



Maximum duration of the audit engagement

Preliminary remarks.

Articles 17 and 41 of the Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 contain specific requirements regarding statutory audit of public-interest entities (hereinafter, Regulation) aimed at addressing the familiarity threat and reinforcing the independence of statutory auditors and audit firms.

Recital 21 of the Regulation states that:

“In order to address the familiarity threat and therefore reinforce the independence of statutory auditors and audit firms, it is important to establish a maximum duration of the audit engagement of a statutory auditor or an audit firm in a particular audited entity. In addition, as a means of strengthening the independence of the statutory auditor or the audit firm, reinforcing professional scepticism, and increasing audit quality, this Regulation provides for the following alternatives for an extension of the maximum duration: regular and open mandatory retendering or the appointment of more than one statutory auditor or audit firm by public-interest entities. Also, the involvement of smaller audit firms in these measures would facilitate the development of the capacity of such firms, thus broadening the choice of statutory auditors and audit firms for public-interest entities. An appropriate gradual rotation mechanism should also be established with regard to the key audit partners carrying out the statutory audit on behalf of the audit firm. It is also important to provide for an appropriate period within which such statutory auditor or audit firm may not carry out the statutory audit of the same entity.”

This document is intended for auditors and audit firms, audit committees, oversight bodies, professional bodies, public interest entities (hereinafter, PIES), and other stakeholders and includes the guidelines adopted by the CEOB on the matter of duration of the audit engagement.

The guidelines provide for a minimum standard in order to give orientation and are non-binding. However, Member States are encouraged to implement the guidance in their respective jurisdictions to ensure a consistent approach across the European Union (hereinafter, EU). The guidelines for application are limited to the European legislation and must be adapted, if necessary, to national specificities that derive from the options foreseen in the Regulation. It is also the reason why they do not contain examples. Above-mentioned national specificities cover the following aspects:

- the minimum duration of the audit engagement can be longer than 1 year,
- the maximum duration of the audit engagement can be shorter than 10 years,
- the maximum duration of the audit engagement can be increased up to 20 years in case of public tendering once the initial maximum duration of 10 years or shorter is finished,
- the maximum duration of the audit engagement can be increased up to 24 years once the initial maximum duration of 10 years or shorter is finished, if more than one statutory auditor or audit firm has been simultaneously engaged, and

- the participation of the key audit partners responsible for carrying out a statutory audit can be ended earlier than seven years from the first financial year they acted as key audit partners.

When applying the guidelines, it is important to give due consideration to the underlying intention and spirit of Articles 17 and 41 of the Regulation to address the familiarity threat and reinforce independence and to ensure that the provisions are applied in a non-abusive way.

This note, drawn up by the CEAOB, is without prejudice to the Q&As published by the European Commission.

Frequently asked questions.

A) TOPICS RELATED TO ARTICLE 17 DURATION OF THE AUDIT ENGAGEMENT.

1. How to calculate the duration of the audit engagement? How has the network of the auditor or audit firm to be considered in the duration of the audit engagement?

The duration of the audit engagement is to be calculated as from the first financial year covered in the audit engagement letter in which the statutory auditor or audit firm (hereinafter, auditor) has been appointed for the first time to carry out consecutive statutory audits of the same PIE.

Following the literal interpretation of Article 17.8, this duration will be interrupted either when the auditor stops carrying out the statutory audit to the PIE or when the entity no longer fulfills the PIE condition. If the duration of the engagement is interrupted, the calculation will start again and not continue after the auditor is reappointed or after the entity qualifies again as a PIE, except – where applicable – in the cases that the audit firm is acquired or merged with another audit firm that continues to carry out the statutory audit service to that entity. (See question 8).

If more than one auditor is appointed the calculation shall be applicable for each auditor, separately.

The maximum duration of the audit engagement is applicable only for the individual PIE and the auditor and does not affect any other entities of the network. However, after the expiry of the maximum duration of the engagement, neither the auditor nor a member of their network within the Union shall undertake the statutory audit of the same PIE within the following four-year period.

With regard to both, calculation of the maximum duration and cooling-off-period, national competent authorities are encouraged to closely monitor compliance by auditors with the intention and spirit of the rotation and cooling off requirements, within the boundaries set by national legislation. This includes focusing on auditors, audit firms or networks that might be part of a legal construction which might aim at avoiding these obligations.

However, considering the spirit and the purpose of the Regulation to avoid the familiarity threat when implementing the rotation requirements, it is highly recommended to consider that if an auditor stops providing audit services to the PIE for a period shorter than four years (so called “cooling-off period”) and is appointed again to provide audit services to the same PIE after that interruption, the calculation of the maximum duration would not restart. Instead, the number of years during which the auditor has been providing audit services to the PIE prior to the interruption would be added to the years of provision of audit services to the same PIE by the same auditor after the interruption.

2. How is the minimum duration of the engagement applied?

The duration of the initial audit engagement is one year; or more in cases where the Member State has decided to prolong the initial duration based on the option included in Article 17.2.a) of the Regulation. Such period should be regarded as the reference period for the initial appointment of the statutory auditor or audit firm.

However and despite this initial appointment, the auditor or the audited entity can terminate the contractual relationship before the end of that period on proper grounds, as stated in Article 38 of the Directive 2006/43/EC as amended by Directive 2014/56/EU (hereinafter, Directive), including unexpected incompatibilities that impaired independence or other circumstances foreseen in the respective Member State legislation.

3. How is the duration of the audit engagement implemented in the case of a group audit?

The maximum duration of the statutory audit engagement shall be calculated individually for entities, located within the EU, that are considered PIEs, in accordance with Article 2.13 of the Directive. It does not apply to a group of undertakings as a whole nor to the parent undertaking, or to the subsidiaries within a group if they do not qualify as PIE. Each PIE is subject to the rules governing rotation in the Member State where it is located. If the parent undertaking is required to rotate the auditor, this would not require the rotation of the auditor of the subsidiaries unless the maximum duration of their respective engagements has elapsed.

4. Which are the conditions for the extension of the maximum duration of 10 years or less?

- a) Maximum duration up to 20 years in case of public tendering.

The option only applies if provided by national legislation of the relevant Member State. For those cases, the Regulation requires that the public tendering has to take effect upon the expiry of the initial maximum duration of 10 years or less.

The total duration can be extended to a maximum of 20 years, irrespective of the initial maximum duration of the audit engagement.

- b) Maximum duration up to 24 years in case of joint audit.

If a Member State has decided to use the joint audit option for extending the engagement period up to the maximum period of 24 years as foreseen in the Regulation, irrespective of the initial maximum duration of the audit engagement, more than one statutory auditor or audit firm has to be simultaneously engaged and the statutory audit results have to be presented in a joint audit report as referred to in Article 28.3 of the Directive.

The calculation of the maximum duration of the audit engagement shall be performed for each auditor separately and considering that after the initial maximum duration of 10 years has elapsed for an auditor (either in a solo scenario or in a joint audit) the condition to extend the maximum duration is that more than one statutory auditor is appointed.

- c) Extension for a further engagement of no longer than two years in exceptional cases.

In exceptional and duly justified cases, the PIE may request the national competent authority to grant only one extension, that may be up to 2 years, to reappoint the statutory auditor.

The extension for exceptional cases may be applied irrespective of the applicable maximum duration of the audit engagement, provided that the conditions of Article 17.4 have been met, that is, a public tendering following Article 16.2 to 16.5 of the Regulation has to be organized (except in the case of PIEs exempted by Article 16.4 of the Regulation) or more than one statutory auditor has to be simultaneously engaged, provided that, in this latter case, the statutory audit results are presented in a joint audit report as referred to in Article 28.3 of the Directive.

Since the financial statements are prepared, audited and approved by reference to a financial year but necessarily after the end of that financial year, the mention to the “two years” period for the extension should be understood as referred to 2 financial years and thus covering audit services provided by reference to such financial years but delivered after the end of those periods.

It is always up to the national competent authority, to decide on requests for extension and on the timing of the decision on a case-by-case basis, to the extent permitted by the respective legislation.

5. When does an entity become a PIE?

For the purpose of the Directive and the Regulation, entities are PIEs from the moment they fulfil the criteria of a listed company, a credit institution or an insurance undertaking set out in EU law. In practice this means, for example, that a listed company qualifies as a PIE from the moment its securities are admitted to trading on a regulated market in the EU, regardless when it was defined as a PIE under EU law.

In addition, Member States may designate other entities as PIEs under national legislation. Such entities are to be considered PIEs when they fulfil the criteria set by the Member State.

In the particular case of an entity that qualifies as a PIE during the course of a financial year, for example, due to the admission of its securities on a regulated market, the calculation of the maximum duration of the audit engagement should start the first year the audited entity was a PIE at the time of the reporting date, this is the closing date of the financial statements.

6. What are the conditions for the rotation of the key audit partner? Can key audit partners after their cessation become engagement quality control reviewers for the same audit engagement? Are the engagement quality control reviewers required to rotate?

Article 2.16 of the Directive defines key audit partners as follows:

- A) The statutory auditor(s) designated by an audit firm for a particular audit engagement as being primarily responsible for carrying out the statutory audit on behalf of the audit firm; or
- B) In the case of a group audit, at least the statutory audit at the level of the group and the statutory auditor(s) designated as being primarily responsible at the level of material subsidiaries; or
- C) The statutory auditor(s) who sign(s) the audit report.

The key audit partner shall cease his or her participation in the statutory audit of the audited entity not later than seven years from the date of the appointment. Years of involvement of the key audit partner in the audit before the entity qualified as a PIE are not required to be included.

Member States may apply stricter terms for the cessation of the key audit partner.

The key audit partner shall not participate again in the statutory audit of the audited entity before three years have elapsed following his or her cessation.

In those Member States where it is not mandatory or subject to professional self-commitment, it is also highly recommended as a good practice that the key audit partner is not appointed as engagement quality control reviewer during the cooling-off period, as it could impair its objectivity to perform the responsibilities laid out in Article 8 of the Regulation due to a high familiarity threat.

For the reasons mentioned in recital 21 of the Regulation, in those Member States where the rotation of the engagement quality control reviewer is not mandatory or self-committed, such rotation is also recommended as a good practice, with the same maximum terms as for key audit partners.

7. Who are the persons within the audit firm that need to rotate on a gradual basis?

Most senior personnel involved in the statutory audit need to rotate on a gradual basis, according to Article 17.7 of the Regulation. They should be identified by the auditors, according to the professional categories established by them and according to the assignment of personnel to each audit engagement. Nevertheless, most senior personnel includes, at least those who – not being the key audit partners and engagement quality control reviewers – participate, within the audit team, in the direction, review or supervision of the audit engagement and the members of the audit team who are registered as statutory auditors.

8. How do the mergers and acquisitions affect the calculation of the maximum duration of the audit engagement?

The second subparagraph of Article 17.8 of the Regulation aims at preventing the circumvention of rotation requirements. Disregarding changes of the form of the auditor's legal entity following mergers or acquisitions the focus must be placed on the economic or actual continuity of the auditor in substance. This approach ensures the effectiveness of EU Law and achieves the rationale of the rotation requirements, that is, the promotion of the independence and the avoidance of conflicts of interest derived from the familiarity threat. This rationale is also consistent with the approach of substance over form, according to which the economic substance and its concrete effects precedes the formal legal design (of previous mergers/acquisitions).

Therefore, the duration of the engagement in case of mergers and acquisitions of audit firms should count from the original audit engagement carried out by one of the merged audit firms, that is, regardless the effect of the merger or as if the merger has not taken place.

In case of a merger of a PIE with (an)other entity/ies, if the auditor of the absorbent entity or the new entity created after the merger was the auditor of any of the PIEs involved in the merger, the duration of the engagement should count from the original audit engagement of the PIEs involved in the merger. The same criteria will be applicable to acquisitions, demergers and other changes in ownership structure.

However, in the event of uncertainties in the context of such restructurings, auditor shall immediately report such uncertainties to the national competent authority, which shall discuss and ultimately determine the relevant date of the beginning of an audit engagement for the maximum duration of a given audit engagement on a case-by-case basis and by considering the approach of substance over form.

This applies both to auditors and audit clients.

B) TOPICS RELATED TO ARTICLE 41 TRANSITIONAL PROVISIONS.

9. How do the transitional provisions of Article 41 of the Regulation apply?

Paragraphs 1 and 2 of Article 41 state a particular maximum duration of certain audit engagements. These paragraphs are applicable irrespective of the options exercised by Member States regarding the extension of the duration of the audit engagement.

On the contrary, in paragraph 3 of Article 41, the extension of the maximum duration of the audit engagement in case of public tendering (Article 17.4.a) of the Regulation) or in case of appointment of more than one auditor (Article 17.4.b) of the Regulation) will have to be considered, as foreseen in the respective legislation of the Member State.

The expression “enter into” or “renew” must be understood as referring to the appointment of the auditor provided that this appointment is related to the audit of financial statements corresponding to a financial year that starts before 17 June 2020 or 2023, respectively.

The cooling off period foreseen in Article 17.3 of the Regulation will also be applicable when the transitional provisions of Article 41 apply.

For the purpose of the calculation of the maximum duration of the audit engagement in accordance with this Article, entities are PIEs from the moment that they fulfil the criteria of a listed company, a credit institution or an insurance undertaking set out in EU law, regardless when it was defined as a PIE under EU law.

For the purpose of this Article and to count the number of years the auditor has been providing audit services to the PIE, the financial years closed at the date of entry into force of the Regulation should be considered.

a) Application of Article 41.1.

This is applicable to auditors that at the date of entry into force of the Regulation (that is, 16 June 2014) have been providing uninterrupted audit services for the PIE for 20 or more consecutive years.

When the start of the first financial year covered in the audit engagement is prior to, or on, 16 June 1994, the audited entity will not be allowed to renew or enter into an audit engagement with the given audit firm or statutory auditor for periods that start on or later than 17 June 2020.

b) Application of Article 41.2.

This is applicable to auditors that at the date of entry into force of the Regulation (that is, 16 June 2014) have been providing uninterrupted audit services for the PIE for 11 or more and less than 20 consecutive years.

When the start of the first financial year covered in the audit engagement is between 17 June 1994 and 16 June 2003, the audited entity will not be allowed to renew or enter into an engagement with the given audit firm or statutory auditor for periods that start on or later than 17 June 2023.

c) Application of Article 41.3.

As indicated earlier, the application of Article 41.3 of the Regulation considers the extension of the maximum duration of the audit engagement in case of public tendering (Article 17.4.a) of the Regulation) or in case of joint audit (Article 17.4.b) of the Regulation) adopted by the respective Member State.

Any mandate which was entered into before 16 June 2014 and was in place as at 17 June 2016, other than those referred to in paragraphs 1 and 2 of Article 41, is permitted to stay in place up to the respective national maximum duration that may be prolonged by public tender or simultaneous appointment of more than one auditor.

ANNEX. LEGAL BASIS

Article 17 of the Regulation (EU)No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities (hereinafter, Regulation)

“1. A public-interest entity shall appoint a statutory auditor or an audit firm for an initial engagement of at least one year. The engagement may be renewed.

Neither the initial engagement of a particular statutory auditor or audit firm, nor this in combination with any renewed engagements therewith shall exceed a maximum duration of 10 years.

2. By way of derogation from paragraph 1, Member States may

(a) require that the initial engagement referred to in paragraph 1 be for a period of more than one year;

(b) set a maximum duration of less than 10 years for the engagements referred to in the second subparagraph of paragraph 1.

3. After the expiry of the maximum durations of engagements referred to in the second subparagraph of paragraph 1, or in point (b) of paragraph 2, or after the expiry of the durations of engagements extended in accordance with paragraphs 4 or 6, neither the statutory auditor or the audit firm nor, where applicable, any members of their networks within the Union shall undertake the statutory audit of the same public-interest entity within the following four-year period.

4. By way of derogation from paragraph 1 and point (b) of paragraph (2), Member States may provide that the maximum durations referred to in the second subparagraph of paragraph 1 and in point (b) of paragraph 2 may be extended to the maximum duration of:

(a) 20 years, where a public tendering process for the statutory audit is conducted in accordance with paragraphs 2 to 5 of Article 16 and takes effect upon the expiry of the maximum durations referred to in the second subparagraph of paragraph 1 and in point (b) of paragraph 2; or

(b) twenty four years, where, after the expiry of the maximum durations referred to in the second subparagraph of paragraph 1 and in point (b) of paragraph 2, more than one statutory auditor or audit firm is simultaneously engaged, provided that the statutory audit results in the presentation of the joint audit report as referred to in Article 28 of Directive 2006/43/EC.

5. The maximum durations referred to in the second subparagraph of paragraph 1 and in point (b) of paragraph 2 shall be extended only if, upon a recommendation of the audit committee, the administrative or supervisory body, proposes to the general meeting of shareholders or members, in accordance with national law, that the engagement be renewed and that proposal is approved.

6. After the expiry of the maximum durations referred to in the second subparagraph of paragraph 1, in point (b) of paragraph 2, or in paragraph 4, as appropriate, the public-interest entity may, on an exceptional basis, request that the competent authority referred to in Article 20(1) grant an extension to re-appoint the statutory auditor or the audit firm for a further engagement where the conditions in points (a) or (b) of paragraph 4 are met. Such an additional engagement shall not exceed two years.

7. The key audit partners responsible for carrying out a statutory audit shall cease their participation in the statutory audit of the audited entity not later than seven years from the date of their appointment. They shall not participate again in the statutory audit of the audited entity before three years have elapsed following that cessation.

By way of derogation, Member States may require that key audit partners responsible for carrying out a statutory audit cease their participation in the statutory audit of the audited entity earlier than seven years from the date of their respective appointment.

The statutory auditor or the audit firm shall establish an appropriate gradual rotation mechanism with regard to the most senior personnel involved in the statutory audit, including at least the persons who are registered as statutory auditors. The gradual rotation mechanism shall be applied in phases on the basis of individuals rather than of the entire engagement team. It shall be proportionate in view of the scale and the complexity of the activity of the statutory auditor or the audit firm.

The statutory auditor or the audit firm shall be able to demonstrate to the competent authority that such mechanism is effectively applied and adapted to the scale and the complexity of the activity of the statutory auditor or the audit firm.

8. For the purposes of this Article, the duration of the audit engagement shall be calculated as from the first financial year covered in the audit engagement letter in which the statutory auditor or the audit firm has been appointed for the first time for the carrying-out of consecutive statutory audits for the same public-interest entity.

For the purposes of this Article, the audit firm shall include other firms that the audit firm has acquired or that have merged with it.

If there is uncertainty as to the date on which the statutory auditor or the audit firm began carrying out consecutive statutory audits for the public-interest entity, for example due to firm mergers, acquisitions, or changes in ownership structure, the statutory auditor or the audit firm shall immediately report such uncertainties to the competent authority, which shall ultimately determine the relevant date for the purposes of the first subparagraph.”

Article 41. Transitional provisions.

“1. As from 17 June 2020, a public-interest entity shall not enter into or renew an audit engagement with a given statutory auditor or audit firm if that statutory auditor or audit firm has been providing audit services to that public-interest entity for 20 and more consecutive years at the date of entry into force of this Regulation.

2. As from 17 June 2023, a public-interest entity shall not enter into or renew an audit engagement with a given statutory auditor or audit firm if that statutory auditor or audit firm has been providing audit services to that public-interest entity for 11 and more but less than 20 consecutive years at the date of entry into force of this Regulation.

3. Without prejudice to paragraphs 1 and 2, the audit engagements that were entered into before 16 June 2014 but which are still in place as at 17 June 2016 may remain applicable until the end of the maximum duration referred to in the second subparagraph of Article 17(1) or in point (b) of Article 17(2). Article 17(4) shall apply.

4. Article 16(3) shall only apply to audit engagements after the expiry of the period referred to in the second subparagraph of Article 17(1).”