

Emerging Issues and Outreach**I. Emerging Issues**

1. The matters noted below are those that, after discussion, the Emerging Issues and Outreach Committee (EIOC) believes warrant consideration by the Board.
 - A. MG ROVER CASE
2. Background information about the MG Rover case was presented during the executive session of the December 2013 IESBA meeting as part of an initial briefing to the Board regarding the case (see Agenda Item 5-B). This information was also provided to the IESBA Consultative Advisory Group (CAG) at its March 2014 meeting along with a summary of the main findings in the UK Financial Reporting Council's (FRC's) tribunal report into the case and the possible implications of these findings.
3. The tribunal report raised several questions relating to the public interest and public interest entities (PIEs). The tribunal:
 - (a) Found that MG Rover was, although not listed, a "public interest company;"
 - (b) Found that every accountant should "consider the public interest when accepting any assignment" (whether or not in relation to a public interest company);
 - (c) Rejected Deloitte's contention that a corporate financier serves the public interest by properly advising his clients within the Code of Ethics of the Institute of Chartered Accountants in England and Wales (ICAEW Code); and
 - (d) Found that Deloitte was aware of the public interest and breached its obligations to consider the public interest before accepting or continuing the appointment.
4. The current IESBA Code includes a number of references to the public interest (see Appendix 1).
5. There are frequent references to the public interest issue in the tribunal report, but they do not conclusively, or consistently, set out exactly what Deloitte should have done to consider the public interest.
6. There are a number of comments within the report from the tribunal which could be taken to imply that the tribunal was interpreting the public interest obligation in ICAEW's Code in a very broad sense (see relevant extracts from the ICAEW Code in Appendix 2 and a summary of the FRC's interpretation in Appendix 3).
7. These comments include:
 - "...members ... owe duties not only to their clients or employers but also to the public. All have a duty to consider the public interest and its bearing on the work that they are doing and the potential or actual threats to their work.... We do not accept that, except in audit and reporting accountant work, the only duty that a member has is to his client provided that he is acting honestly and with integrity. It is this duty to consider the public interest that provides comfort to the client that matters are being dealt with properly and with integrity. It is however

something which might put a chartered accountant at a disadvantage in corporate finance and other matters as against other parties who are not members of the ICAEW.”

- “A corporate financier, [the respondent] said, provides support for commerce by giving best advice to his or her client, not by assuming the role of the market or regulators or government and deciding which bidder in a corporate transaction has the public interest on their side. We do not accept this to be the position. It suggests that the Respondents in the case of Project Platinum had no obligation to consider the public interest...”
 - “MG Rover was a public interest company ...In those circumstances the Respondents should have given consideration to the public interest when acting as they did and should have considered whether to accept or continue with their engagement in [the project]. They should have considered whether [the project] was in the public interest, their assessment should have been recorded in writing.”
8. The tribunal stated that “member firms, whether they are acting as auditors, corporate advisers or in any other capacity owe duties not only to their clients or employers but also to the public ... we [the tribunal] do not accept that the only duty that a member has is to his client provided that he is acting honestly and with integrity.”
 9. There appears to be a suggestion that in relation to one of the two projects (Project Aircraft) the engagement itself may have been appropriate at one stage but at some stage it became apparent that some of the assets of MG Rover were going to be used to benefit the Phoenix Four. It is not suggested that such a result would have been in any way illegal but the tribunal held that at that point “Deloitte should have declined to continue their engagement.” Deloitte has been given right to appeal the six (out of a total of 13) findings that relate to this project. The appeal is currently under consideration with a result not expected until the third quarter of 2014.
 10. The findings suggest that an accountant is under an obligation to consider the moral worth of a particular client or a particular transaction and is obliged to breach his contract when he decides a particular outcome is no longer in the public interest. This obligation apparently falls on every accountant but the tribunal does not explain how an accountant is to judge if he is in breach of this principle. A later decision on the appeal process by a lawyer commissioned by the FRC narrows this interpretation to ensuring that the relevant parties have the means to make their own informed decisions.
 11. In addition, the tribunal noted that “there is no evidence of the public interest having been considered adequately or at all.” However, guidance on record-keeping matters relating to the public interest is vague. The tribunal has assumed that since there is no evidence on the file to prove that the public interest had been considered, it must not have been considered.
 12. The ICAEW Code advises that “it may be in the best interests of the professional accountant to document the substance of the issue, the details of any discussions held, and the decisions made concerning that issue.”
 13. However, apart from audit-related considerations and setting out the basis of determining fees, the ICAEW Code does not, and never has, required the documentation of ethical considerations.
 14. Nevertheless, the report criticizes the lack of documentation in considering the public interest. This may suggest that, as far as the tribunal is concerned, the notion that no record means no action or consideration is no longer just applicable to audit.

15. The ICAEW Code makes documentation discretionary. However, the tribunal was arguing that the firm should have considered documentation on how the public interest has been considered “in this context.”
16. One of the tribunal's central contentions is that the main car company should have been considered to be a public interest entity (PIE). They cite, for example: “huge interest ...great support... from the public ... talk ...about the saving of a major car manufacturer...and large numbers of local jobs ... a great deal of political will...”
17. The ICAEW Code defines a PIE as a listed company or other entity deemed to be a PIE by law or regulation. Nevertheless the ICAEW Code does add (directly from the IESBA Code) that firms are encouraged to consider other entities with a wide range of stakeholders as PIEs. The tribunal was not applying a definition of a PIE, but stating that MG Rover was of public interest because of the wide range of stakeholders.
18. The ICAEW Code definition of a PIE is not strictly relevant as it relates only to assurance engagements. However, the tribunal is using the concept not to argue that a different set of rules should apply but that because the car company was a PIE, it should be regarded as a separate entity from the other companies owned by the Phoenix Four, on which Deloitte was also providing advice.
19. As a result of the MG Rover case, the ICAEW Ethics Committee is discussing the requirements within its Code on how to consider the public interest and what the public interest means for the individual accountants.
20. Staff understands that the principal argument against changing the ICAEW Code itself is that the current guidance on public interest is fit for purpose given the wide variety of circumstances, and any change would undermine the framework approach to ethical guidance. Ethical principles are subjective and unless a precise, rules-based approach is desired, there will inevitably be an element in which society's moral values will be relevant in deciding how fundamental principles are to be interpreted.
21. It is relatively straightforward to identify activity which would constitute an egregious breach of the public interest. However, in most cases, the degree to which the public interest may need to be elevated is highly judgmental.
22. Pursuant to the issues highlighted by the case, ICAEW is considering issuing guidance on:
 - (a) Recommending that its members consider whether there is a public interest aspect to their work (providing examples of suitable indicators);
 - (b) Drawing attention to the key relevant elements of the public interest framework; and
 - (c) Noting that if this indicates that there is more than one potential client, at least one of which has a public interest, then safeguards need to be applied such as proposing independent advice.

CAG Representatives' Comments

23. Among other matters, some CAG Representatives commented as follows:
 - There is a need to consider what the public interest means. The Public Interest Oversight Board has undertaken some work on the topic. It may also be necessary to go back to the

definition of a PIE. However, it is not advisable to make piecemeal changes to the Codes. Rather, the totality of the issue should be considered.

- There is a question as to whether individuals who are involved in a given transaction but who are not accountants (for example, lawyers) would be expected to consider the public interest.
- There may be merit in considering the case further given the potential for a regulator to make decisions based on the precedent it sets without a definition of the public interest being established in the Code.
- References to the public interest appear to be continually made now that the Code is very much based on the concept of the public interest. While the public interest would be difficult to define, there is a need to consider what can be done to better explain or frame it in a way that would be useful.
- There is a question as to whether the public interest would need to be considered if the transaction had been successful. The question was raised because, at initiation of the events, the Phoenix Four had been seen as saviors of MG Rover. Public interest concerns were only raised when it became apparent that the transaction ultimately had not been a success and had resulted in large job losses and questions being raised as to the UK Government's actions.
- There is a question as to whether one would wish the considerations to take on a political dimension, for example, if accountants are to be asked to consider what is unethical or not based on whether people are going to lose their jobs.

24. The PIOB observer at the meeting suggested consideration of whether the findings of the tribunal would have been different under the IESBA Code compared with under the ICAEW Code.

Matters for Consideration

As there is an appeal process ongoing, it is important not to debate the merits of the MG Rover case itself. IESBA members are asked for views on the following:

1. Are there any specific actions the Board should consider taking as a result of the decisions reached in this case as they pertain to defining what is in the public interest? Possible actions could include, for example, board consideration as to whether:
 - The concept of "public interest" is applicable only to audit and other assurance engagements or to other professional services provided by professional accountants.
 - Professional Accountants in Business (PAIBs) require guidance on what is expected from a PAIB as relates to the public interest.
2. Do public interest considerations only apply to PIEs or all entities?
3. Are there other specific matters that should be taken into consideration in further reflecting on the implications of the case, notably, whether the definition of a PIE should be revisited?

If the Board feels there are no actions or matters arising from the MG Rover case, the EIOC will consider the issue closed.

B. Aggressive Tax Avoidance

25. Much of the current tax regulations around the world were put in place at a time when value could be clearly attributed to each stage of a supply chain and the tax jurisdiction of the economic activity was predominantly the home market. In recent times, these lines have become blurred. A business does not require a physical presence in a country in order to operate and assets (such as people and capital) can be moved across international borders with ease. With goods and services being sold through complex supply chains, it is not always easy to identify where profit is created and whether a country is receiving its proper share of revenue. In addition, tax abatement or mitigation schemes, put in place by local governments or other public authorities to stimulate or encourage investment in specific regions or industries, are being exploited by large multinationals to lower their tax bill.
26. Companies engaging in aggressive tax avoidance justify their actions by pointing out that their actions are not illegal and they have a duty to shareholders to minimize their tax bills.
27. G20 countries are working together on how to address the aggressive tax avoidance issue and are aiming for an automatic¹ exchange of information (among G20 members) on tax-related matters by the end of 2015.
28. Legal tax planning by businesses should in principle be accepted as a legitimate means of minimizing expenses in the same way that they would be expected to reduce any other business cost to maximize profits and shareholder value. It is not unreasonable for corporations to make use of low tax rates, or other tax benefits, which countries offer to compete for foreign investment. However, concerns are raised when companies appear to be exploiting loopholes created by outdated tax laws to avoid paying the appropriate amount of tax. In this regard, prominent individuals, including but not limited to politicians, have raised concerns over the role of accountants in assisting firms as they pursue aggressive tax avoidance. Mr. Michael Izza, the ICAEW's chief executive officer, has in particular taken a strong stance on the role of accountants in assisting companies engaging in aggressive tax avoidance. He has stated on his blog the following:

"As ICAEW Chartered Accountants, our code of ethics, which is the foundation for how we behave, is clear that we must do nothing to bring our profession into disrepute. Any members involved in aggressive tax planning... are doing exactly that, and are risking the reputation of the vast majority of our members who provide valuable and honest support to businesses and individuals and who want nothing to do with such (aggressive tax avoidance) schemes.

ICAEW Chartered Accountants should be trusted to abide by our Code of Ethics... any ICAEW Chartered Accountants who are engaged in (aggressive tax avoidance) schemes... need to look at themselves in the mirror and ask – am I upholding the honor and reputation of ICAEW Chartered Accountants and am I seen to be doing that? If the answer is no then they need to ask themselves whether they want to belong to our profession or not?"

¹ Automatic exchange of information involves the systematic and periodic transmission of "bulk" taxpayer information by the source country to the residence country concerning various categories of income (e.g. dividends, interest, royalties, salaries, pensions, etc.) It can provide timely information on non-compliance where tax has been evaded either on an investment return or the underlying capital sum even where tax administrations have had no previous indications of non-compliance.

29. IESBA members should note that other accountancy bodies (notably CPA Canada and the UK ACCA) are presently considering the need to provide their members with additional guidance on this topic.

CAG Representatives' Comments

30. A Representative noted that the matter of aggressive tax avoidance is potentially one of vast scope and complexity involving, among other matters, legislation from different jurisdictions, cross border interactions and numerous players. It was also noted that within the European Commission, an expert group had been set up to consider the matter. It was felt that approaching the matter from a high level perspective would be necessary because of the need to understand the issues from varied angles, and that developing a solution ultimately would be a complex endeavor.
31. Another Representative questioned whether accountants would be liable if they do not provide the best possible tax advice to their clients.
32. It was also noted that the tax advice being provided to companies engaging in aggressive tax avoidance was not illegal and governments consistently use tax incentives as a method of luring companies to invest in their jurisdictions.

Matter for Consideration

4. Do IESBA members believe developments in this area warrant specific actions by the Board, other than ongoing monitoring? If so, what should these be (e.g., inclusion in the strategic plan)?

C. Other Matters for Consideration

(a) European Union (EU) Audit Reform

33. On December 17, 2013, the EU Council announced that a preliminary agreement had been reached with the European Parliament on the framework of the EU audit reform. The EU Council and European Parliament have co-decision making power on EU reforms. On December 18, 2013, the Committee of Permanent Representatives approved this agreement.
34. The current preliminary approval is to adopt the legislation for non-PIEs as a directive and for PIEs as a regulation. The EU Parliament and the EU Council will take a final vote on adoption of the legislation in the 2nd quarter of 2014. Assuming the vote is for approval of the proposed reforms, a process of translating the reforms into the various languages of the EU member states will commence. The translations will be incorporated within the official text of the EU. This process is expected to be completed by early Q3 2014, after which member states have two years to adopt the legislation. It is thus expected that the reforms will come into force in the second half of 2016.
35. EU Key Audit Partner (KAP) rotation requirements currently dictate a seven-year engagement period and three-year cooling-off period, with individual states given the option to decrease the maximum permitted engagement period. Firm rotation requirements must be overlaid with this. It should be noted that while the UK operates a bifurcated rotation system, with Lead Audit Engagement Partners and Quality Control Review Partners serving a longer cooling-off period, there is no mandatory firm rotation requirement in the UK.
36. Under the proposed reforms (which are applicable only to PIEs), to appoint an auditor a tendering process is required. At least two firms must be tendering and a recommendation must be obtained

from those charged with governance as to who they prefer. The minimum time that a firm must serve on an audit is one year, though member states have discretion to require longer period. Similarly, the maximum time an auditor can serve is 10 years, though individual states have discretion to require a shorter period. Implementation is thus likely to be patchwork throughout the EU.

37. Audit firms will be required to rotate every 10 years but public listed companies will be able to extend the audit tenure for another 10 years upon voluntary tender. In the case of joint audits, the extension period will be up to 14 years, hence a 24-year maximum period is a possibility. In extraordinary circumstances, this could be further increased by up to two years.
38. The implementation of the new audit requirements will be staggered. Firms will have six years to implement the requirements if the auditor had been in place for more than 20 years, nine years to implement if the auditor had been in place for between 11 and 20 years and must follow the new rules from the date they come into force if the auditor has been in place for less than 11 years.
39. Rotation requirements for senior personnel have also been mandated, but it has not been defined who the term “senior personnel” would encompass.
40. A rotated partner will also not be permitted to have interaction with the audit client or audit team during his or her cooling-off period. However, no indication has been provided as to the extent that this restrictions needs to be applied.
41. The agreement also proposes a 70% cap on the fees earned for non-audit services rendered to a PIE audit client. Non-PIEs are dealt with through guidance on threats and safeguards. Thus, an audit firm would not be able to tender for non-audit services worth more than 70% of the audit fees paid over any three year period, though there is no indication on how to calculate this and approval is required on a case by case basis.
42. A long list of prohibited services has been devised. While under the IESBA Code a degree of leeway is permitted under materiality thresholds, under the EU reforms, a prohibited service is entirely prohibited. Member states will have the right to allow some tax and valuation services to be provided if they are immaterial and have no direct effect on the audited financial statements. Within the legislation, there is still room for member states to diverge on major issues such as the list of prohibited non-audit services and the duration of the rotation.
43. According to Ernst & Young, the estimated cost to the EU economy of rotating the auditors of more than 30,000 PIEs could be more than €16bn (\$22bn).
44. This measure aims at limiting risk derived from conflicts of interest, when auditors are involved in decisions impacting the management of a company. It would also limit substantially the “self-review” risks for the auditors.
45. Appendix 4 sets out Commissioner Michel Barnier’s reaction to the audit reforms and provides additional details on the reforms.
46. The EIOC noted that at the June 2012 IESBA meeting, the Board had considered the arguments for and against mandatory firm rotation or tendering on a “comply or explain basis.” The Board had concluded that there was insufficient evidence for it to establish a formal position on either approach. The Board had therefore agreed to closely monitor the developments in the EU and other parts of the world, but at the same time to review the long association provisions in the Code, particularly with respect to partner rotation, to ensure that they continue to be robust.

47. In addition to monitoring the developments within the EU, Board leadership has been actively reaching out to leadership within the EC to seek to raise awareness and recognition of the Code as a leading set of ethical standards for the global profession.
48. With respect to the EU agreement in the area of non-audit services, IESBA staff has also committed to gathering an understanding of the nature and extent of differences between the agreed provisions in the EU text and the relevant provisions in the Code.

Matter for Consideration

5. IESBA members are asked if the EU developments concerning audit reform warrant specific actions by the Board other than those noted above and any considerations by the Long Association and Non-Assurance Services task forces as part of their projects.

If so, what should these actions be?

(b) Other Developments

49. CAG Representatives were invited to advise of international developments of which they are aware that might merit Board consideration. No specific matters were noted.

Matter for Consideration

6. Are there other developments internationally that members believe the Board should consider as part of its Emerging Issues initiative?

II. Outreach

50. Board leadership and other representatives have already been active in undertaking outreach activities since the beginning of the year. For information, the year-to-date outreach activities and those that have been scheduled for later in the year are presented in Agenda Item 5-C.
51. CAG Representatives had no immediate suggestions for possible outreach opportunities for the Board with their member organizations, but were invited to reflect on the matter and to advise staff should such opportunities be identified.

Matter for Consideration

7. IESBA members are asked for any comments on the outreach activities presented in Agenda Item 5-C and to advise of any further opportunities for outreach that the Board could explore.

Appendix 1

Key References to “Public Interest” Included in the IESBA Code

The IESBA Code includes the following key references to the concept of public interest:

1. Accepting responsibility to act in the public interest as a distinguishing mark of the accountancy profession:

A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. Therefore, a professional accountant's responsibility is not exclusively to satisfy the needs of an individual client or employer. [Paragraph 100.1]

2. A requirement to comply with the Code to serve the public interest:

In acting in the public interest, a professional accountant shall observe and comply with this Code. If a professional accountant is prohibited from complying with certain parts of this Code by law or regulation, the professional accountant shall comply with all other parts of this Code. [Paragraph 100.1]

3. The conceptual framework approach assisting professional accountants in acting in the public interest:

The conceptual framework approach assists professional accountants in complying with the ethical requirements of this Code and meeting their responsibility to act in the public interest. [Paragraph 100.6]

4. When a professional accountant should consult a member body or regulator, if an outcome may not be in the public interest

When a professional accountant encounters unusual circumstances in which the application of a specific requirement of the Code would result in a disproportionate outcome or an outcome that may not be in the public interest, it is recommended that the professional accountant consult with a member body or the relevant regulator. [Paragraph 100.11]

Appendix 2

Extracts from the ICAEW Code of Ethics

Approach, Scope and Authority

Professional accountants have a responsibility to take into consideration the public interest and to maintain the reputation of the accountancy profession. Personal self-interest must not prevail over those duties. This Code helps professional accountants to meet these obligations by providing them with ethical guidance.

General application of this code part A

100.1

A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. Acting in the public interest involves having regard to the legitimate interests of clients, government, financial institutions, employers, employees, investors, the business and financial community and others who rely upon the objectivity and integrity of the accounting profession to support the propriety and orderly functioning of commerce. This reliance imposes a public interest responsibility on the profession. Professional accountants shall take into consideration the public interest and reasonable and informed public perception in deciding whether to accept or continue with an engagement or appointment, bearing in mind that the level of the public interest will be greater in larger entities and entities which are in the public eye.

Therefore, a professional accountant's responsibility is not exclusively to satisfy the needs of an individual client or employer. In acting in the public interest, a professional accountant shall observe and comply with this Code. If a professional accountant is prohibited from complying with certain parts of this Code by law or regulation, the professional accountant shall comply with all other parts of this Code.

100.6

The circumstances in which professional accountants operate may create specific threats to compliance with the fundamental principles. It is impossible to define every situation that creates threats to compliance with the fundamental principles and specify the appropriate action. In addition, the nature of engagements and work assignments may differ and, consequently, different threats may be created, requiring the application of different safeguards. Therefore, this Code establishes a conceptual framework that requires a professional accountant to identify, evaluate, and address threats to compliance with the fundamental principles. The conceptual framework approach assists professional accountants in complying with the ethical requirements of this Code and meeting their responsibility to act in the public interest. It accommodates many variations in circumstances that create threats to compliance with the fundamental principles and can deter a professional accountant from concluding that a situation is permitted if it is not specifically prohibited.

100.11

When a professional accountant encounters unusual circumstances in which the application of a specific requirement of the Code would result in a disproportionate outcome or an outcome that may not be in the public interest, it is recommended that the professional accountant consult with ICAEW or the relevant regulator.

Appendix 3

Summary of FRC's Interpretation of "Considering the Public Interest"

In considering the allegations against Deloitte and Einollahi, the Executive Counsel to the FRC's Accountancy and Actuarial Discipline Board considered what could reasonably be expected of a member of the ICAEW (be it a firm or an individual) when considering the public interest.

The Counsel believed that it is not accurate that the only duty a member has is to act honestly and with integrity to a client. It was of the view that a member must meet this duty while also considering the effects of their actions on the public interest. It therefore argued that a member should take into consideration the public interest, and a reasonable and informed public perception, when deciding whether to accept or continue with an engagement, bearing in mind that the level of public interest will be greater in large enterprises and public interest entities².

It also believed that this is not confined to audit work and that the public interest is still relevant in corporate finance work. It felt that if this were not the case, principles and statements in the ICAEW Code of Ethics would have specifically excluded corporate finance work or stated that consideration of the public interest is specific only to audit work. It believed that the provision concerning consideration of the public interest in the ICAEW Code is a "statement of general application" in any role that an accountant may take.

The Counsel took the view that the term public interest extends to the concern of clients, government, financial institutions, employers, employees, investors, the business and financial community and others who rely upon the objectivity and integrity of the accounting profession to support the propriety and orderly functioning of commerce.

² MG Rover should have been considered a public interest entity by Deloitte and Einollahi as it was a sizeable manufacturer, it employed large numbers of people in the West Midlands, it sustained much of the local economy and members of parliament discussed its future when BMW chose to sell it to PVH. The fact the MG Rover was privately owned under PVH does not imply that the public interest can be ignored or discounted.



EUROPEAN COMMISSION

MEMO

Brussels, 17 December 2013

Commissioner Michel Barnier welcomes provisional agreement in trilogue on the reform of the audit sector

I welcome the agreement reached this morning between the European Parliament and EU Member States on the reform of the audit sector. This is a first step towards increasing audit quality and re-establishing investor confidence in financial information, an essential ingredient for investment and economic growth in Europe.

Although less ambitious than initially proposed by the Commission, landmark measures to strengthen the independence of auditors have been endorsed, particularly in the auditing of financial institutions and listed companies. This will ensure that auditors will be key contributors to economic and financial stability.

With the agreement, audit firms will be required to rotate every 10 years. Public interest entities will only be able to extend the audit tenure once, upon tender. Under this measure, joint audit will also be encouraged. Despite the extension of the rotation period, this principle will have a major impact in reducing excessive familiarity between the auditors and their clients and in enhancing professional skepticism.

The new rules also provide innovative tools to limit the risk of conflict of interest. To avoid the risk of self-review, several non-audit services are prohibited under a strict 'black list', including stringent limits on tax advice and on services linked to the financial and investment strategy of the audit client. In addition, a cap on the provision of non-audit services is introduced.

Taken together, the agreed measures will considerably strengthen audit quality across the European Union. In this regard, I particularly welcome the agreement on the harmonization of the international standards on auditing (ISAs).

On the cooperation between audit supervisory authorities, I regret that ESMA has not been endorsed as the core structure for coordination but I am pleased that it has been granted an initial mandate on international cooperation.

I congratulate the European Parliament, in particular the Rapporteurs Sajjad Karim and Kay Swinburne and the shadow Rapporteurs the Council, and successive EU Presidencies (Denmark, Cyprus, Ireland and Lithuania) for this major achievement.

It is now high time for auditors to meet the challenges of their role – a societal role.

I trust that once final details are reflected in the text and formally endorsed by the College, co-legislators will also approve the text in coming weeks.

Background

The financial crisis highlighted serious shortcomings in the stability of the EU economic and financial system. Auditors play an important societal role by providing stakeholders with an accurate reflection of the veracity of company's financial statements. However, a number of banks were given clean bills of health despite huge losses from 2007 onwards. In relation to the real economy, inspection reports from the Member States revealed lack of professional skepticism by auditors, misstatements and a lack of fresh thinking in the audits of major companies because of the average long-lasting relationship between the auditor and their clients.

Taken all together, the agreed measures ensure that auditors will be key contributors to economic and financial stability through increased audit quality, stronger independence requirements and more open and dynamic EU audit markets.

The key elements of the new rules include:

1. A clarified societal role for auditors

- **Increased audit quality:** In order to reduce the 'expectation gap' between what is expected from auditors and what they are bound to deliver, the new rules will require auditors to produce more detailed and informative audit reports, with a required focus on relevant information to investors.
- **Enhanced transparency:** Strict transparency requirements will be introduced for auditors with stronger reporting obligations vis-à-vis supervisors. Increased communication between auditors and the audit committee of an audited entity is requested.
- **Better accountability:** The work of auditors will be closely supervised by audit committees, whose competences are strengthened. In addition, the package introduces the possibility for 5% of the shareholders of the company to initiate actions to dismiss the auditors. A set of administrative sanctions that can be applied by the competent authorities is also foreseen for breaches of the new rules.

2. A strong independence regime

- **Mandatory rotation of audit firms:** Audit firms will be required to rotate after an engagement period of 10 years. After maximum 10 years, the period can be extended by up to 10 additional years if tenders are carried out, and by up to 14 additional years in case of joint audit, i.e. if the company being audited appoints more than one audit firm to carry out its audit. A calibrated transitional period taking into account the duration of the audit engagement is foreseen to avoid a cliff effect following the entry into force of the new rules.
- **Prohibition of certain non-audit services:** Audit firms will be strictly prohibited from providing non-audit services to their audit clients, including stringent limits on tax advice and services linked to the financial and investment strategy of the audit client. This aims to limit risk of conflicts of interest, when auditors are involved in decisions impacting the

management of a company. This will also substantially limit the 'self-review' risks for auditors.

- **Cap on the provision of non-audit services:** To reduce the risks of conflicts of interest, the new rules will introduce a cap of 70% on the fees generated for non-audit services others than those prohibited based on a three-year average at the group level.

3. A more dynamic and competitive EU audit market

- **A Single Market for statutory audit:** The new rules will provide a level playing field for auditors at EU level through enhanced cross-border mobility and the harmonization of International Standards on Auditing (ISAs).
- **More choice:** In order to promote competition, the new rules prohibit restrictive 'Big Four only' third party clauses imposed on companies. Incentives for joint audit and tendering will be introduced, and a proportionate application of the rules will be applied to avoid extra burden for small and mid-tier audit firms. Tools to monitor the concentration of the audit market will be reinforced.
- **Enhanced supervision of the audit sector:** Cooperation between national supervisors will be enhanced at EU level, with a specific role devoted to the European Markets and Securities Authority (ESMA) with regard to international cooperation on audit oversight.

The political agreement reached this morning is subject to technical finalization and formal approval by the co-legislators.

For more information

http://ec.europa.eu/internal_market/auditing/reform/