KPMG

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EU audit reform – What you need to know

Fact sheet: Mandatory firm rotation for public interest entities and transition arrangements

The EU Audit legislation introduces additional requirements for EU public interest entities (PIEs[1]), including mandatory firm rotation (MFR). The key MFR provisions are as follows.

EU baseline measure[2]	**10-year mandatory audit firm rotation for all PIEs in the EU.**
Member State options available to:[3]	Extend the period once for up to a maximum further **10 years** where a public tendering process is conducted – to a **maximum term of 20 years**.
	Extend the period once for up to a maximum further **14 years** where there is a joint audit arrangement – to a **maximum term of 24 years**.
	Implement a **shorter rotation period**. For example, Italy has retained its existing rotation requirement of nine years.

When does a tender have to be performed in order to extend the initial 10-year period to 20 years?

The latest possible time for a tender to be performed is after the end of the initial engagement period of up to 10 years. However, in practice companies may decide to put the audit out to tender before the end of this period. Guidance on how to conduct a tender and evaluate external auditors is available in the KPMG Audit Committee Institute's handbook.[4]

To qualify for the 14-year extension, is a joint audit required throughout the initial 10-year period?

No, a company does not need to have a joint audit throughout the first 10-year period in order to qualify for an extension up to 24 years. However, a Member State would need to allow the extension in cases where a company decides to have a joint audit, and the company would be required to have a joint audit for the entire 14-year extended period.

1. See Article 2(13) of the Directive for a full definition: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.158.01.0196.01.ENG.
2. Article 17 of the Regulation.
3. See summary of all Member State options at: http://www.fee.be/index.php?option=com_content&view=article&id=1412&Itemid=106&lang=en.
4. https://www.kpmg.com/Ca/en/services/Audit/AuditCommittee/Documents/ACI-Audit-Committee-Handbook.pdf.

Are there any circumstances in which the company can extend beyond the MFR requirements?

At the request of the audited entity, the national regulators or supervisory authorities can extend the maximum term once for a further two years in 'exceptional circumstances' and only where there has been either a joint audit or a public tender.

How do the MFR rules apply cross-border where a group operates in many EU states, each with a different regime?

At a minimum, each EU PIE within the group will have to comply with the MFR rules applicable to the EU Member State in which it is based (i.e. principle of local law). However, branches of a PIE located in another EU Member State are required to follow the local requirements of the PIE as they form part of the PIE and are not separate legal entities.

How do the MFR rules apply to non-EU companies?

If a non-EU parent has controlled undertakings in the EU, and any of these controlled undertakings are PIEs in their own right, then the PIEs' controlled undertakings will have to rotate their statutory auditor in line with the national law of the Member State where they are incorporated.

If a PIE parent in the EU has non-EU controlled undertakings, then those undertakings are not caught by the PIE definition and therefore they are not required to rotate their auditor.

Do the new MFR requirements replace the need to rotate key audit partners?

No. There is still a requirement for key audit partners to rotate after a maximum of seven years, although a number of Member States require shorter partner rotation periods (this is also one of the Member State options). The regulation has extended the cooling off period from two years to three years.

If a company becomes a PIE – e.g. on a flotation – and has the same auditor before and after its PIE status change, does tenure as auditor before it became a PIE count towards the relevant MFR limits?

No – the period as auditor before the year in which the company becomes a PIE is not included in determining when the relevant limits are reached for the purpose of establishing which MFR transition rules apply.

If two PIE companies merge to create a new legal entity (also a PIE) and the same auditor is engaged before and after the merger, then what are the relevant time limits for MFR transition?

If a new legal entity is created because of the merger and is itself a PIE, then the audit tenure for MFR transition purposes generally starts to count from the date of creation of the new legal entity. However, legal advice may be required to assess the specifics of each case.

What are the transition rules for MFR?

There are specific MFR transition rules in Article 41 of the Regulation[5]. These are based on the length of the existing statutory auditor/client relationship as at 16 June 2014 and are outlined in the diagram below.

Transition measures for MFR (Regulation: Article 41)

Auditor tenure as 16 June 2014			
Tenure <11 years	**2 –12 years transition** – from 17 June 2016 MFR rules apply on expiry of the 10 year term.	***Options to extend if Member State allows***	
Example1: audit tenure commenced between ***June 2003–June 2006***	Example 1 – **expiry of 10 year term is 2016**; option to extend if Member State allows.	***17 June 2016***	***+10 years:*** *tender – 2026* / ***+14 years:*** *joint audit – 2030*
Example 2: audit tenure commenced in ***June 2009***	Example 2 – **expiry of 10 year term is 2019**; option to extend if Member State allows.	***June 2019***	***+10 years:*** *tender – 2029* / ***+14 years:*** *joint audit – 2033*
Tenure 11–20 years	**9 years transition** – from 17 June 2023 the auditor cannot be reappointed.	***17 June 2023***	
Tenure >20 years	**6 years transition** – from 17 June 2020 the auditor cannot be reappointed.	***17 June 2020***	

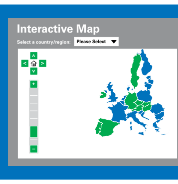
5. http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.158.01.0077.01.ENG.

What are the practical considerations for selection and management of professional advisers in light of this regulatory change?

All EU PIEs will be affected by EU audit 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.

Ask yourself ...	Immediacy and depth of the impact of the new rules		Considerations
How many EU PIEs are in the group?	Few	Many	The rules may affect more entities than first thought.
What is the extent of my global footprint?	Local (EU only)	Global	The rules may affect undertakings located outside of the EU.
What is the longevity of the current auditors as at 16 June 2014?	Low	High	This will affect all EU PIEs but auditor longevity and mergers and acquisitions drive the timing of rotation as we transition to the new rules.
What level of outsourcing activities or global contracts exist with audit firms? (other than current auditors)	Low	High	The type of service may limit the number of audit firms available to tender for the statutory audit.
Does my business require auditors with specialised skills?	General	Specialised	The expertise needed may limit the number of audit firms with the right skill set available to tender for the statutory audit.
Where are my EU PIE subsidiaries located? Are there cross border implications?	Known	Unknown	Differing rotation rules may create a patchwork of auditors in the group – audit coverage by the group auditor may become an issue.

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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