- Restrictions on non-audit services in line with national law.
- Limited restrictions on non-audit service – ‘absolute prohibitions’ apply.
- No restrictions on non-audit services. MFR is not applicable.
- MFR applies and restrictions on non-audit services in line with national law.

* MFR only applies in this scenario when the EU Branch is also subject to a statutory audit. Restrictions on non-audit services in line with national law still apply.
 # Subject to Member State interpretation – consult your local KPMG contact.

Ask yourself ...

How many EU jurisdictions do I have a footprint in?
Do I have any branches that fall downstream of an EU PIE?

When do the NAS restrictions apply?

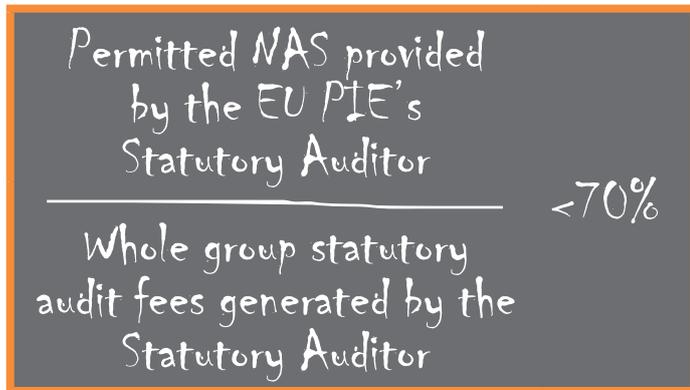
The restrictions on NAS apply to the first financial year beginning on or after 17 June 2016.

The statutory auditor’s network is prohibited from providing any of the ‘absolute prohibitions’ from this same point in time.

How does the ‘cooling-in period’ requirement apply to entities outside of the EU?

‘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.’ (Article 5.1(E) is the only prohibited NAS that cannot be provided by the auditor one year before the first period as statutory auditor (‘cooling-in period’). This service also constitutes one of the ‘absolute prohibitions’ which has an impact outside of the EU. However, it appears that the ‘cooling-in period’ requirement would not apply to entities outside of the EU.

Does the NAS fee cap have any extra-territorial effect?



The fee cap applies only to permitted NAS provided by the statutory auditor of the EU PIE in a given Member State to the EU PIE, its controlled undertakings and its parent entity.

Statutory audit fees generated by the EU PIE's statutory auditor for work performed for non-EU parent companies of the EU PIE and non-EU controlled undertakings of the EU PIE would be included in the calculation of group statutory audit fees.

The cap does not apply to the entire audit firm network.

Ask yourself ...

What is my current spend on NAS by the auditors both upstream and downstream from the EU PIE?

There are many Member State options – how do I know which rules will be applicable to my EU subsidiaries?

Each of the 28 EU Member States were required to transpose the legislation into country law by 17 June 2016. Until each Member State has completed this process, global multi-nationals will not have a complete picture of the new requirements and the impact to their European operations.

See our [KPMG interactive map](#) for information on how countries have implemented the Member State options.

Are similar laws and regulations being considered outside of the EU – for example, MFR exists in India?

Companies should also be aware that countries outside of the EU are considering, or may have already implemented, similar requirements.

For further information please see our [EU Audit Legislation FAQs](#) and [Interactive Map of Member State Legislation](#), and speak to your usual KPMG contact.



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Publication name: *EU Audit Reform – what you need to know: Fact sheet: The impact of the reforms beyond the EU*

Publication date: October 2016

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